

**2008-09**  
COMPLIANCE PROGRAM



**Australian Government**  
**Australian Taxation Office**



# Foreword

The vast majority of Australians pay their tax appropriately, knowing their fellow Australians do the same. It is this confidence that is the foundation of the high levels of voluntary compliance we see in Australia. In turn, high levels of voluntary compliance minimise costs for the community and the cost of administering the tax and superannuation systems.

In such an environment, we can differentiate our approach, minimising the intrusiveness of our compliance activities on those who want to comply, other than as a source of support, while being able to better identify those people and transactions that represent a higher risk. This is the basis of our Compliance model and risk management approach (see page 6).

In dealing with members of the community, we tailor our response according to their history of compliance and approach to us, individual circumstances and risk profiles. This is supported by new technology including sophisticated intelligence and analytics capabilities.

For individuals this means on the one hand making it easier to comply, for example, by offering people the option of pre-filling their returns with information from third parties including their employers and financial institutions. On the other hand, third party information, including data from overseas revenue agencies, is also automatically matched against our records to identify cases where people are not reporting all their income.

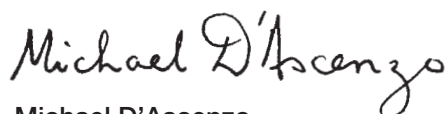
For small businesses, we are a source of support, helping new businesses start off on the right track with, for example, sound record-keeping practices that minimise the tax risks of cash transactions or unexpected debts. When businesses get into difficulties, but demonstrate a willingness to do the right thing, we will get them over the line where we can, such as giving them reasonable lodgment and payment arrangements.

For large businesses, we offer 'no surprises' compliance arrangements with corporate entities which have a sound tax risk management framework and are open and transparent with us.

Maintaining community confidence requires a level playing field for all businesses, so that those who try to avoid their obligations do not have an unfair advantage over honest business people. Where businesses show a reckless disregard for their obligations the community expects us to respond firmly and professionally.

Through this annual compliance program and other initiatives, we help people understand and meet their tax and superannuation obligations at the lowest possible compliance cost to them.

Most Australians want to get it right the first time and appreciate that the tax and superannuation systems are there for their collective interests. Our compliance program is also about supporting them.

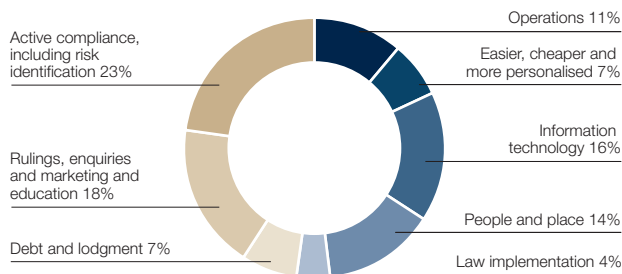


**Michael D'Ascenzo**  
Commissioner of Taxation

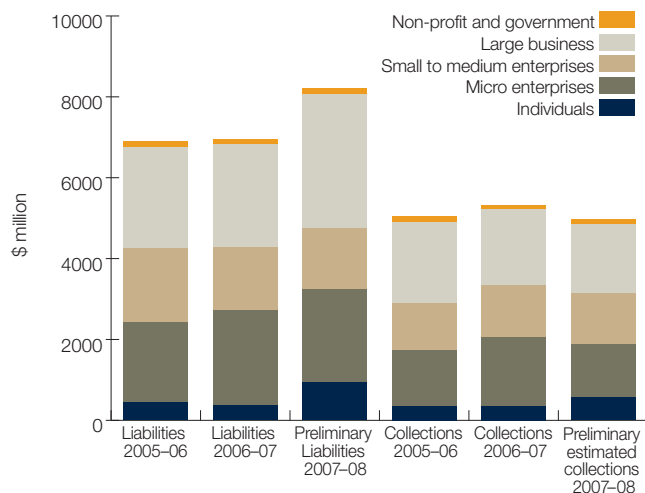
# Summary of compliance results 2007-08

The results for 2007-08 in this publication are based on preliminary data and are indicative only. Final results will be published in our *Annual report 2007-08*, due for release in October.

## EXPENDITURE 2007-08



## ACTIVE COMPLIANCE RESULTS 2005-06 TO 2007-08



### NOTES

Liabilities are the net value of debit and credit amendments from active compliance intervention on returns, statements and claims. The impact is a combination of tax, penalties, interest and transfer payments and cover excise, goods and services tax, income tax and superannuation products.

Results include activities undertaken to prevent incorrect refunds or payments being issued.

Preliminary estimated collections 2007-08 include (i) actual monies received from liabilities raised in 2007-08 and liabilities raised in prior years, and (ii) estimates using rates determined by a sampling approach and based on collections in 2006-07 from liabilities raised in 2006-07. These rates were then applied to liabilities raised in 2007-08.

The 2005-06 and 2006-07 figures are taken from the *Annual Report 2005-06* and the *Annual Report 2006-07*.

Cash collections for 2005-06 and 2006-07 include collections on tax, penalties and interest raised in prior years from all areas. Cash collections for 2007-08 do not include any collections on tax, penalties and interest raised in prior years, except for the large income tax area. Therefore, collections in 2007-08 are not directly comparable to the other years.

Liabilities over the last three years have been higher than cash collections as a proportion of liabilities raised as a result of large audits results which are in dispute and take time to resolve through court processes.

## OUR HELP AND ADVICE ACTIVITIES

Activity	Quantity	Total
<b>Public rulings</b>		
Public rulings and tax determinations*	107	
Class rulings	104	
Product rulings	95	
<b>TOTAL</b>		<b>306</b>
<b>Private rulings</b>		
<b>TOTAL</b>		<b>12,000</b>
<b>Phone calls answered</b>		
Tax practitioners	1,469,000	
General	7,777,000	
<b>TOTAL</b>		<b>9,246,000</b>
<b>Presentations and seminars</b>		
Tax practitioners	232	
General	1,869	
<b>TOTAL</b>		<b>2,101</b>
<b>Business assistance visits</b>		
	8,000	
<b>TOTAL</b>		<b>8,000</b>
<b>Hits to ato.gov.au</b>		
	96,500,000	
<b>TOTAL</b>		<b>96,500,000</b>

\* Includes 54 final products and 53 draft products.

Preliminary liabilities 2007-08 show that there has been a significant increase in the liabilities raised in the large market. This was due to a small number of aged audit cases being finalised with large amended assessments. Furthermore, our lodgment strategy resulted in the identification of a small number of late lodgers in the large market which resulted in the posting of unexpected large liabilities.

There has also been an increase in the liabilities raised in the individuals market. One primary driver of this was our increased use of telephony and correspondence channels in our lodgment compliance work. Another factor was an increase in audit results from highly wealthy individuals.

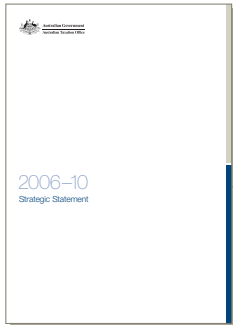
Preliminary estimates of credit amendments arising from the resolution of disputes and interest remission in 2007-08 in the large market is approximately \$623 million. These amendments generally relate to liabilities raised prior to 2007-08.

Of reported liabilities for 2007-08, the preliminary estimate indicates that \$2,069 million is in dispute from the large market results. Disputes may take several years to resolve.

Active compliance results include voluntary disclosures for superannuation guarantee obligations, high income individuals, people involved in offshore tax arrangements and other tax planning arrangements. Also included are disclosures for large market GST and income tax matters.

# Open and accountable administration Australia's tax and superannuation systems

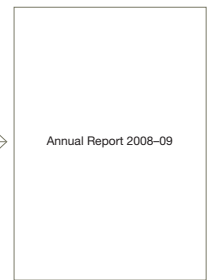
In our **strategic statement** we set our strategic directions and framework for the future



In our **corporate plan** we outline our key corporate priorities for the next 12 months and beyond



In our **annual report** we give an account to the government and community of our performance



Our **business model** forms part of the strategic statement

INDIVIDUALS AND BUSINESSES SELF-ASSESS

WE HELP TAXPAYERS AND THEIR ADVISERS UNDERSTAND THEIR RIGHTS AND OBLIGATIONS

WE MANAGE RELATIONSHIPS AND DIFFERENTIATE OUR RESPONSES

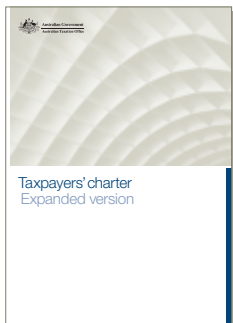
WE SHAPE OUR INTERNAL CAPABILITIES

WE MAKE IT AS EASY AS POSSIBLE TO COMPLY

WE VERIFY COMPLIANCE USING A RISK MANAGEMENT APPROACH AND PROMOTE VOLUNTARY COMPLIANCE

WE HELP SHAPE EXTERNAL CAPABILITIES

In the **taxpayers' charter** we explain your rights and obligations, and the standards of professionalism that you can expect from us



In our **making it easier to comply** booklet we explain how we work with the community to improve the administration of the tax and superannuation systems



In our **compliance program** booklet, we describe how we encourage high levels of compliance with Australia's tax and superannuation laws and detail areas of risk to compliance



## OUR COMMITMENT TO YOU

We are committed to providing you with advice and information you can rely on, so we make every effort to ensure that our publications are correct.

If you follow advice in this publication and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we must still apply the law correctly. If that means you owe us money, we must ask you to pay it but we will not charge you a penalty. Also, if you acted reasonably and in good faith, we will not charge you interest.

If you make an honest mistake in trying to follow our advice and guidance in this publication and you owe us money as a result, we will not charge you a penalty. However, we will ask you to pay the money, and we may also charge you interest.

If correcting the mistake means we owe you money, we will pay it to you. We will also pay you any interest you are entitled to.

You are protected under GST law if you rely on any GST advice in this publication. If you rely on this advice and it later changes, you will not have to pay any extra GST for the period up to the date of any change.

If you feel that this publication does not fully cover your circumstances, or you are unsure how it applies to you, you can seek further assistance from us.

We regularly revise our publications to take account of any changes to the law, so make sure that you have the latest information. If you are unsure, you can check for a more recent version on our website at [www.ato.gov.au](http://www.ato.gov.au) or contact us.

This publication was current at **August 2008**.



### FEEDBACK

Please email your comments to [compliancefeedback@ato.gov.au](mailto:compliancefeedback@ato.gov.au)

### MORE INFORMATION

For copies of this document phone **1300 720 092** or visit [www.ato.gov.au](http://www.ato.gov.au)

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**OUR PROGRAM SETS OUT, FOR EACH SEGMENT, OUR VIEW OF COMPLIANCE WITH THE TAX AND SUPERANNUATION SYSTEMS BY THE AUSTRALIAN COMMUNITY. IT IS A POSITIVE STORY!**

It also outlines our concerns about where compliance is at risk and the actions we are taking to address this.

As always, our intention is to alert people and businesses upfront to risks so they can avoid the pitfalls. We outline the practical help we can provide.

Increasingly we are also providing practical guidance on what people and businesses need to do to self correct and get back on track. A great example is at page 16 for those who got caught up in concealing income through offshore accounts.

We also outline the risks of detection and the consequences for those thinking of ignoring their obligations. This is very important for reinforcing everyone's confidence in our tax and superannuation systems.

**Jennie Granger**

Second Commissioner, Compliance

# Headline issues for 2008–09

## Delivering on new measures and government policy

We will be supporting implementation of a range of new measures including:

- expanding our coverage of income tax compliance, funded by a special government investment. The \$700 million over four years for income tax compliance work will deliver an estimated \$5.7 billion in additional revenue, mainly from large businesses and wealthy individuals. The extra funding acknowledges the need for income tax compliance work to keep up with an expanding and increasingly-complex economic environment that includes greater cross-border business, investment and employment activity (see pages 17, 24, 36 and 50).

- supporting the introduction of First Home Saver Accounts, for which eligible account holders will receive a government co-contribution as well as concessional tax treatment on investment earnings or interest (see page 17).
- fuel tax credits expansion that means many more businesses, including those in the building and construction industry, will be able to make claims (see pages 26, 42 and 68).

## Saving for retirement

The effectiveness and security of the superannuation system is central to encouraging saving for retirement.

Our priorities are:

- helping employers meet their superannuation obligations (which now allow late payments to be offset against the superannuation guarantee charge) through initiatives such as a web-based decision tool and calculator (see page 32)

- investigating employee complaints where employers have not met their superannuation obligations (see page 32)
- helping trustees and auditors of self-managed superannuation funds (SMSFs) to meet their obligations by providing tailored information products and tools (see page 33)
- ensuring contributions and withdrawals from superannuation comply with the rules for concessional tax treatment (see page 42)
- deterring and detecting schemes designed to illegally access money in superannuation (see page 86).

### **Maintaining compliance in a global economy**

We are making more systematic use of data matching to verify tax compliance of international transactions. Data on an increasing range of financial transactions is automatically exchanged with over 40 foreign tax administrations. Even where information is not readily available, as is the case with tax havens, we systematically analyse Australian Transaction Reports and Analysis Centre (AUSTRAC) data on international financial flows to identify the overseas assets and income of Australian residents (see page 38).

Significant improvements in voluntary compliance have resulted from our joint efforts with other agencies under Project Wickenby to tackle abusive schemes involving tax havens (see page 87).

### **Improving small business compliance**

We have revamped our practical support to encourage small businesses to adopt sound business practices that help them meet their tax obligations. Proper record keeping, for example, mitigates the tax risks associated with cash transactions and unexpected debts.

We promote self-service while also ensuring that personal support is available when needed, particularly where the business has a change in circumstances. By intervening early when businesses fail to lodge statements and returns or fail to pay their tax liabilities, we can help them get back on track and remain viable (see page 23).

### **Tackling abuse of the tax system**

Abuse of the tax system is often associated with other types of criminal activity. We work with other regulatory and law enforcement agencies where we see serious threats, such as organised avoidance or other attempts to defraud the Commonwealth through the revenue system (see page 85).

# ***Our approach to tax compliance***

Our mission is to achieve high levels of voluntary compliance with Australia's tax and superannuation laws. Supporting a range of economic and social policies, we:

- collect income tax, GST (on behalf of the states and territories), and excise
- make payments for a range of benefits (including the baby bonus, family tax benefits and excise grants)
- regulate the payment of superannuation contributions and the operation of small superannuation funds.

Income tax (including personal tax, company tax and capital gains tax) is the largest source of federal revenue, accounting for around 76% of total revenue we collected in 2007–08. GST accounted for about 15% of total revenue, while excise on alcohol, tobacco and petroleum accounted for about 9%.

## **Our compliance strategies**

We believe that being open and accountable about our compliance activities encourages voluntary compliance. This is why we publish our compliance program – describing the tax and superannuation compliance risks we are most concerned about and what we are doing to address them. It reflects a 'prevention is better than cure' approach.

Risks for us are structures where tax and superannuation systems are not working as intended by Parliament. Our compliance program involves a mix of services (including helping people understand their rights and obligations and also helping them access benefits to which they are entitled), and verification and enforcement activities (such as risk reviews, audits and prosecutions).

The program is strongly influenced by our collaboration with the community through professional and other representative groups. For example, tax practitioners can provide valuable insights on compliance risks.

Maintaining public confidence in the tax system requires us to keep the community informed on how we go about encouraging everyone to pay their fair share of tax and ensuring there is a level playing field for business. Our compliance program is driven by risk, which guides the allocation of our limited resources. By making the program public, we invite community feedback on our strategies and priorities.

Intelligence gained from these activities helps us keep Treasury and the Government informed on how the tax and superannuation systems are working. It also allows us to have input on proposed new measures.

### Frameworks

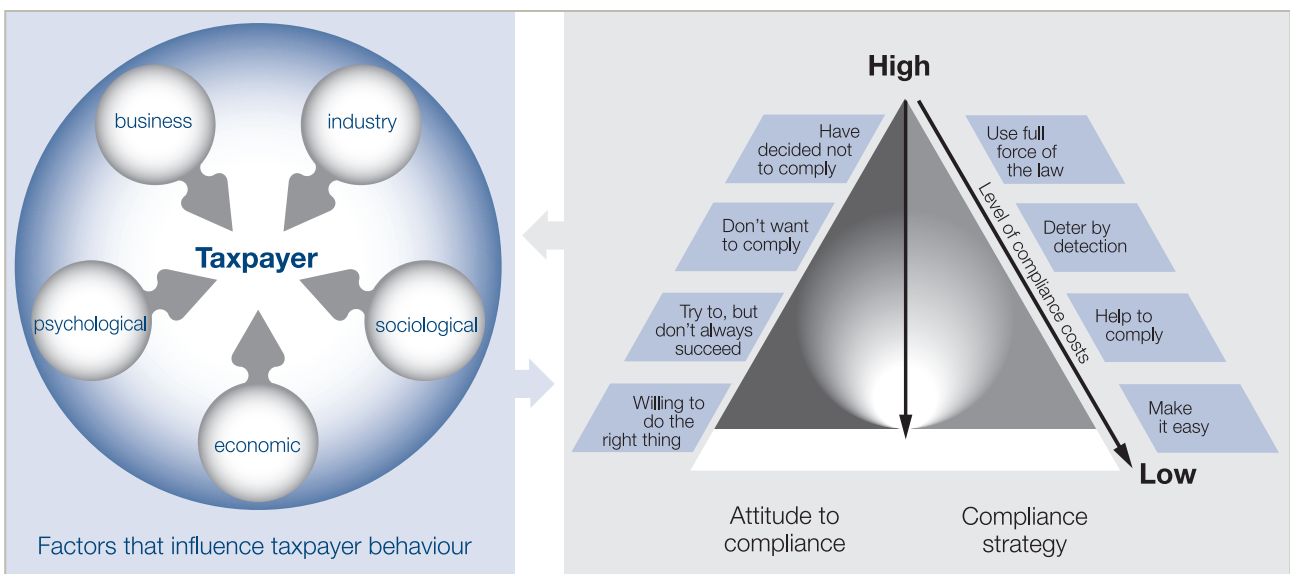
In pursuing the outcomes set out in our strategic statement and corporate plan (see ‘Open and accountable administration’ on page iii), the compliance program is guided by the taxpayers’ charter and our compliance model.

The charter requires us to be open and to treat people fairly and with respect, to inform people of their rights, obligations and entitlements, and to act in accordance with the law.

The compliance model (see figure 1 below) is based on the premise that we can influence behaviour through our responses and interventions. It directs us to address the cause rather than the symptoms of non-compliance. To do this we need to understand the business, industry, sociological, economic and psychological factors that drive behaviour.

The model’s core principle is to make compliance (including access to entitlements and benefits) as easy as possible for those who want to comply. At the other end of the spectrum, we apply the full force of the law when people wilfully seek to abuse the system.

Figure 1: The compliance model



## Our compliance processes

### Making it as easy and inexpensive as possible

On the assumption that the vast majority of people want to comply with their obligations, our starting point is to make compliance as easy and inexpensive as possible. There are three main aspects to this.

First, we consult and collaborate with individuals and their advisers to co-design the administrative processes that affect them. An empathetic, user-based approach ensures administrative solutions are designed around what works for the community.

Second, we aim to provide individuals and their advisers with the information they need to understand their rights and responsibilities. Information products are tailored to the needs of different taxpayer segments and industries. People are encouraged to come to us for personalised advice.

Third, we aim to provide convenient and inexpensive ways for people to undertake transactions with us, such as reporting information, and making and receiving payments.

We are also working with other agencies to develop whole-of-government solutions that minimise red tape and compliance costs – such as sharing of information to pre-fill forms and returns, standard business reporting and multi-agency online accounts.

### Verifying and enforcing compliance

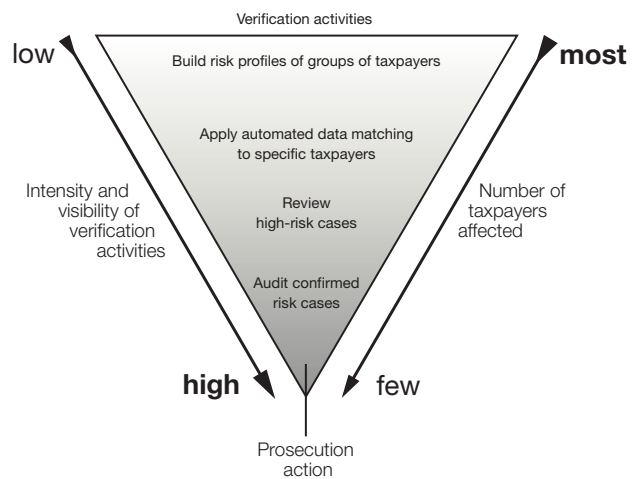
While our compliance verification activities vary according to the taxpayer segment, they generally involve:

- building risk profiles – identifying risk characteristics among taxpaying groups (such as transaction patterns) by analysing information we collect in returns and from third parties (such as financial institutions, government agencies and auditors of self-managed superannuation funds)
- data matching and applying risk profiles to taxpaying groups – identifying inconsistencies, unreported transactions and other risks by automatically checking returns against their past behaviour and third-party data
- reviewing specific individuals and businesses where we identify inconsistencies or other risks
- auditing individuals and businesses where reviews confirm the risk and taking other action where necessary.

Tax returns (including activity statements and other reports) are the foundation for verifying compliance, which is why we put so much emphasis on the need for people to lodge returns in full and on time. The returns also contain information required by others, such as the Australian Bureau of Statistics.

When risks are identified, our contact with people depends on the nature and complexity of the risk. But it typically starts with letters and phone calls seeking more information or clarification, and extends to field visits and audits where required. Risk profiling is as much about identifying individuals or businesses that represent little or no risk to the tax and superannuation systems, as it is about identifying non-compliance (see figure 2).

**Figure 2:** Visibility of compliance verification



## How we organise our work

The compliance program is structured around a set of taxpayer segments we use to tailor our help and verification activities across all taxes and payments, including superannuation and excise.

The segments are:

- individuals
- micro enterprises – those with an annual turnover under \$2 million
- small to medium enterprises – those with an annual turnover of \$2 million to \$250 million
- large businesses – corporate groups with an annual turnover above \$250 million
- non-profit organisations
- government organisations.

The compliance program addresses compliance issues in terms of their relevance to these taxpayer segments. It also outlines how we work with tax practitioners – who perform a vital role in the self-assessment system as intermediaries – and how we tackle serious abuse of the tax and superannuation systems.

**WHILE THIS PUBLICATION EXPLAINS HOW WE PLAN TO RESPOND IN 2008–09 TO THE CURRENT MAJOR RISKS TO THE TAX AND SUPERANNUATION SYSTEMS, IT DOES NOT ATTEMPT TO COVER EVERY ASPECT OF OUR COMPLIANCE WORK. OUR PLANS ARE ALSO SUBJECT TO CHANGE DURING THE YEAR, IN RESPONSE TO EMERGING RISKS AND TO FEEDBACK FROM THE COMMUNITY.**

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# 01



## Individuals

EACH YEAR, AROUND 11.8 MILLION INDIVIDUALS LODGE INCOME TAX RETURNS AND CONTRIBUTE APPROXIMATELY 42% OF OVERALL TAXATION REVENUE. MOST TAX PAID BY INDIVIDUALS IS COLLECTED BY EMPLOYERS.

PERCENTAGE OF INDIVIDUALS WHO USE A TAX AGENT TO LODGE THEIR INCOME TAX RETURN

73%

OF THOSE WHO PREPARE THEIR OWN RETURNS, OVER 60% (AROUND 1.9 MILLION) LODGE ONLINE USING E-TAX

60%

PERCENTAGE OF ADULT AUSTRALIANS (7.26 MILLION) WHO OWN SHARES

46%

Individuals have increasingly complex tax affairs. Around 46% of adult Australians (7.26 million) own shares, according to the Australian Securities Exchange, and 1.6 million own rental properties. People are investing more, and actively managing their retirement investments, including through SMSFs. The number and value of claims for work-related expenses is increasing every year and the types of claims have broadened, with home office and technology tools featuring in recent years. Around six out of seven employees now claim work expenses and the figure rises to nine out of ten across the higher income ranges.

For most individuals, lodging an annual income tax return is their major (and sometimes only) interaction with us. Most taxable income comes from salary and wages, government pensions and benefits and personal investments. Many people receive income from multiple sources – around 8.6 million individuals receive salary and wage income, 4.4 million receive investment income and 2.4 million senior Australians receive income from other sources.

## HEADLINE ISSUES

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### **Investors**

We have a particular focus this year on capital gains from the sale of property and shares, rental income and expenses, and superannuation contributions that exceed contribution limits. We will continue our use of pre-filing to assist people to correctly return their interest, dividend income and unit trust distribution. We are also increasing our monitoring of aggressive new financial products and arrangements to ensure financial products comply with the tax and superannuation laws (see page 15).

### **Executives and directors**

Our review of the compliance of senior executives and directors of public companies is being expanded to private companies and resident executives and directors of foreign-owned companies. The focus is on their remuneration packages and any failure to report equity benefits and cash or share bonuses (see page 17).

### **Work-related expenses**

Given the continuing strong growth in claims for work-related expenses, we will maintain our focus on compliance, including undertaking reviews and audit activities, particularly in relation to nurses, medical practitioners and chefs. More generally – not just in these occupations – we will be looking at anomalous or ‘out of pattern’ claims for self-education, car and travel expenses (see page 17).

### **Refund fraud**

This year we are closely examining refunds that suggest a pattern of poor practice by certain tax agents, and taking rigorous action against people who prepare returns for others without being a registered tax agent (see page 17).

## OUR GENERAL APPROACH

We aim to help people get it right the first time, reducing the cost to them for follow-up enquiries.

Our compliance approach is to provide individuals and tax agents with the information and services they need to comply with their obligations. We provide data received from third parties, so that they can check and use it to prepare tax returns. Upon receipt of returns we look to identify instances where people may not have met their obligations and we follow up on discrepancies. Where information is left out or incorrect, we give them an opportunity to explain the apparent discrepancy, and where necessary we amend the return. We remit penalties where there has not been culpable behaviour. In cases of deliberate fraud or evasion we may take prosecution action.

### Helping people comply

We provide a wide range of information and advice, online, in print, on the phone or in person, to help people meet their obligations and receive all of their entitlements.

Along with information, decision-making tools available on our website are designed to help people understand the possible tax consequences before they start financial or other transactions, and complete their tax returns correctly.

A major breakthrough for individuals is the ability to pre-fill their returns with information already reported to us by them or third parties. Tax agents can access pre-filling information via online reports, and pre-filling is also available to people who use e-tax to lodge their returns. Tax agents drew on the pre-filling report 2.8 million times for 2006–07 returns, while over one million of the 1.9 million people who used e-tax for their 2006–07 returns chose to pre-fill them.

For 2007 returns, we included bank interest and managed fund information from 24 financial institutions, share dividends from two major registries, and information from Centrelink, the Department of Veterans' Affairs, and the Department of Education, Employment and Workplace Relations. We also trialled including information from pay as you go (PAYG) payment summaries.

For 2008, e-tax will include more information:

- PAYG payment summaries in cases where the employer or superannuation fund provides the details to us electronically
- private health insurance data from Medicare Australia
- some data from previous years' returns including deductions in some circumstances
- personalised compliance reminders
- data on the Higher Education Loan Program
- investment income from more financial institutions, share registries and managed funds

Where a person reported rental or dividend income for the previous year, but does not report either the same type of income or a capital gain or loss for the current year, they will get a message about possible capital gains tax consequences.

Features such as these reduce the amount of time people need to spend on their returns and help them get it right first up. For 2007–08 returns, some people with simple affairs may be able to lodge their returns based primarily on pre-filled information (although we acknowledge that we do not have all relevant information and individuals still have to check their sources of income are covered). Tax agents will be able to automatically transfer pre-filling data into the software they use to prepare returns, provided the software provider has developed the necessary interfaces.

We will continue to consult with the community and the tax profession on how we can further improve these tools, drawing on new technology as it becomes available. We will also progressively make more information available through pre-filling.

We recognise that tax can be difficult for some people who come from a non-English speaking background. Our team of bilingual officers work with people who may be having difficulties understanding their obligations and entitlements and more broadly with community groups. This work is completed by our Tax Help volunteers.

We are also focusing on ensuring that recent immigrants and those with any overseas income or assets are aware of their reporting obligations. Under the Offshore Voluntary Disclosure Initiative (OVDI), in less than one year there have been 858 disclosures of \$36 million in previously undeclared taxable income from a variety of individuals.

### Checking returns

Data matching is used to check the accuracy of returns. Details of reported income are automatically matched with information provided by third parties (see 'Data matching helps get it right' on page 14). Where there are discrepancies that may indicate a failure to correctly declare income, we may contact the person and ask them to explain.

Many discrepancies are quickly resolved after direct contact with the person, particularly in cases where the amount has been declared in the tax return but in the wrong place. Where they fail to respond within a specified period, we will resolve the issue using the information at hand. This usually results in an amendment to the person's assessment to include the omitted income. Where further tax is payable, a shortfall interest charge is imposed along with a penalty, depending on the circumstances.

### Risk profiling

At a broad level we undertake sophisticated profiling of information in returns and compare returns to identify unusual patterns of income and claims. Data matching also helps us identify gaps and unusual patterns of transactions.

We also monitor compliance trends by analysing returns at the tax agent level to identify patterns that may indicate compliance risks. Where we identify a trend of common mistakes or claim patterns outside occupational or industry norms, we contact the agent and individuals to verify the return information and check the agent's tax return preparation and record-keeping practices. If the errors persist, we may refer the tax agent to the relevant Tax Agents' Board.

### Registering for a tax file number

We maintain the integrity of the client register by strict proof of identity requirements at the point of registration. Staff are trained to detect fraudulent identity documents and scrutinise some applications more closely. We also match information on application forms with data from other sources, including the registers of births, deaths and marriages, to verify details before issuing tax file numbers.

We review the population of active tax file numbers to identify instances where the individual might not have an ongoing obligation and archive these cases. Any subsequent activity is investigated to ensure that it is legitimate and we take further action where there are indications of fraudulent activity.

## Data matching helps get it right

In 2007–08, we received around 78 million records with income details for individuals from a wide range of organisations and government agencies that are required, under specific income tax law, to provide this information. These records include:

- payment summaries from employers
- details of interest, dividend and unit trust distributions from investment bodies
- details of payments to (and tax withheld from) non-residents by payers of interest, unfranked dividends and royalties
- details about contributors, dependants and health cover for each person covered by a private health insurance policy from private health insurance funds and Medicare Australia
- details of welfare benefits from Centrelink, the Department of Veterans' Affairs and other government agencies.

In addition, we also received the following information through agreement and/or the use of the Commissioner's formal information-gathering powers:

- net medical expenses reported on the Medicare financial tax statement
- property data from state and territory government authorities
- share data from the Australian Securities Exchange and other share registries

- details of financial transactions, including data on significant cash and suspect transactions and international funds transfers, from AUSTRAC.

We also exchange information with other agencies, including Centrelink, the Department of Immigration and Citizenship, and the Child Support Agency.

Under double tax agreements, we supply information to other countries about the Australian income of overseas residents who pay tax in Australia, including their investment income. We also receive information from participating countries on the income earned by Australian residents in those countries.

To support the expansion of return pre-filing, we are encouraging large employers and financial institutions to provide their data as early as possible after the end of the financial year, in advance of the required date. The response to these approaches has been very encouraging. Most organisations contacted agreed to provide information in the first three weeks of July, covering four million payment summaries and over 50 million investor records.

At a broader level, to combat identity-related tax fraud, we continue to work with other government agencies, sharing intelligence and participating in whole-of-government approaches, including the National Identity Security Strategy.

### Lodging returns

We use risk profiling and data matching to identify people who are not complying with their lodgment obligations, particularly where failure to lodge in full and on time increases other tax risks.

This year we are focusing on people who:

- are expected to have high tax liabilities, based on their history or third-party information
- are in high-profile professions that influence the wider community, such as the legal profession and sportspeople
- have child support obligations
- are identified as high risk from major enforcement projects such as Operation Wickenby and cash economy compliance projects
- receive foreign income.

As well as warning people not to use unregistered tax preparers, we use analytical tools to identify returns prepared by people who are not registered tax agents. In reviewing these returns, we often find major inaccuracies that result in significant increases in tax assessments, along with interest and penalties. Where appropriate, we refer unregistered preparers for prosecution.

### Refunds and claims

Before we issue refunds, they are automatically analysed to detect errors or possible fraudulent activity. Where we identify claims that appear to be outside industry or expected norms, we may check all aspects of the person's return such as income statements and claims for offsets, including matching the return information with data supplied by third parties.

Depending on the circumstances, we may then:

- contact an individual or their tax agent to get more information
- contact a person's employer to verify employment details
- undertake more detailed investigations, or
- refer the matter for prosecution.

## SPECIFIC COMPLIANCE ISSUES

### Investors

#### Undisclosed rental income and incorrectly-claimed rental deductions

Under-reporting of rental income and over-claiming of deductions is a continuing compliance issue. In 2006–07 returns, around 1.5 million individuals declared rental income totalling \$19.4 billion and deductions totalling \$25 billion. Deductions have increased by 11.8% in 2006–07 returns to 30 June 2008.

In 2008–09 we will focus on landlords who incorrectly claim deductions for interest or those whose claims for capital works exceed the construction expenditure. We will also look for cases where initial repair or renovation costs are incorrectly claimed as repairs and maintenance, instead of being attributed to the capital cost of the property. Our activities will also focus on non-deductible claims for body corporate fees to cover the cost of capital improvements or capital repairs, borrowing expenses where claims are incorrectly claimed for stamp duty on the purchase of the property title, and incorrect return schedules.

We will also contact tax agents whose clients have unusual patterns of rental claims.

We will write to new entrants to the investment property market, advising them how to report rental income and claim deductions. We will also write to people identified as being at risk of not complying, reminding them to check the accuracy of their claims before lodging their returns.

#### Asset sales

We focus on educating people about their obligations while raising awareness of our increasing ability to detect non-compliance through data matching. While compliance with capital gains tax obligations appears to be improving, we are trying to lift this further. The number of people who declared net capital gains rose by 3.8% in the 2005–06 income year. This suggests that more Australians are aware of their capital gains tax obligations. No doubt it also reflects activity in the market.

Improved awareness is also suggested by significant increases in the use of capital gains tax information on our website and in publications.

We are further expanding our data matching. This year we will match information on asset transactions from state and territory title and revenue offices, securities exchanges and share registries, and reports from managed funds.

We will also write to people who purchased investment properties, shares or units in a managed fund last year to inform them of their capital gains tax obligations if they dispose of these assets. We will also write to people who appear to have made capital gains, alerting them to their reporting obligation.

Reviews of at-risk cases this year will include individuals who made a gain from disposing of assets to invest in superannuation.

We will also focus on whether capital gains distributed to investors in managed funds have been correctly classified.

## Managed investment schemes

We encourage promoters of managed investment schemes to apply to us for product rulings that provide investors with certainty on the deductions that can be claimed. Product rulings are listed on our website. Where a ruling has not been issued, we encourage potential investors to apply to us for a private ruling on the tax implications of the investment.

Investors need to be aware they are not protected if the scheme is not implemented as described in the product ruling and that the product ruling does not relate to the commercial viability of the arrangements.

We will check that managed investment schemes are implemented as described in their product rulings and we identify schemes that have proceeded without product rulings.

## Dodgy schemes

Tax exploitation schemes are aggressive arrangements with little or no economic substance that are created mainly to obtain a tax benefit not intended by the law. The promoter penalty laws provide for significant legal responses to promoters of tax exploitation schemes.

Unfortunately, some investors are vulnerable to the temptation of a tax 'minimisation' scheme. Our brochure that provides simple tips for investors says it all: *Don't take the bait* (NAT 8625).

We monitor advertising and follow up intelligence on dodgy schemes as soon as we become aware of them. Taxpayer alerts provide early warnings of our concerns. Fortunately, people are becoming more wary of schemes, especially offshore ones, and they are increasingly likely to bring suspect schemes to our attention. When we identify aggressive tax planning schemes, we encourage participants to come forward early to take advantage of the provision that allows significant reductions in penalties for those who make full and true voluntary disclosures.

## Overseas bank interest

Before immigrating to Australia on a retirement visa from the United Kingdom, a couple invested a sizeable amount of money in the Channel Islands. Alerted by media reports to the OVDI, the couple approached a tax agent to enquire if the interest earned on this investment was taxable in Australia.

As a result they each made voluntary disclosures of \$300,000 over five years. The couple stated that they believed that they did not have to declare foreign income in Australia and only became aware that they may have been misinformed due to the media reporting of the OVDI.

## Deceased estate

Solicitors acting for an estate discovered that the deceased had established a trust in Hong Kong and transferred significant amounts into it. Further investigation by the solicitors led to the conclusion that the deceased had not addressed the Australian tax consequences of this trust.

The solicitors made a voluntary disclosure on behalf of the estate and are working with us to resolve this issue and allow the finalising of the estate.

## Saving for retirement

### Employee superannuation

We received around 20,000 complaints in 2007–08 from employees in relation to their employers not paying the correct superannuation guarantee contributions or not offering choice of superannuation fund. We have reduced the time it takes to finalise them. We are now able to keep employees informed, in writing, of the progress of our investigation.

Historically, many employee complaints have been received after the employee has stopped working for the employer or when the employer is close to liquidation. This delay limits our ability to collect the superannuation charge on behalf of the employee.

We expect to make available by the end of 2008–09 an online tool for employees to allow them to check whether they are eligible for superannuation guarantee and if they have received the correct contribution for each quarter. Where contributions are not correct, the person can lodge a complaint online.

### Over-claiming deductions for superannuation contributions and excess contributions

Superannuation funds are required to report annually all details of member contributions. We match this information against income tax returns to check that claims for contributions match what the fund received and also to make sure that the contribution caps have not been exceeded. Where the cap has been exceeded, we will send an assessment for excess contributions tax. A compulsory release authority will also be sent and be used to withdraw the tax amount from the superannuation fund where the non-concessional cap has been exceeded.

### Lost members register

We will continue our emphasis on reuniting individuals with their lost superannuation. We will continue to support and make available to the community our online tool, SuperSeeker, for individuals to find their lost superannuation. Additionally we will write to one million individuals about their reported lost accounts, and we will review a further 200,000 lost accounts and follow up with the accounts' owners by telephone.

### Accessing superannuation early

People can only access their superannuation early in very special circumstances.

We work closely with industry regulators to investigate superannuation that is accessed without authority. Improper early access will lead to the amount withdrawn being taxed at the marginal tax rate, and may also result in further tax penalties and prosecution.

### First Home Saver Accounts

We will manage the introduction of First Home Saver Accounts from 1 October 2008. Our focus will be on ensuring that people have the information and advice that they need to understand the eligibility requirements and consequences of saving with this product. We will also continue to work with the First Home Saver Account providers to finalise administrative processes.

### Executives and directors

This is our second year of activity to deal with under-reporting of income by high income people. We will continue to write to public company executives who appear to have under-reported income, with a focus on shares and options received as remuneration.

We are expanding our compliance activities to include senior executives of private and foreign-owned companies. Failure to report equity benefits and cash or profit share bonuses is a key area of interest.

We are also checking the returns of individuals involved in takeovers to ensure income and capital gains crystallised by these transactions are correctly reported.

Where compliance action with senior executives identifies significant issues that are relevant to other employees, we will extend our compliance work to the larger population.

### Employees

#### Incorrectly-claimed work-related expenses

Employees are increasingly claiming work-related expenses, with around 83% making claims in 2006–07, reflecting an 8% growth in the value of claims, to \$13.6 billion to 30 June 2008.

Work-related expenses present a continuing compliance issue. In 2008–09 we will focus on:

- occupations with a pattern of large and/or rising claims or with issues identified from other intelligence
- returns which do not fit the pattern for a particular occupation
- claims in returns lodged by tax agents that are outside the norm for their client base.

Based on our analysis of claim patterns for the previous year, we are also paying special attention in 2008–09 to claims from nurses, medical practitioners and chefs.

Employees need to be able to substantiate the value and eligibility of claims in excess of the first \$300. We review any claims that are outside normal work-related expenses claim patterns and, if necessary, request additional information to substantiate them.

Our compliance approach has a strong emphasis on 'prevention is better than cure'. We alert the community to what we are focusing on at tax time and write to people we think are at risk of over-claiming (based on their last year's return) before they lodge in the current year. We provide personalised information to raise awareness and understanding of their rights and responsibilities. The average adjustment following one of these letters is a reduction of 15% in claims. We also send information to people who in the previous year claimed work-related expenses for the first time.

### Refund fraud and integrity

Our strategy is to deter refund fraud before returns are lodged. We examine returns for patterns that indicate a group of people are acting fraudulently together, or orchestrated attempts by preparers to undermine the integrity of the tax system.

While the vast majority of tax agents do the right thing, we are systematically identifying and reviewing agents where there is a pattern of activities that suggests non-compliance. For agents who demonstrate suspect practices and appear unwilling to modify this after our initial contact, we will commence a rigorous program of reviews and audits of their clients' tax affairs and may refer the agent to the relevant Tax Agents' Board.

There are indications that some people from non-English speaking backgrounds, who sometimes struggle to understand their tax obligations, are increasingly turning to unregistered preparers and certain tax agents to help them make claims to which they are not entitled. In response, we are increasing reviews and audits, imposing penalties and referring cases for prosecution where appropriate.

### Expanding our coverage of income tax issues

Increased government funding will allow us to focus more on income tax compliance of individuals. This includes:

- closely monitoring the tax affairs of investors
- looking for high risk employee expenses claims that appear to be outside industry or expected norms
- examining the tax affairs of senior executives in private and foreign-owned companies
- expanding information matching coverage of those failing to correctly report.

## SNAPSHOT OF OUR 2007–08 ACTIVITIES

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### Individuals

#### Income tax

- We amended 176,000 individuals' original assessments, while individuals self-amended 482,000.
- We reviewed 25,500 returns in relation to high risk refunds resulting in revenue adjustments of \$38 million.
- We sent educational letters to 495,500 individuals about claiming work-related expenses. We also wrote to another 76,200 individuals asking them to either review their claims before lodging their returns or to provide further information. Around 19,100 reviews or audits were completed resulting in revenue adjustments of \$14.7 million.
- We sent educational letters to 119,700 individuals about rental income and expenses. We also wrote to 64,900 individuals asking them to review their claims. About 7,200 reviews or audits were completed resulting in revenue adjustments of \$9.2 million.
- We reviewed or audited 6,690 people concerning capital gains tax resulting in revenue adjustments of \$51.5 million. We also sent 30,000 educational letters and wrote to another 6,190 individuals who sold assets alerting them to their potential capital gains tax obligations.
- We identified 175 high income individuals who had potential remuneration discrepancies in their returns. Voluntary disclosures were received in 62.5% of these cases and revenue from this project has now exceeded \$27 million.
- We compared third-party information against returns. 164,700 income and benefits discrepancies resulted in revenue adjustments of \$127 million.
- We acquired and processed 133 million share transactions and also matched 19.5 million real property transactions (covering 2004–2008) to people.

## Superannuation

- We sent 2.2 million letters to individuals informing them they may have lost track of their superannuation.
- We wrote to 5,200 individuals who had not included reportable fringe benefit amounts in their returns, resulting in the recovery of \$2.3 million in over paid co-contributions.
- We contacted members of 430 SMSFs who were involved in illegal early access schemes.
- We conducted our first civil prosecution of trustees of a SMSF, where they accessed funds in their SMSF to pay off a personal debt of a member.
- We conducted verification reviews with 300 funds to ensure that individuals who have claimed a personal income tax deduction in respect of their personal superannuation contributions, have complied with their obligation to lodge and receive acknowledgement of the appropriate declaration from the fund. These reviews resulted in the identification of 948 individuals (sourced from 98 funds) who have incorrectly claimed a tax deduction with an associated value of over \$12 million.

## Lodgment

We wrote to 377,800 individuals following up their lodgment, telephoning 11,800 to further ensure they met their obligations. This led to the finalisation of 48,600 income tax returns and fringe benefits tax (FBT) returns, and 85,400 activity statements, raising liabilities of \$111.1 million.

## Tax agents

We wrote to over 200 tax agents and visited another 300 about work related expense claim patterns. Where we detected tax agents with an unusually high number or value of claims we conducted reviews and audits.

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## **Micro enterprises**

THE MICRO ENTERPRISES SEGMENT INCLUDES BUSINESSES WITH AN ANNUAL TURNOVER OF UNDER \$2 MILLION AND CONSISTS OF APPROXIMATELY:

SOLE TRADERS, CONTRACTORS AND CONSULTANTS

1 MILLION

COMPANIES

700,000

PARTNERSHIPS

420,000

TRUSTS

500,000

SUPERANNUATION FUNDS

390,000

There are around 2.5 million small businesses and 390,000 SMSFs in this market segment. The small businesses range from one person operations to entities with significant numbers of employees. A number of micro enterprises are operating in new and innovative ways, with electronic and international trading becoming more common.

While micro enterprises are located in industries across the economy, more than 60% are in property, trades, construction, finance, primary production and retail. They pay around 11% of all tax we collect and employ nearly 22% of all people employed in Australia. About 95% of micro enterprises lodge their returns through tax agents.

Compliance issues for micro enterprises arise particularly in relation to their responsibilities as employers – managing PAYG withholding, superannuation guarantee and FBT obligations.

## HEADLINE ISSUES

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### **Assisting small business to stay on track**

We recognise that small businesses are time poor and their financial affairs can be complex. Many struggle to meet their tax and superannuation obligations, on top of other regulatory burdens. We are improving our assistance program to support micro enterprises at critical points in the business life cycle, with a particular emphasis on helping businesses get started and get back on track. This includes helping them meet obligations in relation to cash transactions and tax and superannuation debt (see page 23).

### **Employer obligations, including superannuation guarantee**

Given the major role of micro enterprises as a source of employment, it is very important they meet their employer obligations. We are increasing our audit coverage of employers (see page 24).

### **Cash economy**

We will be expanding our coverage with a more focused cash economy strategy that includes regional activities, business-to-consumer transactions and micro enterprises with conspicuous consumption or multiple obligations.

We have started developing, with industries, benchmarks that businesses in cash economy industries can use as a guide to getting it right.

We continue to use data matching to detect unreported income. We also check for inconsistencies between household and personal assets and reported levels of income (see page 24).

### **International dealings**

With around 40% of exporters being micro businesses, we will focus on ensuring offshore income including dividends and interest, royalties and rental income are correctly reported (see page 25).

### **Capital gains on sales of assets and investments**

We will increase our activities in relation to reporting capital gains and the accuracy of capital losses, as well as the correct application of small business concessions (see page 25).

### **Managing tax debt**

Many micro businesses encounter difficulties in managing their tax payment obligations. They account for about two-thirds of outstanding collectable tax debt at any point in time. We are using risk profiling to detect problems much earlier so we can make contact and offer help before the problem becomes harder or more expensive to fix (see page 26).

### **Saving for retirement**

Many small business owners investing for their retirement choose to establish their own superannuation fund. We are developing new tools for trustees and auditors to help them achieve high levels of compliance with superannuation and tax laws (see page 26).

## OUR GENERAL APPROACH

While most micro enterprises try to meet their tax obligations, they are often hampered by a lack of time and resources. We are looking at ways to improve their understanding and make it easier for them to meet their obligations.

We also try to make sure that micro enterprises attempting to avoid their tax obligations are brought to account so they do not have an unfair advantage over those who do the right thing. We aim to be as unobtrusive as possible to the great majority who want to get it right, while being highly visible to those who present a higher risk.

Profiling is used to identify potential tax risks such as businesses operating outside industry or economic norms. To identify unreported transactions, such as omitted income and capital gains, we match information from third parties against that reported by the business.

Our compliance analysis also takes into account the risks associated with stages of the business life cycle.

Depending on the circumstances and the level of risk, compliance activities may include letter and telephone contact, visits, reviews, audits, assessments made on the basis of available information, penalties and court action and prosecution.

### Our small business assistance program

The aim of our small business assistance program is to provide support where and when it is needed in a practical and effective way. In addition to offering one-on-one assistance visits, we provide telephone support, as well as seminars and workshops.

A major challenge for us is to ensure that small businesses are aware of the help and support that we offer – in some cases small business owners may not know that they can come to us for tax help, or they may just be wary about coming to us at all. This year we will be exploring early intervention strategies – to identify and offer support (either directly or through third parties) to small businesses that are starting to experience difficulties.

We contact small businesses that have escalating tax debts or an increasing number of overdue lodgments, to offer support to get back on track.

We will continue to provide practical tools to enable small businesses to become self-sufficient in their dealings with us. These range from the Business Portal, which enables businesses to lodge returns and pay online, to easy-to-use business tools such as e-Record to help with record keeping and a new electronic tax calendar, that are available from our website.

## OUR COMPLIANCE STRATEGIES ARE BASED ON THE BUSINESS LIFE CYCLE

The needs of micro enterprises in managing their tax affairs tend to be aligned with the business life cycle, so both our support and verification compliance activities are structured around the following stages.

### Business start up

To help those new to business, our small business assistance program offers supporting material and an assistance visit service to help with record-keeping and activity statements. Our products for new businesses include Getting started, Keeping good records and *Tax basics for small business* (NAT1908). Free seminars and workshops providing business information and support in all capital cities and some regional areas are also available.

To help people determine their eligibility and need for an Australian business number (ABN), a tool is available on the Australian business register (ABR) website at [www.abr.gov.au](http://www.abr.gov.au) and our website at [www.ato.gov.au/businesses](http://www.ato.gov.au/businesses). To minimise the number of inappropriate registrations, we are systematically reviewing those that do not appear to represent active businesses. We also look for evidence of attempts to improperly re-start a business before discharging obligations from a previous business.

### Operating

Businesses need to meet their obligations such as lodging activity statements and income tax returns on time, as well as paying the associated tax liabilities. Along with the legal requirements, there are very sound business reasons for ensuring accurate and timely record-keeping. Failure to read the warning signs from business records is one reason for the high rate of small business failure.

### How we can help

Poor record-keeping is often a symptom of poor compliance with tax and other obligations. Our field activities may include reviewing record-keeping practices. Where we identify poor record-keeping, we offer advice and assistance. Depending on the circumstances, we may schedule another visit to check that it has improved. Where a business owner does not make a genuine attempt to change their practices and their record-keeping remains unsatisfactory, we apply a graduated approach to penalties, extending to prosecution for those who consistently fail to meet their obligations.

As a business grows and diversifies, new issues are likely to emerge including employing staff, creating subsidiary business structures such as trusts, and diversifying into overseas markets. Many of our educational and compliance activities cover this stage in a business.

Our free online services and support tools such as the business portal, self-help calculators, a record-keeping tool and range of information products (both paper and online) provide information on specific tax and superannuation topics. We provide seminars, workshops and visits to assist business operators and staff to understand their tax obligations.

We recognise that many micro enterprises depend on bookkeepers and tax agents, and our support includes offering a flexible lodgment program for returns lodged through tax agents (see Tax practitioners, page 70).

### Running into difficulty

Business circumstances can change and seasonal fluctuations can also be a source of cash flow stress. PAYG instalments can be varied to account for changing circumstances, including seasonal variations in income, and our record-keeping tool helps micro enterprises manage their cash flow.

Businesses have a responsibility to pay any tax liabilities by the due date, and should address any underlying record-keeping issues that affect their ability to do this. We encourage businesses struggling to meet their obligations or manage their tax debt to contact us as early as possible so we can help them get back on track.

### Business failure or disposal

When a micro enterprise ceases to operate and has an ABN, we expect to be notified within 28 days of the business ceasing to ensure changes are made including to the ABR.

We follow up outstanding obligations including lodgment of activity statements and final income tax returns. Outstanding capital gains or losses need to be addressed and if incorrectly calculated on cessation of a business they may be identified via data matching and be subject to review. Benefits derived by shareholders when a company ceases may also be reviewed.

Good record-keeping is also required at this stage. Records must be retained for five years, including records of sales (including sale of the business) and purchases, payments to employees, and payments to other businesses.

## SPECIFIC COMPLIANCE ISSUES

### Lodging returns

To identify businesses that pose the highest risk of not lodging or lodging late, we compare information from internal and external sources and tailor our activities to the level of risk and the compliance history of each business. We deal with failure to lodge by contacting businesses by letter or telephone, undertaking field reviews, making assessments based on information available, imposing statutory penalties and taking prosecution action.

This year we have a particular focus on:

- businesses that are expected to have high tax liabilities (based on their history or third-party information)
- businesses that fail to lodge on time or only meet part of their lodgment obligations
- business operators with child support obligations.

### Refund fraud

We monitor unusual and high value GST and income tax refund claims. Before refunds are issued, they are automatically checked against a set of criteria, based on intelligence from our compliance activities, to detect incorrect or fraudulent statements and returns. We undertake pre and post-issue verification checks by telephone, by visiting the business or by contacting third parties.

### Expanding our coverage of income tax issues

The Government's additional investment in our income tax compliance work will be used to increase coverage across the spectrum of our activities. This includes:

- increased auditing of employer obligations, including superannuation payments for employees
- increased use of data matching to detect unreported income
- contacting personal services income entities that have not completed a personal services schedule as requested in the letter issued pre-lodgment
- increased compliance activities on unreported and incorrectly calculated capital gains and incorrect application of capital losses
- compliance risks associated with structures including: examining partnership and trust distributions to ensure they are correctly reported by the beneficiaries; checking deductions against trust distributions to ensure they are properly allowable; and loss companies incorrectly claiming a tax offset for franking credits, resulting in incorrect refunds
- a focus on company carry forward losses incorrectly calculated and claimed via data matching, label analysis and audit activity
- a more focused cash economy strategy including business-to-consumer transactions and micro enterprises with conspicuous consumption.

## Foreign source income not correctly disclosed

We match data on dividends, interest and royalties supplied by overseas revenue agencies with income tax return and AUSTRAC information to identify unreported foreign income. We will also explore the use of data from payment service providers to identify Australian residents involved in foreign transactions.

## Sale of assets and investments

This year we are doing more checks of reporting of capital gains by micro enterprises. We will focus on sales of real property and shares, creation and attribution of capital losses and correct use of the capital gains tax small business concessions. We will also focus on correctly accounting for capital gains tax when operators are exiting a business.

A continuing focus is on checking whether capital gains have been accounted for where assets have been transferred into a superannuation fund or where proceeds from the sale of assets have been transferred into a fund.

To identify risks, we will expand our use of data matching, using information on asset transactions from state revenue offices, land titles offices, share registries and other sources.

Our activities will include:

- writing to businesses who appear to have made a capital gain alerting them to their reporting obligations
- contacting businesses and carrying out reviews or audits where we identify a risk that a capital gain or loss has been omitted or calculated incorrectly, or the small business concessions have been incorrectly applied.

## Partnership and trust distributions

Micro enterprises include over 920,000 partnerships and trusts. We are reviewing distributions from partnerships and trusts and beneficiary returns to check that the distributions have been correctly disclosed.

Partners and beneficiaries who may have failed to comply with their obligations will be offered the opportunity to voluntarily disclose and may receive concessional treatment in relation to penalties. We will be writing to tax practitioners and advising them where we identify clients who may not have correctly disclosed distributions. Appropriate cases will be escalated to audit.

## Property transactions

The GST treatment of property transactions remains a significant compliance issue, and our responses include:

- progressively refreshing our range of help products including developing aids such as fact sheets and property check lists
- clarifying the law in areas of uncertainty
- carrying out reviews and audits in the case of:
  - unreported property sales
  - incorrect application of the margin scheme
  - incorrect reporting of adjustments events, and
  - businesses who try to avoid their obligations by not lodging activity statements or not registering in the system.

We are investing further effort to improve our understanding of the property sector and its GST and other tax risks and aid the design of strategies to mitigate these risks. For example we will improve our processes of identifying non-compliance by enhancing the matching of data provided by third parties such as property registries and financial institutions with the information reported by micro enterprises. We will also examine whether the financing and reporting arrangements used by property developers show any tax risks.

We continue to work with builders and developers through industry consultative forums to improve our understanding of the industry, consider the impact of current economic conditions and keep them informed of law changes in a timely manner.

## Dodgy schemes

We focus on identifying promotion of tax exploitation schemes and providing early warning to participants to highlight our concerns about specific schemes and arrangements.

Our brochure *Don't take the bait* provides some simple tips for investors who may be tempted by a tax 'minimisation' scheme.

The promoter penalty laws provide for significant remedies against promoters of these schemes. We encourage participants to come forward early to take advantage of significant reductions in penalties for those who make full and true voluntary disclosures.

## Saving for retirement

Given the increasingly important role of SMSFs in the superannuation system and their access to concessional tax treatment, we are putting increased emphasis on ensuring high levels of compliance.

Our compliance activities will continue to focus on regulatory issues associated with protecting retirement investments, such as loans, in-house assets, borrowings and non-arms length transactions, but we will also be looking more closely at their income tax compliance.

We will also be continuing the early intervention strategy for new funds, including checking all new funds where the approved auditor has reported a breach of a regulatory provision. Our aim is to help new trustees understand and comply with their obligations and address any lack of knowledge or understanding quickly so they get back on the right track. Active compliance activities will cover at least 10% of all new funds.

Trustees who travel and work overseas for extended periods of time are at risk of their SMSFs not meeting the definition of an Australian superannuation fund. A draft ruling has been issued to provide guidance to trustees in these circumstances and we will continue to provide targeted communications to those who may need to consider this issue.

We also monitor approved auditors to ensure they are fulfilling their roles. The approved auditor compliance program provides help and education (including support through professional organisations) to improve the skills and knowledge of auditors as well as targeting those who are not prepared to properly meet their responsibilities (see Tax practitioners, page 70).

## Fuel tax credits

Eligibility for fuel tax credits was expanded from 1 July, allowing many businesses to claim a fuel tax credit for the first time and giving many existing claimants an additional entitlement. We are partnering with a diverse range of intermediaries including the retail and insurance industries, federal and state government agencies and industry associations to distribute fuel tax credit brochures to their business clients, members and stakeholders.

We are also sending 74,000 businesses an email informing them of the expansion. An eligibility tool is available on our website to help businesses understand their entitlements.

This will be accompanied by work to build our understanding of the industries and businesses new to fuel tax credit entitlements so we will identify and monitor those that are outside of industry norms for claiming fuel tax credits. Firm action will be taken where deliberate non-compliance is identified.

## Helping businesses meet their payment obligations

Micro enterprises continue to account for about two-thirds of outstanding collectable debt (debt not subject to dispute or insolvency) at any point in time.

We understand that businesses can have cash flow problems and fall behind on their payment obligations. In these situations they should contact us early. We will treat them fairly and take their individual circumstances into account.

If businesses who are experiencing difficulty meeting their tax obligations call us early, it is much easier for us to help them address their debt and prevent the problem becoming worse. Addressing debt earlier, while it is still manageable, also improves the prospects for the business's ongoing viability.

This year we are putting more emphasis on managing debt cases through to finalisation. We continue to intervene early and quickly follow up where people fail to pay when they have a payment arrangement in place.

To ensure a level playing field for business and fairness for all, we will respond firmly to those businesses that consistently choose to ignore our approaches and their obligations. Where necessary, this will involve garnishee notices, director penalty notices and statutory demands, and liquidation or bankruptcy proceedings.

A continuing priority is to reduce debts more than two years old and collect superannuation guarantee charge debt owed by employers, even small amounts. With the latter, our experience is that the earlier the intervention with the employer, the better the outcome for employees.

## Getting back on track

A husband and wife run a small business as a partnership. The wife has always been the Australian Taxation Office (ATO) contact. The partnership has had a good compliance history over many years, but recently tax debts have started to escalate.

Aware of the partnership's good compliance record, the debt collection officer contacted the husband and found that he was unaware of the debt. He advised that his wife had recently been diagnosed with a serious illness that had affected her ability to manage the business's financial affairs.

A medical certificate was provided outlining the illness along with a letter explaining the circumstances leading to the tax debt. Considering the circumstances, the general interest charge was reduced and a payment arrangement accepted based on the husband obtaining a secured bank loan.

The tax debt was cleared in line with the payment arrangement and the business is on track to meeting its tax obligations.

## Taking firmer action

A car repairs company owed the ATO a substantial amount of money. We made numerous attempts to obtain payment, including discussions with the company's accountant during which we informed them of legal and garnishee options that would be considered if the debt was not addressed. After the company repeatedly failed to meet agreed timeframes to enter into a payment arrangement, the case was escalated for firmer action.

Through asset checks, bank accounts were identified and a garnishee notice was issued requesting the bank to forward an amount from the company's account to the ATO. This resulted in the ATO receiving a payment towards the debt with the possibility of further payments. It also prompted the company to engage with us on a sustainable payment plan that ultimately resulted in full payment of the debt.

A catering company began falling behind in its lodgment and payment of business activity statements. We contacted the director each time the company failed to meet its tax obligations. The director would then lodge any outstanding business activity statements and enter into a payment arrangement.

The payment arrangements repeatedly defaulted shortly after being entered into. We warned the director that any further defaults would result in the ATO commencing legal recovery action. When the company failed to comply with yet another payment arrangement, further investigation of the company's financial information revealed that it appeared to be trading insolvently.

We issued a statutory demand requiring the company to pay the debt. When the company failed to comply with this demand, we applied to the court for an order to wind-up the company. This resulted in the company being liquidated with the proceeds distributed to creditors.

## SNAPSHOT OF OUR 2007–08 ACTIVITIES

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### Micro enterprises

#### Supporting micro enterprises

We provided practical support to over 73,000 new and established micro enterprises to help them understand and meet their tax obligations. This included:

- 7,600 assistance visits
- 1,150 seminars and workshops delivered to small business, superannuation funds and investors, and
- 45,200 outbound education calls to new and existing small businesses at key times in their business lifecycle.

We strengthened our relationships with key organisations and co-designed and developed the computer tool *Your small business tax calendar*.

#### Employer obligations

We conducted 2,730 field audits, 1,300 outbound telephone reviews and 18,900 desk reviews of employers' compliance with their PAYG withholding, superannuation guarantee and FBT obligations, raising revenue of \$252.2 million.

### Income tax

We completed 3,000 reviews and audits, raising \$62.4 million. These activities included:

- 4,100 advisory letters and 350 reviews and audits of personal services income, raised \$4.9 million
- 26,900 advisory letters and 320 capital gains tax reviews and audits raised \$12.3 million
- 340 income tax reviews and audits of business expense claims raised \$745,800, and
- 21 reviews and audits of refunds raised \$1 million.

### GST

- Our phone and field verification checks resulted in 21,600 activity statements being adjusted.
- We conducted 710 audits involving serious fraud and evasion raising net liabilities of \$71.7 million in GST.
- We undertook 2,000 reviews and audits in relation to property transactions, raising net liabilities of \$45.3 million in GST.

## Excise

- We conducted an education campaign to inform businesses of their entitlement under the fuel tax credits expansion.
- We provided 37 new excise clients with pre-issue alcohol licence education.
- We conducted 1,040 audits and reviews of fuel tax credits and fuel grants clients, and 540 internal reviews.

## Superannuation

- We acted on 16,000 employee complaints about employers' superannuation guarantee obligations. In 2007–08, \$239 million was raised in superannuation guarantee liabilities.
- We undertook over 9,400 audits and reviews of SMSFs.
- We conducted 123 superannuation specific seminars and over 750 general seminars, we also responded to over 600 requests for speakers.

## Lodgment

We wrote to 1.3 million micro enterprises following up their lodgment, telephoning 39,900 people to further ensure they met their obligations. This led to the finalisation of 343,400 income tax returns and FBT returns, and 222,400 activity statements, raising liabilities of \$786.5 million.

## Debt

- Using a range of strategies focusing on early intervention and ongoing engagement, we reduced micro enterprises collectable debt by close to 1%.
- In helping micro enterprises meet their payment obligations, we negotiated 438,000 payment arrangements.
- We issued 8,300 garnishee notices, 4,200 director penalty notices and 2,000 statutory demands to those who chose not to engage with us or who continually defaulted on agreed arrangements.
- We also commenced legal recovery action against 7,300 micro enterprises.

## Cash economy

- We wrote to, phoned or visited more than 68,000 businesses during the year to check for non-compliant cash economy behaviour. Our compliance activities established more than \$100 million in total liabilities.
- The Tax Evasion Hotline (**1800 060 062**) received more than 30,500 reports from those in the community willing to tell us about suspected failures to meet tax obligations.
- In collaboration with a number of trade associations, we published the first three of the business norm benchmarks intended to clearly demonstrate relationships between inputs and income for a range of trades. These related to roof tiling, painting and floor sanding and polishing.

## DEALING WITH THE CASH ECONOMY

Unrecorded and unreported cash transactions – the ‘cash economy’ – put an unfair burden on the majority of businesses that abide by the rules, and undermine the community’s confidence in the tax system.

The temptation to hide cash income often arises out of business-to-consumer transactions. The damage this does can go beyond impacting on the tax system. Without a receipt, consumers face the risk that, if the goods or services they bought turn out to be faulty, they have no evidence to support a claim for refund or to have the problem fixed.

Our strategies to tackle the cash economy include educating the broader community about the risks and focusing on industries that have been more prone to this activity, including building and construction, restaurants and cafes, and some parts of retailing.

We are currently considering whether to introduce tax-withholding arrangements for some of these high-risk industries.

### Encouraging businesses back on track

On the basis that prevention is better than cure, we write to businesses that may be vulnerable to participation in the cash economy, giving advice about their obligations and how to keep proper records. In 2008–09 we will contact around 50,000 businesses in this way.

In addition, through our small business assistance program, we emphasise the importance of good record-keeping practices for businesses receiving cash payments. Where we find a business at risk, we offer them a free electronic record-keeping tool and encourage the operator to attend a record-keeping seminar.

Last year we collaborated with several trade associations to develop benchmarks so that people operating businesses in those trades could understand what income levels might be expected, based on their business activity. This year we will extend this approach, expanding the number of trade benchmarks and also look to work with tax practitioners who have clients in these trades.

Our aim is to encourage tradespeople operating outside business norms to assess their own circumstances and adjust their behaviour if necessary.

### Data matching helps select businesses for review or audit

This year we plan to undertake more than 5,000 cash economy reviews and audits, involving written and phone enquiries as well as field visits. Increasingly we are using data matching to risk assess large numbers of businesses that operate in the cash economy area. For example, we have used data from insurance providers, shopping centre operators and regulatory authorities to identify potential non-reporting of cash income in hot spots such as retailing, personal services and the residential building sector.

Data matching is also used to identify people who appear to be living beyond their means – where their reported income is inconsistent with their spending. For example, we match tax return data against information from government licensing bodies on luxury cars and boats. We investigate significant discrepancies through desk and field reviews and audits. These can result in adjustments to tax liabilities, penalties and, in some cases, prosecution.

### The community plays its role as well

A common characteristic of people who do not disclose all of their income is that they are more likely to break the rules in other areas of life, not just in tax.

For example, we find that some business owners do not report cash sales in order to keep their reported income low enough to receive a social security benefit or avoid child support payments. Our research tells us that this is what the community finds least acceptable about the cash economy.

We encourage the community to report instances of potential tax evasion and now receive around 30,000 reports each year. With recent improvements in our Tax Evasion Hotline, 86% of calls are now answered within two minutes. The community can also provide information to us via fax, our website, mail and through other government agencies.

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## Hidden income detected by data matching

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Data matching led to the auditing of a self-employed concreter who undertook an expensive renovation of the family's \$700,000 house and purchased a new 4WD vehicle for \$72,000 while reporting a household income of barely \$10,000 for the year.

An analysis of the family's living expenses suggested that they would need a household income of at least \$70,000 to maintain their lifestyle.

Our auditors conducted a record-keeping review of the concreter's business records and found them inadequate. Contacting several of his customers, they discovered that he regularly insisted on being paid cash. Also, his customers had often paid more than the amounts on the invoices in his records – in some cases more than twice the recorded amount.

The audit found the concreter had understated his income over three years, leading to:

- a GST adjustment of \$14,000
- an income tax adjustment of \$64,000
- a penalty of more than \$38,000 (which took into account his behaviour), and
- consideration for possible prosecution action.

## MEETING EMPLOYER OBLIGATIONS

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Employers play a crucial role in Australia's tax and superannuation systems. More than 800,000 employers withheld and paid more than \$110 billion to the ATO last year on behalf of their employees. This represents about 43% of net tax revenue. Employers also make superannuation guarantee contributions for employees and have FBT obligations where they provide non-cash benefits to employees.

We promote employer compliance by providing them with the tools and information they need to comply with their obligations. We use data matching and intelligence to identify employers who are at a high risk of not complying, followed by reviews and audits when risks are confirmed.

### Helping employers comply

Larger employers generally have good systems to manage their employer obligations. Compliance issues are more common with smaller employers and often stem from poor business practices, including inadequate record keeping or cash flow management, and not having any back-up when unexpected problems arise, such as personal issues or the loss of a key staff member.

Helping employers meet their obligations is an integral part of our small business assistance program. This program supports businesses at critical points in the business lifecycle, such as when they decide to take on an employee. This year we are contacting new employers by phone to help them understand how to comply with their employer obligations.

### Reviewing employers compliance

We use data matching to detect cases that appear to be incomplete or inconsistent, such as where:

- information reported by an employer in activity statements does not match the credits claimed by their employees in their tax returns
- employers' PAYG withholding annual reports do not match amounts reported in their activity statements
- an employer is registered under a state or territory workers' compensation scheme but does not appear to be registered for PAYG withholding.

We also receive complaints about potential cases of non-compliance, such as where an employee does not receive a payment summary or an employer is believed to be paying cash wages and not withholding tax.

In our reviews we bring the employer's reporting up to date and make arrangements for them to pay any outstanding amounts. We continue to monitor their compliance after review.

Some employers use 'phoenix' arrangements to evade their obligations. This involves cycling their operations through a series of companies which are liquidated without paying their debts. Employers identified as high risk are carefully monitored and contacted promptly if their compliance lapses (see Phoenix arrangements, page 40).

### Superannuation guarantee

We have updated our information and tools to take into account two changes applying from 1 July 2008:

- The minimum superannuation guarantee contributions are calculated on the basis of ordinary time earnings, simplifying things for employers who may previously have been required to use, for example, an earnings base found in an award.
- The superannuation guarantee late payment offset measure has been extended to superannuation guarantee contributions made more than one month late, making it easier for employers who make a late payment to a superannuation fund or retirement savings account to offset part of their superannuation guarantee charge liability.

We receive around 20,000 complaints a year from employees about their employers not paying the correct superannuation guarantee contributions or not offering choice of superannuation fund. We have reduced the time it takes to resolve them, taking firm action against employers who do not comply.

Our analysis suggests that employers in hairdressing and beauty, engineering design and consulting, and building and industrial cleaning are at a higher risk of not meeting their superannuation obligations. We continue to monitor their compliance after review.

## SUPER TOOLS FOR TRUSTEES AND AUDITORS

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Around 380,000 SMSFs hold more than \$285 billion in assets – about 25% of all assets in Australia's superannuation system.

The continued strong growth in SMSFs, with 33,000 new funds registered during 2007–08, poses challenges for trustees and those who support them.

SMSFs have a maximum of four members, all of whom must effectively be trustees of the fund. This means that more than 700,000 Australians are legally responsible for their own superannuation fund.

While trustees are responsible for the management of their fund, they must appoint an approved auditor who, in undertaking an annual audit, must identify and report to us certain contraventions of the superannuation laws.

We have a dual responsibility for SMSFs. As well as monitoring and facilitating their tax compliance, we also regulate SMSFs for the purposes of the superannuation laws. Other superannuation funds are regulated by the Australian Prudential Regulatory Authority (APRA).

### Support for trustees

When a new SMSF is established, each trustee must now sign a declaration that they are aware of and understand their obligations and responsibilities. To support this, we send each new trustee (or director of a corporate trustee) a start-up kit which sets out their role and responsibilities.

They can also subscribe to *SMSF News*, an online newsletter that alerts trustees and advisers to changes in the rules and clarifies areas of uncertainty. With the input of ASIC, it also provides management tips.

Under an early intervention strategy, we also contact by phone or letter at least 10% of all new trustees, including all those where the approved auditor has reported a contravention of the rules. Where our enquiries reveal compliance failures or risks, we provide advice and help to get them back on track.

Results from this activity in 2007–08 reveal that practically all SMSFs contacted satisfied the eligibility requirements and that most trustees had sufficient basic knowledge of the core rules and obligations. However, a significant minority did not appear to understand the sole purpose test and were unaware of the restrictions on the types of assets that can be acquired from related parties.

These learnings inform the design of new help products as well as future compliance work.

### Tools for auditors

Our compliance work with auditors of SMSFs has revealed that some have difficulty in identifying contraventions of the superannuation rules. The resulting inconsistency in reporting impacts on the accuracy of our risk-assessment work. This work aims not only to identify non-compliance but also to minimise the intrusiveness of our compliance activities on those funds that do comply.

To improve the quality of audits and reporting, we have developed an electronic tool, called eSAT, for SMSF auditors to identify and report contraventions. Currently being piloted with a representative group of auditors, eSAT is expected to be released by the end of the year.

eSAT steps auditors through the preparation of the audit report and provides the user with supporting information and case studies.

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# 03

## ***Small to medium enterprises***

THE SMALL TO MEDIUM ENTERPRISES SEGMENT INCLUDES BUSINESSES WITH A TURNOVER OF BETWEEN \$2 MILLION AND \$250 MILLION AND CONSISTS OF APPROXIMATELY:

NUMBER OF ENTERPRISES IN AUSTRALIA

**130,000**

CONTRIBUTION OF TOTAL TAX WE COLLECT

**15%**

PERCENTAGE OF PEOPLE EMPLOYED BY SMALL TO MEDIUM ENTERPRISES

**26%**

There are around 130,000 enterprises in Australia with an annual turnover of between \$2 million and \$250 million. These small to medium enterprises<sup>1</sup> consist mainly of privately held groups. This segment also includes more than 1,340 highly wealthy people who, with associates, effectively control \$30 million or more in net wealth.

Small to medium enterprises pay around 15% of the total tax we collect. They contribute a further 12% of total tax collected through amounts they withhold from payments to employees. More than 26% of people employed in Australia during the year worked for small to medium enterprises.

<sup>1</sup> A significant increase in the number of groups with an annual turnover greater than \$100 million has led us to change our definition of a small to medium enterprise, lifting the maximum turnover threshold from \$100 million to \$250 million. This change will enable us to more effectively monitor compliance of both medium and large enterprises.

## HEADLINE ISSUES

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### **Increased focus on income tax compliance**

Increased government funding will allow us to focus more on income tax compliance by small to medium enterprises generally, and particularly those with turnovers between \$100 million and \$250 million. We plan to risk assess all enterprises in this category over the next four years to form a preliminary view of their level of risk (see page 37).

### **Highly wealthy individuals**

With additional funding to expand our High Wealth Individuals Taskforce, we will further increase monitoring compliance by highly wealthy individuals, followed up where necessary by reviews and audits (see page 37).

### **Tax planning around business exits**

Discussions with businesses and tax professionals have given us a better understanding of the compliance risks that arise when owners dispose of their businesses, and this year we will be undertaking more targeted compliance activity (see page 39).

### **Fuel tax credits**

The expansion of the fuel tax credits scheme on 1 July 2008 has resulted in a significant increase in the number of businesses eligible to claim fuel tax credits. As well as communicating the benefits to eligible businesses, we will focus on understanding the compliance behaviours of new categories of claimants (see page 42).

## OUR GENERAL APPROACH

Small to medium enterprises range from very simple businesses which have high turnovers to businesses with complex structures involving multiple entities, including subsidiaries of large multinationals.

Generally, smaller businesses do not have access to the same resources and expertise as large businesses, although they may have to deal with equally complex tax issues. The relative lack of disclosure requirements for private companies also presents us with particular compliance challenges, as does the personal connection the controllers have with their businesses.

Our risk-management approach with small to medium enterprises is to:

- provide businesses with the information and support they need to comply with tax obligations
- alert businesses to compliance risks – that is, practices and patterns of activity that may suggest non-compliance
- take action against those who deliberately or persistently fail to comply, which may include letter or phone contact, visits, audits, penalties or court action.

Our compliance assurance tools include data matching – that is, comparing information that businesses provide to us in returns with information supplied by third parties, including financial institutions, government agencies and industry. This process is increasingly automated and comprehensive.

We also use statistical analysis to help identify tax risks based on business operating patterns that are outside industry norms or expected economic performance.

When undertaking risk assessments and other compliance activities we focus on the economic group (including related companies, superannuation funds, trusts, partnerships and in particular the controlling individual) rather than the individual entities. We also look at the transparency of business transactions between associated entities and their tax effects.

Our compliance monitoring also takes into account the tax risks associated with different stages of the business life cycle, such as growth spurts, succession planning and business disposals.

To help businesses manage their tax affairs we continue to provide help and information products tailored to the specific needs of small to medium enterprises, particularly those at the lower end. Our web-based business portal has made advancements in capability and we encourage businesses to take advantage of the business portal for electronic lodgment and reporting obligations. On our website we have a comprehensive range of new and updated education products available, for example:

- FBT and entertainment for small business
- fuel tax credits expanded from 1 July 2008
- frequently asked questions for service trusts
- Division 7A Calculator and Decision Tool.

## EXTRA INVESTMENT IN INCOME TAX COMPLIANCE

For the expanding small to medium enterprises segment, the Government's additional investment in our income tax compliance work will be used to increase coverage of what are increasingly complex business dealings, including international transactions. The segment has been broadened and now includes businesses with a turnover up to \$250 million.

We intend to use this funding for expansion across the full spectrum of compliance activities, including:

- helping businesses manage their tax affairs, through innovative products and services
- clarifying the law in areas that are unclear
- enhancing our information collection and data-matching capability
- risk assessing, over the next four years, all businesses with an annual turnover of \$100 million to \$250 million, and following this up with more reviews and audits
- engaging more closely with small to medium enterprises and their advisers, including discussing with them what we are seeing in terms of their tax and economic performance, how this compares with industry norms and what this might mean in terms of our view of their level of risk
- increasing the number of reviews and audits of small to medium enterprises.

### Promoting and verifying compliance by the highly wealthy

The Government has provided us with additional funding to expand our High Wealth Individuals Taskforce. Over the next three years this will allow us to increase monitoring of highly wealthy individuals who, together with associates, effectively control \$30 million or more in net wealth and to conduct more risk assessments, reviews and audits. As at June 2008, 1,340 individuals were being monitored by the taskforce and this number is growing.

To provide guidance on tax compliance for wealthy people we published in early 2008 *Wealthy and wise: A tax guide for Australia's wealthiest people* (NAT 71960), developed in association with tax advisers to wealthy people. This booklet and associated brochure *Wealthy Australians and tax compliance* (NAT 71961) are designed to facilitate a discussion between wealthy people and their advisers, with a checklist of questions to help the people broadly assess whether their tax obligations are being properly managed. The booklet was personally sent by the Commissioner to highly wealthy people to help them understand how we identify tax risk and what we will challenge.

Based on this successful collaboration, we are inviting the advisers who contributed to the development of *Wealthy and wise* to continue to work with us to develop and co-design advice and audit products and information collection tools.

We had 400 reviews of wealthy people in progress at 30 June 2008 compared with 38 at 1 July 2006. We also expect to have at least 110 audits underway in 2008–09.

In addition to undertaking more reviews and audits, the taskforce is developing a more sophisticated risk-assessment approach. The aim is to learn more about the behavioural and structural drivers of compliance risks among the highly wealthy and to improve research, intelligence and analytical tools and methodologies.

This will enable us to focus more effectively and will also improve our understanding of the risks of non-compliance of closely-held private groups in general.

### Income tax and FBT compliance activities

This year we plan to undertake 595 reviews and 370 audits of small to medium enterprises. These will focus on income tax and FBT compliance issues, including:

- lodgment
- capital management
- international transactions, including transfer pricing and tax havens
- capital gains
- tax planning around business exits
- trusts
- service trusts
- FBT
- losses
- prescribed private funds
- phoenix arrangements.

We will also contact 1,300 small to medium enterprises by letter or phone to verify specific income tax and FBT issues.

## SPECIFIC COMPLIANCE ISSUES

### Lodging returns

Some small to medium enterprises appear to be using non-lodgment or partial lodgment as a means of circumventing our compliance programs.

In 2008–09 we are focusing on:

- checking to ensure that entities are up to date with their business activity statements and income tax lodgment obligations, especially those with turnover of \$100 million to \$250 million and highly wealthy people
- industries and sectors with higher rates of late lodgment, including financial and insurance services; property, building and construction; and SMSFs.

### Capital management

We are continuing to focus on business owners who try to extract value from their private companies without paying the correct tax, such as by:

- using loans, payments and debt forgiveness by private companies to, in effect, distribute company profits to shareholders or their associates in a form other than dividends
- using mechanisms such as share buy-backs, capital reductions and the sale of shares to exit from businesses – particularly in relation to disposing of nominally pre-capital gains tax assets (where a capital gain may still arise) and tax issues arising out of actions to enable the business to be sold, such as writing off or forgiving shareholder loans.

Last year we took action to raise awareness of amendments to the law regarding shareholder and associate loans and payments, including issuing Law Administration Practice Statement PS LA 2007/20, which provided a self-correction option for past breaches. We have recently released a Division 7A Calculator and Decision Tool to assist people to comply with that law. Our focus in 2008–09 will be on identifying and dealing with cases where businesses did not take advantage of the option to self-correct past loan or payment breaches. We will also continue to monitor compliance with shareholder and associate loans and payments in light of the amendments made to the law.

### International transactions

#### Transfer pricing and profit shifting

We continue to examine transactions between related Australian and offshore entities that shift profits from Australia to other countries, undertaking reviews and audits in high-risk cases, particularly in relation to businesses with turnovers between \$100 million to \$250 million. This work will be supported by the program of Advanced Pricing Arrangements (APAs), which we enter into with individual businesses to provide certainty about the tax treatment of their transfer pricing arrangements and help reduce their cost of compliance.

#### Use of tax havens and preferential tax regimes

While many dealings with tax havens are legitimate, they are sometimes used to evade tax and other legal obligations.

We continue to check and verify that transactions with tax havens are legitimate, using data matching and analysis. We target high-risk transactions reported by AUSTRAC, identifying those involved and undertaking reviews and audits where necessary.

## Other international risks

Our compliance activities will include:

- targeting non-lodgment of thin capitalisation schedules and reviewing the correct application of safe harbour rules
- data matching, including the use of information provided by our overseas counterparts, to identify whether:
  - businesses are complying with withholding obligations in respect of foreign residents and for overseas payments of interest, dividends and royalties
  - foreign residents with GST registrations are meeting their income tax obligations
  - foreign residents are declaring income or capital gains from taxable Australian property
  - Australian residents are declaring capital gains from overseas assets
  - Australian residents are reporting their foreign income.

## Capital gains

Compliance issues we are focusing on include:

- misclassifying ordinary income as capital gains to obtain a more advantageous tax position
- incorrectly retaining or claiming carry-forward capital losses, where the continuity of ownership or same business test is not met, and incorrectly applying the consolidation loss rules, including the available fraction calculation
- claiming small business concessions when not eligible, or incorrectly calculating the claim
- failing to report capital gains tax events, including by non-residents
- failing to correctly report capital gains on property and share disposals
- incorrectly re-setting the cost base of assets, particularly under consolidation
- arranging to reduce the capital gain when a business is sold
- arranging to avoid capital gains tax on offshore transactions
- failing to account for capital gains where assets are transferred into a superannuation fund, or where proceeds from the sale of assets have been transferred into the fund.

## Tax planning around business exits

In 2007–08 we focused on raising awareness of the rules among businesses and their advisers, and understanding the issues in this area. While educational and law clarification activities will continue, this year we will be shifting our emphasis towards active compliance. We will be examining business restructures where the primary objective is to receive a tax advantage through the use of demergers, consolidation or trust cloning rather than for preparing a business for sale. We also intend to examine tax risks associated with a sale of a business such as correct treatment of pre-CGT assets, earnouts and eligibility for small business CGT concessions.

## Trusts

### Assessing trust income

We will seek judicial clarification of a number of trust issues including the effectiveness of clauses in trust deeds that seek to equate trust income with trust taxable income. Some clarification may also be provided by the outcome of the appeal to the Federal Court from the recent Tribunal decision in *P & D Bamford, P & D Bamford Enterprises Pty Ltd v. Commissioner of Taxation*.

While awaiting clarification, we do not propose to conduct active compliance activities specifically in relation to these issues. However, if such issues arise in the course of an audit prompted for some other reason, or if we are asked to provide a ruling on these issues, we will apply the law as we understand it to operate. As guided by the courts, we understand that the provisions in the trust deed dealing with the entitlements of unit holders do not alter the character of amounts in the hands of the trustee.

### Trust cloning

We will seek to identify cases where trust assets have been transferred to a new or mirror trust and a CGT exception claimed (generally referred to as 'trust cloning'). Our particular focus will be on cases involving the permanent deferral of tax, such as where there is a claimed increase in the cost base of the transferred asset.

Our intelligence gathering and research processes may involve contacting trustees and obtaining details of their trust deeds and other information. We also encourage trustees with 'cloned' trusts to seek our advice if they have any uncertainty about the correct application of the law to their circumstances.

### Service trusts

We are measuring the effectiveness of our strategies to improve voluntary compliance in relation to service entity arrangements through the risk analysis of tax return data and other information.

Based on this, we have contacted some legal and accounting firms where recent tax performance remains a concern and we will continue these reviews as required. We will also be gauging the level of voluntary compliance in other professional sectors. Arrangements in line with our guidance material will have a low risk of audit unless there are concerns about the actual existence of the arrangements. We will also be monitoring changes in professional structures to determine whether the underlying risk of income alienation has abated.

Help and information have included the publication on our website of answers to frequently asked questions, and a survey to test current levels of awareness and knowledge. We also plan further consultation with the medical profession and their advisers to identify the need for further guidance.

### FBT

The correct FBT treatment of business-owned motor vehicles continues to be an area of focus, particularly in relation to the private use of vehicles and the provision of luxury vehicles to business principals. Our education activities will also emphasise the correct accounting treatment of any employee contributions that may reduce the taxable value of benefits provided.

Our data-matching activities will help identify high-risk employers for further compliance action.

### Losses

We are responding to high-risk cases of loss generation and utilisation more quickly, given the shorter periods for amending income tax returns disclosing losses. Our compliance focus is on the larger enterprises.

Compliance issues include:

- recouping losses without taking into account changed ownership or the fact that a different business is being conducted
- misclassifying losses as capital or revenue
- carried-forward revenue losses where the origin of the loss is artificial or has no economic basis
- incorrectly applying the consolidation loss rules.

### Prescribed private funds

Prescribed private funds are a special category of non-profit entity established for philanthropic purposes. The number of registered prescribed private funds continues to increase, as does the value of the funds held in them. With many prescribed private funds associated with highly wealthy individuals, an area of concern for us is the interaction between these funds and the other associates of their economic group. Greater detail on our prescribed private fund compliance activities can be found within our Non-profit organisations chapter on page 60.

### Phoenix arrangements

Phoenix arrangements – that is, attempts to evade tax through the deliberate, systematic and sometimes cyclical liquidation of related corporate trading entities – continue to be a focus.

In 2008–09 we are maintaining an emphasis on early intervention by:

- more effectively identifying and tracking phoenix operators through better use of systems and intelligence
- discouraging new or emerging phoenix operators from repeating this behaviour, by identifying and contacting them earlier about their behaviour
- targeting facilitators and promoters of such behaviour.

We continue to take firm action against the more egregious phoenix operators.

As phoenix arrangements sometimes involve non-compliance outside the tax jurisdiction, we will work and exchange intelligence with other government agencies, especially the Australian Securities and Investments Commission (ASIC).

Where we have evidence of offences that may warrant prosecution, we will continue to work with the Australian Federal Police (AFP) and the Commonwealth Director of Public Prosecutions (CDPP).

## GST

### Refund Integrity

Small to medium enterprises represent a significant refund integrity risk, with \$171 million in refund adjustments made across 1,149 cases in 2006–07. To maintain the integrity of the refund system, we continue to undertake pre-issue and post-issue checks to ensure that refund claims are correct. If we are concerned about a refund we will contact the businesses or third-party supplier to substantiate claims.

### Property transactions

In monitoring property transactions for GST and other tax compliance we are focusing on:

- unreported property sales
- the correct application of the margin scheme
- incorrect reporting of adjustment events
- disengaged clients who avoid their obligations by not lodging activity statements or not registering in the GST system.

Matching data, such as property registries with return information is being further developed.

With the aim of clarifying the law to make it easier to comply, we will also consult with external stakeholders, including tax professionals and the property industry, on issues such as:

- whether a partnership can use the margin scheme
- the GST treatment of real property transferred through the execution of a deed of partition
- reviewing the definition of residential premises and commercial residential premises and the interaction between the two
- clarifying the five-year rule on when residential premises cease to be new residential premises.

### Financial supplies

We continue to find cases of financial supply transactions not being correctly reported. This year we will maintain a focus on:

- GST incorrectly recovered on costs relating to making input-taxed financial supplies
- recovery of GST using a fair and reasonable apportionment methodology.

Our compliance activities will include issuing public rulings, providing help and information, undertaking reviews and audits, and advising Treasury where the law is not operating as intended.

### International

We continue to enhance our understanding of cross-border issues with the aim of maintaining high levels of compliance and a business environment that does not give an unfair advantage to businesses that fail to correctly apply GST on goods and services consumed in Australia. We will focus on transactions where supplies are being made to non-residents but provided to unregistered resident entities or to registered entities not entitled to full credits.

### Integrity of business systems

We have found poor governance and tax risk-management processes during major business events, such as accounting system changes and business restructures, which leads to errors in capturing and reporting GST information. The root cause of these problems generally lies in insufficient resources (systems and people) being devoted to GST risk-management functions.

We are undertaking a range of compliance activities to review controls on GST accounting, particularly in relation to:

- systems and procedure failure
- change management
- specific issues
- lack of technical expertise.

## Dodgy schemes

### Promoted tax exploitation schemes

We will continue to look at any abuse of the private ruling system by promoters who are marketing tax exploitation schemes for income tax or GST. This may occur where a promoter markets a scheme on the misleading and incorrect basis that a ruling will protect investors, but the ruling applies to different circumstances or arrangements.

Our aim is to deter promotion of tax exploitation schemes by financial service providers and law and accounting firms through:

- early identification of schemes
- providing early warning to participants to highlight our concerns about specific schemes and arrangements
- encouraging participants in these schemes to come forward early to take advantage of the provision that allows significant reductions in penalties for those who make full and true voluntary disclosures
- interaction with promoters to review and if necessary investigate their activities to stop the promotion of tax exploitation schemes and apply appropriate remedies under the promoter penalty laws.

We will also be reviewing how financial service providers and law and accounting firms manage risks associated with the promoter penalty laws to emphasise the need for these businesses to implement good governance and risk management practices in relation to these laws.

## Saving for retirement

### Employee superannuation

Small to medium enterprises generally maintain a high level of compliance with their superannuation guarantee obligations. Issues generally relate to partial non-compliance, such as incorrect calculations and late payments, rather than not providing any superannuation support for employees.

### Self-managed superannuation funds

Given the increasingly important role of SMSFs in the superannuation system and their access to concessional tax treatment, we put a lot of emphasis into ensuring high levels of compliance.

While our compliance work will continue to focus on regulatory matters such as loans, in-house assets, borrowings and arms-length transactions, we will also be monitoring more closely the income tax compliance of the controllers of the funds.

To gain a broader level of assurance on the auditing of SMSFs we will continue to monitor the capability of approved auditors, including the larger providers of these services.

## Australian Prudential Regulatory Authority regulated funds – reporting obligations

We will have a continuing focus on ensuring corporate, industry, public sector and retail superannuation funds correctly meet their reporting obligations to us.

We will also check if funds are complying with their obligations under the super simplification measures, including whether they are:

- accepting personal contributions only where they hold a member's tax file number
- ensuring timely and correct reporting of release authorities
- not accepting directly rolled-over employer termination payments
- correctly reporting member contributions of more than \$1 million between 10 May 2006 and June 2007
- crystallising the pre-83 contribution component
- paying unclaimed superannuation money to the ATO.

## Excise

We expect to conduct 150 reviews and audits of small to medium enterprises this year.

## Fuel tax credits

Eligibility for fuel tax credits was expanded from 1 July, allowing many businesses to claim a fuel tax credit for the first time and giving many existing claimants an additional entitlement. We are partnering with a diverse range of intermediaries including the retail and insurance industries, federal and state government agencies and industry associations to distribute fuel tax credit brochures to their business clients, members and stakeholders.

We are also sending 74,000 businesses an email informing them of the expansion. An eligibility tool is available on our website to help businesses understand their entitlements.

This will be accompanied by work to build our understanding of the industries and businesses new to fuel tax credit entitlements. We will identify and monitor those that are outside of industry norms for claiming fuel tax credits. Firm action will be taken where deliberate non-compliance is identified.

## Credit fraud and other serious abuse

We continue to focus on the recurring risk of fuel tax credits fraud that is often facilitated by identity fraud. In particular we will build on the profiling of claimants carried out as part of implementing phase 1 of the fuel tax credits scheme to identify attempts to defraud the community.

Profiling is used more generally to identify criminal activity involving excise and other areas of the tax law.

## SNAPSHOT OF OUR 2007–08 ACTIVITIES

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### Small to medium enterprises

#### Income tax<sup>1</sup>

- We completed 570 audits, 480 reviews and 1,780 phone and letter-based verification activities. As a result, we raised liabilities of \$370 million and disallowed current year and carried forward losses of \$740 million.
- We completed 27 audits and 440 reviews of highly wealthy individuals. As a result, we raised liabilities of \$339 million.

#### Excise

- We commenced an education campaign to inform businesses of their entitlement under the expanded fuel tax credits scheme.
- We reviewed early payment claims prior to the closure of the transitional scheme.
- We conducted 180 audits and reviews of recipients of fuel tax credits and grants. We also conducted 170 internal reviews. These activities raised net liabilities of \$11.7 million.

#### GST

- We raised net GST liabilities of \$266.7 million as a result of 30,000 reviews and audits conducted. Of these, 700 related to property risks and raised liabilities of \$47.9 million.

#### Lodgment

- We sent letters to 15,300 businesses with outstanding lodgment obligations, raising \$56.3 million in net liabilities.
- We phoned 9,500 businesses with outstanding lodgment obligations, raising \$514.9 million in net liabilities.

#### Superannuation

- We acted on 3,200 employee complaints about employers' superannuation guarantee obligations, raising \$131 million in superannuation guarantee liabilities.
- We undertook more than 440 audits and reviews of self-managed superannuation funds.

#### Employer obligations

We conducted 290 field audits, 140 outbound telephone reviews and 6,700 desk reviews of employers' compliance with their PAYG withholding, superannuation guarantee and FBT obligations, raising revenue of \$103.4 million.

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Results of our activities are based on preliminary data and are indicative only. Final results for 2007–08 will be published in our Annual report 2007–08, due for release in October.

<sup>1</sup> Some of these results may include assessments raised against individuals.

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# 4

## Large businesses

THE LARGE BUSINESS SEGMENT INCLUDES GROUPS WITH AN ANNUAL TURNOVER OF MORE THAN \$250 MILLION AND CONSISTS OF APPROXIMATELY:

BUSINESS GROUPS IN AUSTRALIA

1,000

TOTAL TAX PAID BY LARGE BUSINESSES

35%

PERCENTAGE OF PEOPLE EMPLOYED BY LARGE BUSINESSES

25%

There are around 1,000 business groups in Australia with an annual turnover of more than \$250 million.<sup>1</sup> These large businesses each contain on average around 30 entities. Around 60% of these entities are public companies and a similar proportion is Australian-owned. This segment also includes around 80 superannuation funds with 18 million member accounts.

Large businesses pay about 35% of the total tax and 50% of GST we collect. As well as making a significant direct contribution to revenue, large businesses also have significant tax and superannuation obligations as employers of around 25% of Australia's workforce.

<sup>1</sup> A significant increase in the number of groups with an annual turnover greater than \$100 million has led us to change our definition of a large business, lifting the minimum turnover threshold from \$100 million to \$250 million. Businesses with a turnover below this are now classified as small to medium enterprises. This change will enable us to more effectively monitor compliance both above and below the \$250 million threshold.

## HEADLINE ISSUES

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### **Promoting good corporate governance and greater certainty**

We have developed a range of products for large businesses that promote good corporate governance by providing greater certainty for tax risk-management (see page 47).

### **Delivering the Government's policy agenda**

We will be supporting the implementation of a raft of new measures, including those relating to financial arrangements, managed fund distributions and consolidation, as well as contributing to Board of Taxation reviews of managed investment trusts, anti-tax-deferral regimes, GST and other issues (see page 49).

### **Expanding our coverage of income tax compliance**

Increased government funding will enable expanded coverage of income tax compliance risks through a series of industry and issue-based projects (see page 50).

### **Alignment of tax and economic performance**

Significant differences between accounting profit and taxable income can indicate increased tax risk and attract our attention (see page 50).

### **Capital markets, including mergers and acquisitions**

Despite a slowdown in merger and acquisition activity, we continue to see many transactions that involve complex arrangements. We will be examining transactions that, taken as a whole, result in inconsistencies between tax outcomes and the economic nature of the transaction (see page 51).

### **International**

We are concerned about global corporate restructures that shift assets, functions and risks offshore, and financial arrangements whose success relies heavily on artificially-generated tax benefits in Australia without a commensurate economic benefit to Australia (see page 51).

In response to an increase in the level of tax risks associated with complex international arrangements, we are collaborating and sharing information at both the macro and micro level under our treaties with foreign tax administrations (see page 51).

## OUR GENERAL APPROACH

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The value, volume and complexity of transactions undertaken by large businesses carry inherent risks for tax compliance. We work closely with large businesses, reflecting their critical importance in the effective operation of the tax system.

Our approach is based on:

- promoting good corporate governance
- ensuring large businesses have the information and support they need to comply with their tax obligations, including certainty around complex areas of law
- profiling all large businesses to identify both broad trends and specific cases where tax outcomes appear inconsistent with business performance
- reviewing and auditing cases where we identify risks.

Large businesses generally have access to advice, either internally or from external advisers, but their need for higher levels of certainty may prompt them to seek clarification from us, particularly in the case of new law. In turn, we consult with large businesses and their advisers on complex areas of the law, and on administrative processes, to ensure their reporting obligations are as streamlined as possible.

We seek an open dialogue with large business on how the tax system is working in practice, with the aim of co-designing administrative improvements or raising policy matters with Treasury. Many of the compliance issues with large businesses relate to differing interpretations of the law, and we acknowledge the scope for such differences on complex matters.

As with other segments, verifying the compliance of large businesses is based on differentiating our responses according to their behaviours and our view of the risks involved.

We aim to be transparent about our view of the nature and level of a large business's compliance risks, openly communicating our view as early as possible.

In response to both the higher risk in this segment and corporates' preference for certainty, our compliance activities are increasingly being undertaken in close to real time. For example, we make real-time enquiries about the nature and tax outcome of major new transactions and disclosures to the market. We track payments in real time and follow up missed registration, lodgment and payment deadlines. Payments are monitored against expected economic outcomes on a sector-by-sector basis, taking into account factors such as trends in commodity prices.

We also alert large business where our compliance activities reveal an apparent overpayment of tax or a credit adjustment is warranted.

The higher level of scrutiny in this segment is seen in the relatively high proportion of large businesses subject to review or audit, with around 48 significant income tax audits and 210 risk reviews planned for completion in 2008–09.

'We provide more detail about our approach to compliance in our booklet *Large business and tax compliance 2006*, including the indicators and ratios used for profiling, the indicative risk filters used in selecting cases, and details of our review and audit processes.'

## PROMOTING GOOD CORPORATE GOVERNANCE AND GREATER CERTAINTY

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In a regulatory environment that encourages self-regulation and voluntary compliance, the standard of corporate governance has a direct bearing on whether a corporate entity is considered to have a higher, medium or lower tax risk level.

The importance of positive relationships between the revenue agency and the corporate in supporting effective tax risk-management is increasingly recognised around the world, and Australia is seen to be at the forefront of this. A recent Organisation for Economic Co-operation and Development (OECD) study found significant scope for revenue agencies to influence the demand of large businesses for aggressive tax planning advice.

To promote transparency and facilitate good corporate governance by large business, we are open about what we see as tax risks and the issues that attract our attention. For example, *Large business and tax compliance 2006* (NAT 8675) sets out questions to help directors and senior management identify where tax risks may occur so they can be appropriately managed.

Other initiatives designed to provide more certainty for large businesses and to reduce compliance costs include regular meetings at a senior level and a range of advice and assurance services for large business (see table over). The aim of these initiatives is to become more current and more responsive to the corporate's circumstances and approaches to tax risk-management.

We are refreshing our consultative arrangements by establishing a Large Business Advisory Group as the peak consultative forum for large businesses. This group will work with us to improve operational and administrative processes, reduce compliance costs and address technical and administrative issues.

A recent external review of our APAs, while finding that corporates endorsed the program, recommended a series of measures to reinvigorate it and make it more applicable to today's business environment. As a result, we will work with industry to co-design a more sustainable program, looking at issues such as the entry criteria, project management and capability development. We expect an increased demand for APAs, particularly in the pharmaceuticals industry and where companies are operating in countries where there is an active transfer pricing audit program.

## ADVICE AND ASSURANCE SERVICES FOR LARGE BUSINESS

Product	Scope and level of assurance provided	What is involved	Availability and take-up
Private binding ruling	Provides binding advice for a business on how the law applies to a specified arrangement in their circumstances.	The business will seek advice by providing the ATO with a description of the transaction or arrangement and identifying the specific tax implications they require the ATO to rule upon.	About 300 private rulings issued annually to large businesses.
Class ruling	Provides binding advice for an identified class of businesses on how the law applies to a specified arrangement.	A business sends in a request for advice that includes a detailed description of the arrangement or transaction and asks the ATO to publish its opinion on the specified tax implications for a class of persons.	About 90 class rulings issued annually at the request of large businesses.
Product ruling	Provides binding advice on how the law applies to businesses individually who enter into substantially the same transactions with a common entity or group of entities.	The business will seek advice on the tax outcomes of a particular investment arrangement by providing the ATO with a draft product ruling that sets out the details of the investment arrangement and a view of the associated tax implications for the investors for consideration and publication by the ATO.	About 20 product rulings issued annually at the request of large businesses.
Annual compliance arrangement	For income tax risks on an annual basis, this provides a level of practical certainty (to the extent of full and true disclosure) in the form of a sign-off letter from us confirming the outcomes of the risk assessment (which may include an agreement not to audit specified lower risk matters subject to full and true disclosure) and identifying the higher risk issues (for which we will encourage the corporate to use our priority rulings process).	The business provides assurance that it meets the tax risk governance requirements in <i>Large business and tax compliance 2006</i> . We hold joint workshops with the business on disclosed risks throughout the year and prepare an annual joint risk assessment and risk management plan.	Launched on 12 May 2008 and initially available to the largest 50 businesses.
Advance pricing arrangement (APA)	For income tax outcomes of dealings with related parties offshore for up to five years, this provides assurance on the risk of a transfer pricing review or audit and, potentially, double taxation.	We negotiate an agreement with the business (and with the foreign tax administration in the case of multilateral arrangements). Where it is not practicable to conclude an APA with a treaty partner – or there is no tax treaty – the corporate could consider a unilateral APA to deal with the Australian tax risk arising from their related party international dealings.	69 APAs with large businesses and 31 with small to medium enterprises in place at 30 June 2008.

Product	Scope and level of assurance provided	What is involved	Availability and take-up
Forward compliance arrangement (FCA)	<p>For one or more tax obligations, this provides a high level of assurance, including access to concessionary treatment of penalties and interest in the event of tax shortfalls.</p> <p>The transparency and real time engagement achieved through joint commitment to the FCA results in an improved compliance relationship. The results include:</p> <ul style="list-style-type: none"> <li>■ reduced likelihood of surprises</li> <li>■ streamlined approaches for delivering technical support and administrative solutions for compliance difficulties</li> <li>■ less traditional compliance activity.</li> </ul>	<p>Businesses undergo a due diligence review of their tax compliance, entity and tax level governance arrangements, systems and controls for managing risk. Businesses must demonstrate high standards of self-scrutiny, governance, risk management and continuous disclosure. Regular meetings and reviews support the relationship.</p>	4 FCAs in place at 30 June 2008.
GST Annual Compliance Arrangement	<p>For indirect and transaction based tax obligations, this provides a lower level of assurance than FCAs.</p>	<p>The business undergoes a low-intensity due diligence review of their tax compliance and governance arrangements, systems and controls for managing tax risk. Businesses need to demonstrate good standards of self-scrutiny, governance, risk management and continuous disclosure. Regular meetings and reviews support the relationship.</p>	Pilot under way.

## DELIVERING ON THE GOVERNMENT'S POLICY AGENDA

Significant new measures that will impact on large businesses include:

- reintroduction of the taxation of financial arrangements (TOFA) stages 3 and 4 measures, which will take effect from 1 July 2009
- new withholding arrangements for managed fund distributions to foreign residents designed to help establish Australia as a regional financial services centre
- modifications to the consolidation regime designed to improve interactions with other parts of the law
- measures arising from Board of Taxation reviews, including reviews of the rules for managed investment trusts and the anti-tax-deferral regimes, that will impact on cross-border investment flows.

In implementing these measures we are consulting closely with industry and professional groups to ensure large business concerns about administrative matters are fully addressed. Any matters we can't directly address are brought to the attention of the Treasury, along with any unintended outcomes, whether they benefit businesses or the revenue.

We are also working with industry and professional bodies to design effective administrative processes that minimise compliance costs and information products and services to help large businesses implement these measures.

## EXPANDING INCOME TAX COVERAGE

The Government has invested additional funds in our income tax compliance work, reflecting the need for compliance processes to keep up with an increasingly complex economic environment, including greater cross-border business, investment and employment activity.

For the large business segment, the additional funds will enable us to expand our coverage, respond quickly to emerging risks and issues, and deal better with increasing complexity.

## ALIGNMENT OF TAX AND ECONOMIC PERFORMANCE

Large businesses are generally highly compliant with registration, lodgment and payment obligations. Our main concerns relate to the treatment of transactions and other events as reported in tax returns and schedules.

Many of these issues arise from different views on how the law applies to the very complex transactions and environment in which large businesses operate. This is often reflected in differences between tax and economic performance – a company may disclose large accounting profits to its shareholders and the market, but report low levels of taxable income or even tax losses. While there can be good reasons for this, such disparities attract our attention.

We look closely at the timing and permanent adjustments a company makes to its accounting profit in calculating its taxable income and tax payable. We also monitor Business Activity Statements and pay particular attention to deviations from expected results and other external benchmarks.

Specific issues we are examining:

### Characterisation of income and expenses

Transactions that are beneficial for income tax and GST purposes but at odds with their economic substance.

Gains and losses on sale of investment assets including those by trustees of managed investment trusts.

### Consolidation

Cost setting outcomes for entities joining and leaving a consolidated group.

Structuring and tax planning designed to deliver benefits that are inconsistent with the intent of the law.

### Losses

Revenue losses utilised and carried forward that do not meet the loss recoupment and deductibility tests – particularly as they are transferred into consolidated groups.

Loss generation and utilisation that does not reflect economic realities.

### Profit shifting

Related party cross-border dealings where profit reported in Australia does not reflect the economic contribution made here.

## Comparing accounting profits and taxable income

To explore the differences between economic and tax performance we conducted a pilot review of 40 corporates drawn from a range of different economic sectors, with large book-to-tax negative adjustments – that is, those who reported large differences between accounting profit and taxable income.

Working with their advisers, we sought explanations about their book-to-tax adjustments. With 20 companies this involved a quick review of their annual reports and financial statements for any issues, while the remaining reviews were carried out as part of a full risk review.

The pilot review found issues in regard to revenue/capital classification, timing, non-assessable income, loss creation and some straightforward errors – resulting in four cases that will proceed to audit, one case with a significant industry issue where the ATO view is being developed as part of a priority technical issue, and one case where the business made a voluntary disclosure.

We will expand on the pilot next year as part of our increased coverage of the large market, using the additional funding for income tax compliance work.

## **CAPITAL MARKETS, INCLUDING MERGERS AND ACQUISITIONS**

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While slowing economic growth appears to be reducing the level of merger and acquisition activity, we are concerned with the increasing number of complex merger and acquisition transactions where the individual elements comply with the relevant legislative provisions but the overall result produces a tax outcome that does not reflect the economic nature of the transaction.

Where steps in the transaction do not appear to have a clear commercial purpose, but result in overall tax benefits, we will look at the application of the anti-avoidance provisions (see Mergers and acquisitions – what attracts our attention, page 54).

Recognising that many merger and acquisition transactions have short commercial timeframes and require certainty, we strongly encourage large businesses and their advisers to engage us at the earliest possible stage. Specifically, a pre-lodgment meeting with key company representatives will enable us to clarify, for the business community as a whole, our attitude to particular transactions through class rulings. To accommodate the needs of business, we have extended the priority-ruling system to class rulings for complex merger and acquisition transactions that are time sensitive.

Specific issues being examined:

### **Corporate restructures and capital gains tax**

Tax outcomes (including the use of rollovers, the tax values of significant assets and the utilisation of capital losses) of major transactions, including corporate restructures, mergers, acquisitions and divestments of assets from external sources. Transactions that appear contrived and lack commercial reality may attract the general anti-avoidance provisions in Part IVA.

Transactions undertaken by non-residents in relation to taxable Australian property, including business assets of permanent establishments, and transactions that may be contrived to circumvent the operation of the integrity provisions in the new non-resident capital gains tax provisions.

### **Hybrid capital raisings**

Capital raisings that involve the use of hybrid securities (where the instrument contains features that are common to both debt and equity). This includes hybrid instruments that may be classified as debt for income tax purposes but as equity for accounting purposes.

Arrangements where there is a potential for corporate financing instruments to be misclassified as debt rather than as equity, resulting in interest deductions; circumvention of the debt/equity provisions using unit trusts; and tax planning involving stapled instruments, tax-deferred distributions and capital gains tax deferrals.

### **Asset infrastructure deals**

Structuring and financing by investment banks and other intermediaries in the acquisition and management of significant assets such as infrastructure projects.

## **INTERNATIONAL ISSUES**

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We are focusing on:

- global corporate restructures that shift assets, functions and risks offshore
- financial arrangements whose success relies heavily on artificially-generated tax benefits in Australia – which have become more common across a range of commercial activity, including internal financing, structured transactions between financial institutions, and mergers and acquisitions
- transactions and arrangements that re-characterise interest, dividend or royalty income to avoid non-resident withholding tax and seek other tax benefits.

These arrangements are of concern to revenue agencies around the world. In analysing and investigating them for Australian tax purposes, we work closely with our overseas counterparts, sharing information on specific arrangements or businesses.

Specific issues we are examining:

### **Tax havens**

Transactions and arrangements that involve tax havens and other low-tax jurisdictions and that appear to artificially reduce Australian tax. We are concerned about schemes and arrangements where businesses exploit the secrecy laws of tax havens in an attempt to conceal assets and income that are subject to tax in Australia.

### **Cross-border arbitrage**

The use by large businesses of complex structuring and hybrid financial instruments to obtain benefits, such as duplicate deductions or credits, not intended by law, or to take advantage of inconsistencies between the laws in different jurisdictions to the disadvantage of Australia.

### **Transfer pricing and profit shifting**

The use of arrangements between related Australian and offshore entities to shift profits (and tax) from Australia to other countries, including:

- restructuring of Australian-based operations to shift functions, assets and risks offshore, such as the sale of intellectual property at a nominal price in return for a royalty stream, and
- payment of excessive interest, guarantee and other fees, and the provision of services by Australian-headquartered companies to overseas subsidiaries at no charge.

### **Non-resident withholding tax**

Transactions and arrangements that re-characterise interest, dividend or royalty income to avoid non-resident withholding tax and seek other tax benefits. Transactions or arrangements where there has been a failure to withhold from such payments to the foreign resident.

## **GST COMPLIANCE ISSUES**

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### **GST risk-management**

We continue to focus on how businesses manage the tax risks that stem from weaknesses and deficiencies in business systems used in GST reporting. Where risks are identified, we adopt a consultative and collaborative approach with businesses and their advisers in deciding how to respond. Audits are just one of the options open to us. Where appropriate, we deliver targeted information to encourage voluntary compliance.

### **Property transactions**

Compliance issues continue to arise from property transactions, particularly in relation to GST. Our focus is on:

- incorrect reporting of property transactions
- incorrect application of the margin scheme
- GST adjustment events arising from a change in the extent of creditable purpose and failure to recognise and make adjustments relating to purchases of GST-free going concerns.

We continue to work with industry consultative forums and tax professionals to identify high-risk areas of the GST law that require clarification or a higher level of awareness, and develop solutions, including rulings or information products. For example, last year we consulted with the property industry in developing a ruling on the GST treatment of development leases.

As a new approach to compliance assurance for GST, we are piloting the use of risk products with the aim of minimising compliance costs, encouraging disclosure and making better use of our audit resources.

## Financial services and GST

GST compliance issues in the financial services sector include:

- GST incorrectly recovered on the costs of making input-taxed financial supplies, particularly:
  - mergers and acquisitions
  - financial supplies made before 1 July 2000
- recovery of GST using a fair and reasonable apportionment methodology
- supplies of services to associated entities at less than market value.

Our responses will include issuing public rulings and other guidance products to clarify our view of the law, audits where risks are confirmed, and providing advice to Treasury where the law is not operating as intended, whether to the benefit or detriment of the revenue.

## Ensuring correct GST treatment of international transactions

We are examining material risks associated with international transactions to ensure that GST is correctly applied and paid on goods or services consumed in Australia. Our focus is on transactions where supplies are being made to non-residents but provided to unregistered resident entities, or to registered entities not entitled to full credits.

## EXCISE

With large businesses, our focus will continue to be on reviewing their internal controls to ensure the accuracy of large returns. We will also support them in implementing the expansion of the fuel tax credits scheme from 1 July 2008.

## LARGE SUPERANNUATION FUNDS

There are around 80 superannuation funds with income of more than \$250 million. Together these large funds hold assets of around \$660 billion in 18 million member accounts, earn income of around \$90 billion and account for 60% of all income tax paid by superannuation funds.

This year our income tax compliance work will focus on:

- ensuring that the investment and contribution income of large funds is taxed correctly
- identifying trends and unintended consequences arising from the super simplification measure through analysis of tax payments by large funds
- monitoring claims for rebates and exemptions because of their significant impact on revenue
- ensuring compliance with the new rules on the use of funding credits by funds.

We will also continue to focus on ensuring funds regulated by APRA are meeting their reporting obligations to us and are complying with their obligations under the recent changes to superannuation, including:

- crystallising the pre-83 contribution component
- correct and timely actioning of release authorities
- accepting contributions from members only where they hold the member's tax file number.

## PROMOTION OF TAX EXPLOITATION SCHEMES

With the new promoter penalty provisions that have been introduced to combat tax exploitation schemes, financial services providers and law and accounting firms will need to understand and manage the risks associated with their entrepreneurial activity in this regulatory environment.

The standard of governance these businesses apply to the delivery of their services has a significant bearing on whether they are considered to have a higher, medium or lower risk of contravening the promoter penalty laws (see 'Promoter penalty laws yield results', page 79).

Given their influence in the marketplace, the major players are a particular focus for us. We will be looking at how they manage their risks and providing assistance in the form of a good governance guide.

## Mergers and acquisitions – what attracts our attention

While merger and acquisition activity has slowed, we continue to see very complex arrangements and are detecting some significant compliance risks.

### Requests for rulings on part of the transaction

We are increasingly being asked to rule on narrow aspects of a wider, more-complex transaction. In these cases, as in others, the advice we provide can only be relied on to the extent of a full and true disclosure of material facts. Sometimes the individual parts of the transaction may themselves comply with the relevant legislative provisions, but the overall arrangement itself may not.

Where steps in a transaction do not appear to have a clear commercial purpose, but result in overall tax benefits, we will look at the application of the anti-avoidance provisions. As well as the risk to shareholders that the anti-avoidance provisions may later be found to apply to the broader arrangement, directors may be at risk of failing to comply with disclosure requirements.

In the absence of a clear commercial purpose we will thoroughly review the transaction with the aim of understanding the commercial and tax drivers and outcomes, including financing arrangements and the structures and entity types used. We will carefully review the transaction as a whole, particularly any unique or novel features, and assess whether their tax treatment is appropriate.

### Issues relevant to target entities

- Where there are pre-restructure activities, we will consider whether the restructure is undertaken to produce tax benefits.
- Where a new head company of a consolidated or Multiple Entry Consolidated (MEC) group is created, we will consider whether the aim is to uplift the tax cost of assets.
- Where an entity claims to have failed the principal asset test to qualify for the non-resident CGT exemption, we will consider whether there has been any manipulation of the value of the entity's assets.
- Where the overall scheme, transaction or arrangement consists of multiple transactions, we will consider whether the combined effect of the relevant tax provisions leads to unintended outcomes.
- Where hybrid securities are a feature, we will consider the tax effect of the difference between tax and accounting treatment – for example, on entities leaving a consolidated group.
- Where significant transaction costs have been paid, including break fees, we will consider whether the costs have been correctly characterised as revenue or capital and treated correctly.

### Issues relevant to target shareholders

- Where dividends have been paid contemporaneously with the merger and acquisition transaction, we will consider whether the dividend forms part of the consideration for disposal of the share.
- We will consider the extent to which the structure has been influenced by the preferences of the shareholder or unit-holder for tax preferred distributions.
- Where capital proceeds or share capital are paid to the shareholder, we will consider whether the payment is in substance the payment of company profits, realised or unrealised.
- Where a shareholder or unit-holder exchanges their share or unit for a stapled security (or otherwise acquires a stapled security), we will consider whether the creation or acquisition of the stapled security is driven by a desire to substitute tax-preferred distributions for what would otherwise be assessable company or trust distributions.
- Where new shares are issued and other shares cancelled, resulting in a change of ownership of the company, we will consider whether the payments made for the share cancellation should be properly characterised as profit.

### Issues relevant to acquirer entities

- Where a new head company of a consolidated or MEC group is created, we will consider whether the aim is to uplift the tax cost of assets.
- Where the overall scheme, transaction or arrangement consists of multiple transactions, we will consider whether the combined effect of the relevant tax provisions leads to unintended outcomes.
- If the acquiring entity is a consolidated group, we will consider whether the tax values of newly acquired assets have been appropriately set and whether losses and franking credits are being utilised appropriately.
- Where outbound transactions are structured in a way to derive exempt income and generate interest deductions in Australia, we will consider the commerciality of the financing, including hybrid financial products.

## Building better relationships face to face

Since 2005, our senior staff have met on a regular basis with the top 100 corporates to build a relationship of trust and cooperation. Increasingly, the conversations at these meetings with their senior staff are evolving to encompass a robust discussion about their tax performance and broader compliance picture.

So far, most of the top 100 corporates have taken up the offer of regular meetings, which we propose on an annual basis.

We encourage corporates to put issues on the agenda, and we take the opportunity to raise specific issues including their overall tax performance.

### Being open about risk

At the meeting, we table the results of our risk analysis of their tax performance. Where it is significantly outside the trends for their economic sector we ask them to explain the difference.

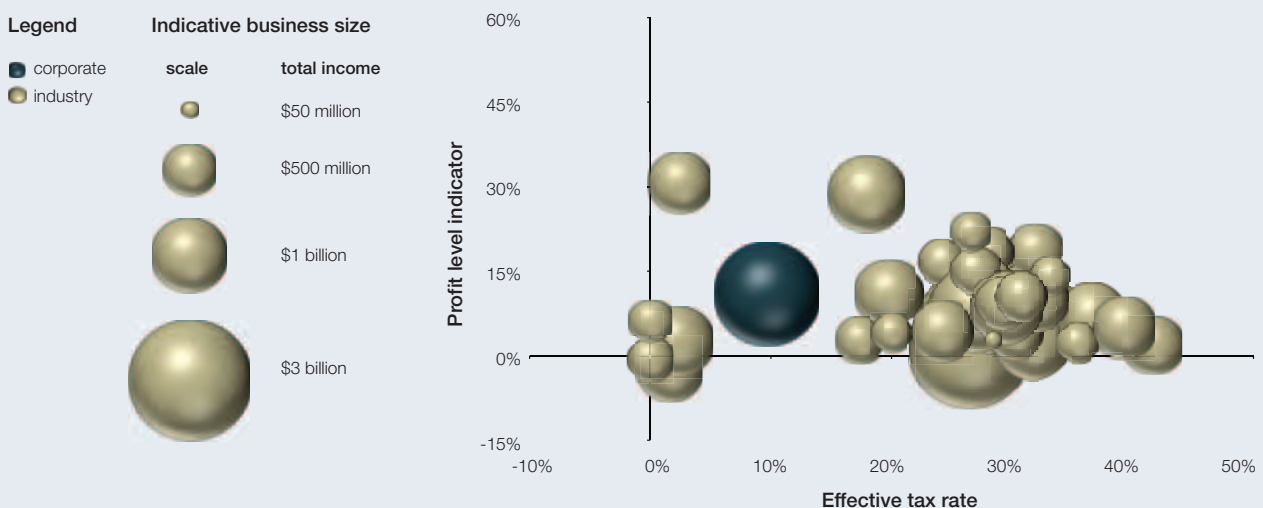
For example, at one of the first visits, to the local arm of a leading financial services provider, we discussed with the chief executive and chief financial officer why the company had been subject to audit for a number of years.

We demonstrated this with the help of a chart comparing their profit and tax performance with that of their peers (see figure 3 below). The chart showed that while the average effective tax rate for the industry was close to the company rate of 30%, the average for this corporate over the previous three years was 10%.

An ATO report on the corporate's key financial performance indicators confirmed that the profit outcomes were consistent with their position in the marketplace and the period of robust economic growth. The tax outcomes, however, were not. We could not identify any convincing explanations for the low effective tax rate, which could be due to factors such as unrealised gains or losses on financial instruments.

Accordingly, we indicated that we would be looking at why this company reported significantly higher levels of tax exempt income and other deductible expenses – compared to their key competitors/peers with almost an identical business operation and market share in Australia. These two issues were identified as the principal reasons for the low average effective tax rate.

Figure 3: Three year comparison of the corporate to industry



In another case involving the finance sector, we identified several high risk transactions as part of an extensive audit of some highly structured financing deals.

We met with their executive leadership (including the chairman, chief executive and chief financial officer) to discuss the history of our interactions and explore if we could build a more open and positive working relationship.

As a result, the corporate voluntarily disclosed a number of other transactions for review.

The corporate indicated they would want to request rulings for any high risk issues that remained unresolved in the open years (the years we had still not reviewed). They acknowledged that their tax governance processes could be improved.

### **Strengthening tax governance through personal contact**

These meetings have the benefit of extending contact between the parties – beyond the level of the corporate’s tax management function, to the chief financial officer and in some cases the chief executive and chairman. It helps us better understand the business and its drivers and provides us with an opportunity to hear how we can improve our own performance.

## SNAPSHOT OF OUR 2007–08 ACTIVITIES

### Large businesses

#### Income tax

- We completed 33 compliance audits of large businesses and 139 comprehensive risk reviews, resulting in over \$1.2 billion in additional collections<sup>1</sup>, \$2.6 billion in new income tax liabilities<sup>2</sup> and over \$1.8 billion in notional tax<sup>3</sup>.
- We completed 222 private binding rulings, 82 class rulings, 29 product rulings and 282 objections<sup>4</sup>.
- We finalised 29 advance pricing agreements and 8 mutual agreement procedural matters.
- We developed a new annual compliance arrangement product to provide large businesses with greater certainty about their income tax risks.
- We resolved 5300 outstanding lodgment cases resulting in \$118 million net liabilities raised.

#### Employer obligations

We conducted 11 field audits, 53 outbound telephone reviews and 281 desk reviews of employers' compliance with their PAYG withholding, superannuation guarantee and FBT obligations, raising revenue of \$4.5 million.

#### GST

Our compliance activities gave rise to \$455 million in additional GST liabilities:

- We finalised over 900 compliance audits focussing on integrity of business systems, financial supplies and property transactions as well as encouraging and responding to an increase in voluntary disclosures. These will remain our focus areas in 2008–09.
- A lead avoidance case concerning a significant property arrangement by a large corporate involving the exploitation of the GST-free sale of going concern and margin scheme provisions culminated in the issue of a Division 165 (scheme) declaration and assessment.
- Through improved risk assessment, we reduced the number of refund interventions to 2,600.
- Voluntary disclosures increased from \$126 million in 2006–07 to \$282 million.
- We issued 244 private indirect tax rulings for the large market, as well as three GST public rulings and four GST determinations that related to, but were not limited to, the large market.

1 Some of this may have been from previous years' activities.

2 Some assessments are subject to disputes which may ultimately be resolved in favour of the business. We will cover this in our *Annual report 2007–08*.

3 For the large business segment, notional tax includes future income tax revenue impacts associated with the reduction of carried forward losses.

4 As well as a range of public rulings which have relevance to large business (see Public rulings program on [www.ato.gov.au](http://www.ato.gov.au)).

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## Excise

- Education and support remains a critical aspect in providing assistance. We have established a client relationship management function to assist large clients in complying with their excise obligations.
- We conducted 18 reviews of large businesses across the excise commodities which focussed on controls to assure the accuracy of returns and claims.
- We conducted 54 audits and reviews on other large clients and 58 internal reviews.

## Superannuation

- We audited 4 unfunded defined benefit schemes to ensure compliance with their obligations around the individual surcharge debt accounts they hold for members.
- We acted on 277 cases relating to employee complaints on employers' superannuation guarantee obligations, raising \$9 million in liabilities.
- We conducted 53 audits of large funds to check whether their reporting of lost members was accurate and complete. One audit on a large administrator covering nine funds found systemic deficiencies with their reporting software, which resulted in 631 members being removed from the Lost Members Register with an associated value of over \$98 million.

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# WCS

## **Non-profit organisations**

NON-PROFIT ORGANISATIONS INCLUDE A RANGE OF BODIES, CLUBS, ASSOCIATIONS, UNIONS, SCHOOLS, HOSPITALS AND COMPANIES AND CONSISTS OF APPROXIMATELY:

NUMBER OF NON-PROFIT ORGANISATIONS

700,000

NUMBER REGISTERED WITH US

190,000

PERCENTAGE OF AUSTRALIANS EMPLOYED BY NON-PROFIT ORGANISATIONS

10%

Non-profit organisations include charitable, religious and community service bodies; sporting and recreational clubs; business and professional associations, and trade unions; private schools; some hospitals; and some large financial and insurance companies.

Research suggests there are around 700,000 non-profit organisations in Australia. Most are not required to register in the revenue system because their turnover is below the minimum threshold level or they are non-taxable. Around 190,000 non-profit organisations are registered with the ATO.

More than 10% of people employed in Australia work for non-profit organisations.

Non-profit organisations are entitled to a range of tax concessions, some of which require the organisation to be endorsed by the ATO or be named in law.

## HEADLINE ISSUES

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### **What is a charity?**

Some members of the community are questioning how broad the concept of a charity is and the extent to which they can engage in non-charitable activity and still be regarded as solely charitable. As a result, we are seeing an increase in litigation and are looking for guidance from the courts on this point (see page 63).

### **Lack of tax expertise in some organisations**

Conscious of the special needs of non-profit organisations – which experience a relatively high turnover of staff and volunteers – we provide them with tailored help (see page 63).

## OUR GENERAL APPROACH

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Non-profit organisations show a strong desire to get it right, but often have a low level of knowledge about how the tax and superannuation systems work. Where compliance issues arise, they are mainly due to mistakes or a lack of knowledge.

Many non-profit organisations have limited resources for managing their tax and superannuation affairs and rely heavily on volunteers (who traditionally have a high turnover rate). Only around half of non-profit organisations have their income tax returns prepared by tax agents, which is low compared with other taxpayer segments.

We focus on providing non-profit organisations with help and advice so that they can comply with their obligations at minimal cost. Compliance risks and issues are discussed with the sector in regular forums and we alert people generally through an online news service, which draws attention to further information on our website.

As with other segments, our verification work starts with comparing information that organisations report in returns against data supplied by third parties, including government agencies and financial institutions. We also monitor trends and analyse information gathered from our review activities and other dealings with non-profit organisations and their advisers.

In the relatively few cases where organisations ignore their obligations or there are deliberate attempts to abuse concessions, our compliance activities escalate to audits and other enforcement action.

We focus on arrangements that seek to abuse the concessional status of charities and deductible gift recipients, including arrangements that seek to manipulate access to the GST concessions. This sometimes involves known promoters of aggressive tax planning schemes.

We also publish details of endorsed organisations online, enabling grant providers and the community generally to verify their tax status.

As with other employers, we follow up complaints by employees and contractors concerning insufficient superannuation guarantee contributions or not being offered a choice of superannuation fund (see page 32).

## HELP AND EDUCATION

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Information products and services are developed in collaboration with representative bodies and government agencies.

Current initiatives are particularly designed to address risks associated with:

- the blurring of boundaries between non-profit and commercial activities
- endorsed organisations maintaining their status
- the treatment of grants received from government agencies
- employer obligations
- the extension of the fuel tax credits scheme from 1 July 2008.

Non-profit organisations also benefit from initiatives designed to help employers in general meet their tax and superannuation obligations (see 'Meeting employer obligations', page 32).

Development of an information package for Indigenous grant providers and recipients has been deferred pending further investigation of their need for this. In the meantime we are working with government agencies to have tax included in their governance training courses for Indigenous grant recipients.

## RECENT ANNOUNCEMENTS AND DEVELOPMENTS IN THE LAW

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In the recent case of *Commissioner of Taxation v. Word Investments Limited*, the Federal Court found that where an organisation raises funds exclusively for a charitable purpose, the fact that it does so through a commercial enterprise, without carrying on any inherently charitable activities itself, does not preclude it from being a charitable institution. The Commissioner has been granted special leave to appeal the decision to the High Court.

In the 2008–09 Budget, the Government announced it would introduce laws to improve the integrity of prescribed private funds, to take effect from 1 July 2009. We will deliver specific products and messages to support the implementation of this measure.

## SPECIFIC COMPLIANCE ISSUES

### GST

We are working with consultative forums to develop a GST 'tips' document designed to help non-profit organisations avoid mistakes with GST.

### Misclassifying supplies as GST-free

We have published guidance material and will work with non-profit representative bodies to identify any further products needed, as well as helping them educate their member organisations. We will update our market value guidelines for classifying activities as GST-free to make compliance easier for non-profit organisations.

### Misclassifying grants

The treatment of grants for GST purposes continues to be a compliance issue due to uncertainty among recipients about how grants – particularly from government – should be treated. We are working with representative forums to see if we can make our view on GST and grants of financial assistance clearer. We will update our market value guidelines to make it easier for non-profit organisations to determine whether supplies are GST-free.

### Pre-endorsement checks

Charities must be endorsed by the ATO to be exempt from income tax. Organisations wanting to receive tax deductible gifts must also be endorsed, unless they are listed by name in the tax law.

We check all endorsement applications. Where information on the application does not match the expected organisational profile we may contact the organisation or conduct a review. In 2008–09 we expect to receive and check around 5,000 endorsement applications.

A range of FBT concessions are available to organisations, depending on their endorsed status. Our focus this year will be on raising awareness of the correct FBT treatments and obligations that flow from these different types of endorsement.

### Changes in activities after endorsement

There is a continuing risk that once organisations have been endorsed they may vary their activities in ways that affect their entitlement to concessions. Accordingly, we emphasise the need for endorsed organisations to review their operations at least annually, or when there is a major change in their structure or operations, and tell us if they are no longer entitled to be endorsed.

To ensure organisations remain compliant, our post-endorsement compliance work in 2008–09 will focus on:

- use of charities for private benefit
- charities involved in tax minimisation schemes
- charities not meeting their ongoing requirements.

We also monitor compliance by undertaking risk profiling and analysing information from third-party sources, including media reports. We follow up discrepancies and may contact the organisation to verify their entitlement to endorsement.

As well as monitoring the operations of endorsed organisations, we look closely at their administrative and financial management processes, particularly the level of self-review. We follow up previously identified compliance failures or risks to ensure that our corrective advice has been followed.

In 2008–09 we expect to review 145 targeted cases to determine if the organisations remain eligible for tax concession and/or deductible gift recipient endorsement.

### Prescribed private funds

Prescribed private funds are a special category of non-profit entity established for philanthropic purposes. The number of registered prescribed private funds continues to increase, as does the value of the funds held in them. Many prescribed private funds are associated with highly wealthy individuals.

We continue to monitor use of these funds to identify and act on non-compliance. In 2008–09 we will be focusing in particular on funds that are:

- not meeting their ongoing requirements after prescription
- being used to obtain tax benefits for individuals or associated entities through arrangements such as offshore investments; inappropriate access to fund property, expenses and benefits by trustees or founders; and distributions to non-eligible recipients.

We expect to review 50 prescribed private funds in 2008–09.

### Clubs and their commercial activities

Clubs and other non-profit organisations that conduct commercial activities to the extent it becomes their main purpose may incorrectly assess themselves as exempt from income tax. As well, taxable clubs sometimes understate their taxable income due to incorrectly classifying transactions as mutual dealings with members.

Our compliance work involves a mixture of help and education and reviewing individual cases. We present key findings from our reviews at the Clubs Consultative Forum.

In 2008–09, we will be looking closely at areas of potential non-compliance identified in our risk monitoring, such as mutual dealings and activities not consistent with any special exemption. We will also release information products to highlight common mistakes and errors and explain the correct tax treatment, including the classification of mutual transactions.

### Refunds of franking credits

Eligible endorsed organisations and listed deductible gift recipients that receive franked dividends are entitled to a refund of the attached franking credits.

We check all refund claims, contacting the claimant for more information if required and, where necessary, undertaking a more detailed review.

## SNAPSHOT OF OUR 2007–08 ACTIVITIES

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### Non-profit organisations

#### Income tax

We completed 45 reviews of prescribed private fund endorsement resulting in 21 cases receiving written advice to implement changes to ensure future compliance with tax obligations.

We checked 3,600 applications for refunds of franking credits, with 161 applications varied down, saving \$3.9 million in revenue.

We reviewed the entitlements for 113 deductible gift recipients and tax concession charities, resulting in 19 entitlements being revoked and 14 cases receiving written advice to implement changes to ensure future compliance with tax obligations. These reviews resulted in \$439,100 in tax and penalties.

We conducted a self review project for 410 charities resulting in 21 entities having their status revoked.

We completed 15 reviews of non-member income in relation to taxable clubs and associations, resulting in \$34,000 in tax and penalties raised and \$1.1 million in carried forward losses disallowed.

We checked around 4,900 applications for endorsement as a charity or deductible gift recipient, with 1,205 disallowed.

#### Employer obligations

Our verification activities checked employers' compliance with their PAYG withholding, superannuation guarantee and FBT obligations. We conducted 93 field audits, 29 outbound telephone reviews and just under 1,500 desk reviews of employers' compliance with their PAYG withholding, superannuation guarantee and FBT obligations, resulting in payments of \$17.2 million.

#### Superannuation

We acted on 286 cases relating to employee complaints on employers' superannuation guarantee obligations. In 2007–08 \$7.8 million was raised in superannuation guarantee liabilities.

#### Excise

We provided fuel tax credits information to non-profit organisations to inform them of their entitlements.

#### Helping non-profit organisations comply

We visited or telephoned 200 non-profit Indigenous corporations to help them understand their tax obligations and report correct information.

We released new web products, including a checklist developed specifically for non-profit employers to help them meet their tax and superannuation obligations in relation to workers. We also released a new web product that provides information on issues relevant to disaster relief, including how to set up an appeal fund, claiming tax deductions for gifts and fundraising concessions.

We issued articles through our online news service including new and updated publications; relevant tax law changes, rulings and court decisions; and information on specific disasters for those wanting to collect funds or make donations to assist victims.

We issued an addendum to our publication *Tax basics for non-profit organisations* (NAT 7966) to update it for legislative changes. We also updated the following core publications:

- *GiftPack for deductible gift recipients* (NAT 3132)
- *Volunteers and tax* (NAT 4612).

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## Government organisations

GOVERNMENT ORGANISATIONS  
ARE EXEMPT FROM INCOME TAX  
AND CONSISTS OF APPROXIMATELY:

NUMBER OF ORGANISATIONS

17,000

PERCENTAGE OF AUSTRALIANS EMPLOYED  
BY GOVERNMENT ORGANISATIONS

15%

GOVERNMENT ORGANISATIONS  
CONTRIBUTE ABOUT

8%

Across the various levels of government there are about 17,000 different organisations employing nearly 15% of all people employed in Australia.

Most government organisations are exempt from income tax and the GST they pay is generally refunded to them. Overall, this segment receives a refund equal to around 3% of the total tax we collect.

As a result of the amounts they withhold from payments to their employees, government organisations contribute about 8% of the total income tax we collect.

## HEADLINE ISSUES

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### Reputation risks in relation to management of tax obligations

We are helping government organisations address the tax risks arising when they restructure or are involved in unusual or complex transactions (see below).

### GST treatment of grants

As the correct GST treatment of grants continues to be a concern for government organisations, we are reviewing our public ruling on grants of financial assistance (see next column).

### OUR GENERAL APPROACH

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Mindful of community expectations for good corporate governance, government organisations show a high level of compliance with their tax and superannuation obligations.

Non-compliance most often occurs when organisations restructure or are involved in unusual or complex transactions, such as commercial ventures (usually in partnership with the private sector).

We provide practical advice and information tailored for government organisations (through a dedicated part of our website), and support services such as private rulings.

We also work closely with treasuries, finance departments and local government organisations to promote good tax and superannuation practice.

Emphasising the need for government entities to lodge activity statements and other returns on time, we check returns and, where there is a risk of non-compliance, undertake reviews and audits of specific cases.

As with other employers, we follow up complaints from employees and contractors who work for government organisations that they do not appear to have been paid sufficient superannuation guarantee contributions or have not been offered choice of superannuation fund (see page 32).

### SUPPORT FOR GOOD TAX AND SUPERANNUATION GOVERNANCE

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Last year we developed a new product for government organisations, incorporating a series of governance questions, a supporting checklist and an explanatory booklet with risk-mitigation examples. Following evaluation and consultation with users, we anticipate making this resource available to a wider range of government organisations.

Products such as this are designed to help government organisations ensure that sound management of their tax affairs is an integral part of good governance practice.

### SPECIFIC COMPLIANCE ISSUES

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#### GST

##### Treatment of grants

The government sector has told us that the correct treatment of grants for GST purposes continues to be a concern for them. In 2008–09 we are working with government grant providers and representatives of recipients to review our public ruling on grants of financial assistance with a view to providing further clarification.

##### Property transactions

We will continue to review the GST treatment of property transactions involving government organisations, communicating the correct position through discussions with agencies, and with audits where there is potential non-compliance. In particular, we are looking at the interaction between government and property developers in the context of development lease arrangements.

##### Machinery of government changes

Government departments frequently restructure, in the process abolishing entities and creating new ones. This can give rise to a range of tax issues, including changes to ABN registration and arrangements for issuing tax invoices.

We are working with representative forums to develop help and education products that explain the correct GST treatment during restructures.

#### FBT

Government organisations face some specific FBT obligations and rules which some of the smaller organisations struggle to maintain the skills and governance arrangements to deal with. We plan to review and update a better practice guide developed in conjunction with the ANAO.

We will also continue to provide assistance to various levels of government facing amalgamation and restructuring issues.

#### Fuel tax credits scheme

The extension of the fuel tax credits scheme from 1 July 2008 will affect local government in particular. To support this, we are providing information and advice to existing and new recipients through local government associations, our website and with the business activity statement.

We will complement this with more reviews of the accuracy of claims and compliance with the scheme.

## SNAPSHOT OF OUR 2007–08 ACTIVITIES

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### Government organisations

#### Employer obligations

We conducted 295 pre-filing visits with Government employers to encourage early lodgment, by electronic means, of their employer obligations end of year report.

#### Superannuation

We actioned 46 cases relating to employee complaints on employers' superannuation guarantee obligations. We raised \$1.9 million in superannuation guarantee liabilities.

#### GST

In 2007 we issued draft ruling GSTR 2007/D2, dealing with GST and development lease arrangements with government agencies. The final ruling has been issued as GSTR 2008/2.

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## ***Tax practitioners***

TAX PRACTITIONERS INCLUDE REGISTERED TAX AGENTS, LEGAL PRACTITIONERS AND BOOKKEEPERS AND APPROXIMATELY:

REGISTERED TAX AGENTS

26,000

PERCENTAGE OF INDIVIDUAL INCOME TAX RETURNS LODGED BY TAX PRACTITIONERS

73%

PERCENTAGE OF BUSINESS TAX RETURNS

95%

Tax practitioners play a vital role in the Australian tax system. Currently there are about 26,000 registered tax agents who interact with us for advice and lodge around 73% of income tax returns for individuals and over 95% of business tax returns. Many agents also provide financial advice and/or act as approved auditors of SMSFs.

Tax practitioners also include legal practitioners who provide tax advice to people or act on their behalf, and bookkeepers who provide accounting and activity statement services to businesses and other organisations.

## HEADLINE ISSUES

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### **Working with the tax profession**

Consultation and research with and feedback from tax professionals and professional bodies is essential for understanding how the tax system is operating in practice and to make improvements to how we administer it so as to minimise compliance costs and provide a level playing field (see page 73).

### **Service and advice**

While tax agents are reporting high levels of satisfaction with our services, we are working to enhance them further. A popular service is the Tax Agent Portal. It is the agents most frequently used tool and has reduced the time they spend contacting us. We now also offer pre-filing reports through the portal. We will continue to develop practical tools to support tax practitioners' practice management and to improve services to them. Recognising their important role, we also provide BAS service providers with their own restricted view of the Tax Agent Portal and a national seminar program (see page 74).

### **Assurance and integrity**

We analyse agent practice compliance trends by looking for unusual patterns in the returns of their clients. Based on information provided by practitioners through our Tax Practitioner Integrity Service information line, we investigate claims of illegal or improper practices, such as return preparation by unregistered agents or the promotion of tax exploitation schemes. Monitoring of the compliance of tax agents with their own tax obligations has shown that the vast majority comply with their obligations, with a significant reduction in the number of tax agents with multiple outstanding lodgments (see page 75).

## OUR GENERAL APPROACH

Effective tax and superannuation administration relies on a capable, sustainable and well regulated tax profession. The profession's role is vital in influencing voluntary compliance and in ensuring that their clients understand their rights and obligations. By supporting and influencing one tax practitioner, we can support and influence many people.

Maintaining healthy tax and superannuation systems depends on a joint effort by the tax profession and the ATO. Managing the relationship will take on extra significance in the period up to 2010, with both parties needing to adjust to significant changes as we upgrade our client and account registers as part of our change program. Such changes are designed to promote transparency, access and usability of information for the tax profession and their clients. Continued and enhanced support for tax practitioners will be critical during this time of transition.

Surveys by external market researchers show that our overall service to tax agents is hitting the mark, with overall satisfaction levels at about 78%. In the coming year we will continue to explore ways to deliver cost-effective services for agents, with the aim of providing greater reliability in the advice and information we provide.

Given their central role in the system, we closely monitor the level of tax compliance of tax practitioners, undertaking risk assessments based on analysing the compliance patterns and trends among practices. Where we see unexpected trends, we check their clients' tax returns as well as the practitioner's practices. Reviews are also undertaken based on information referred from the Tax Agents' Boards and information received through the Tax Practitioner Integrity Service information line.

## WORKING WITH THE TAX PROFESSION

Ongoing discussions and consultations with tax professionals and professional bodies are essential to us fully understanding how the tax and superannuation systems are operating in practice. Peak forums include the Chief Executive Officers (CEO's) Forum, National Tax Liaison Group (NTLG), Superannuation Consultative Committee and the ATO Tax Practitioner Forum (ATPF). Together with the 22 sub-groups that exist to support those peak forums (such as the Lodgment Working Group), the level of engagement is essential to ensuring effective and sustainable administrative arrangements.

We will continue to work closely with these forums during 2008–09 to ensure that we live our consultative, collaborative and co-design values and work with the tax profession to foster a greater sense of 'co-owning' the administration of the tax system. In addition, to provide us with a greater insight on the impacts of our administration on legal practitioners who work in the tax field, we established a Legal Practitioner Consultative Forum which will hold its inaugural meeting in 2008–09.

This year we have worked with some 900 tax practitioners on consultation and co-design projects and invited 3,700 tax and accounting professionals and 2,000 bookkeepers to participate in our surveys. Through our consultative forums a significant number of issues have been managed including:

- Two ATO Practice Statements have been released to provide guidance on the practical administration of promoter penalty laws and three new draft rulings on shortfall penalties have been released for comment.
- A discussion paper on intra-group finance guarantees and loans (relating to the transfer pricing rules) was released for comment.
- Initial discussions were held between tax practitioners and Centrelink on the agency's measures that impact on tax practitioners.
- The provision of pre-filling data for tax returns has been improved and expanded, and a feedback service will be introduced to allow practitioners to provide real time feedback on issues.
- Strong progress has been made towards resolving the top 10 digital certificate irritants raised by tax agents.

This focus on consultation and co-design will continue during 2008–09 on a range of both technical and administrative issues.

Approved auditors of SMSFs play a critical role in maintaining the health and integrity of the superannuation system. We have been working closely with industry to influence the recently introduced minimum competency standards for SMSF auditors and to develop an electronic auditor tool (eSAT), which will help identify issues and report contraventions. We are expecting to pilot the tool from July to October 2008 with a small representative group of approved auditors. We are also improving our data on approved auditors to enhance our ability to identify areas of risk.

### Self-managed superannuation funds

In 2008–09 we will undertake approximately 900 reviews and audits of approved auditors of SMSFs, including:

- reviews that include a 'helping to comply' strategy for those new to the role
- audits, reviews and tailored advice activities to gain assurance that approved auditors of SMSFs apply both auditing standards and regulatory requirements
- reviews of large auditing practices to provide assurance that they have effective internal controls in place to ensure high quality audits.

### SERVICE AND ADVICE

Our aim is to provide practical tools and services for tax practitioners that support their practices and streamline their interaction with us so they can focus on their clients. They are designed to support agents achieving greater self-sufficiency.

All tax agents have access to the dedicated tax agent phone line and fast key code system for technical assistance. We receive some 2 million calls annually from agents, seeking information and advice on the tax and superannuation systems and their clients' accounts.

The Tax Agent Portal continues to be our key channel for agents. In the five years since it was introduced, usage has grown by around 300%, with some 12 million log-ins in 2007–08. Market research found that 95% of tax agents nominated the portal as one of their top three most frequently used interaction methods with 62% reporting it as their first choice. The vast majority of tax practices (82%) stated that they used the Tax Agent Portal on a daily basis.

In January, we released a revised Tax Agents Services Guide which was co-designed with the help of some 50 agents and representatives of the profession to ensure it met their needs. Providing a quick reference to specialised contact numbers and online self help, the card has been well received with some 50,000 additional copies ordered.

In 2007–08 we also introduced periodic webcast presentations for tax agents, with feedback indicating that it is a useful and flexible training tool.

### Improving access to technical advice

While the majority of calls from tax agents relate to registration, accounting and payment arrangements, some 12% of the 2 million calls from tax agents seek advice on tax law or administration. We have been putting more emphasis on improving access to advice; and to reduce the need for agents to call us we continue to invest in online communication tools.

To better understand how we can improve technical advice services for tax agents, we have analysed the nature of agent calls related to CGT. Some 38% of the practitioners had undertaken research on our website before making a call. We piloted providing callers with access to more specialised staff, resulting in 80% of calls being resolved in the first instance. This pilot has provided useful information to help us better understand tax practitioner needs.

We have also piloted a Professional to professional service to help tax agents resolve complex issues by giving them direct phone access to a senior tax officer. When a technical matter comes up, the officer works with the agent – involving other technical experts as necessary – to resolve the issue. To date, we have resolved 18 issues through this initiative. We anticipate a limited expansion of this approach in the coming year.

Other initiatives implemented in 2007–08 include a web-based guide to technical advice and a training product that groups all of our training material in one place on our website.

During 2008–09 we will also offer training packages to assist new tax agent staff, including modules on how to research and on legal research specifically. These will be progressively made available on our websites during the year.

All of these products have been co-designed with tax agents and professional associations and are tested with users before release to ensure they are properly integrated with the way tax practitioners do business.

### Lodgment program

We will continue to refine the tax agent lodgment program, taking into account feedback from agents as well as legislative and revenue requirements.

## Professional to professional

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The Professional to professional pilot commenced on 13 March 2008 and concluded, for evaluation purposes on 15 May 2008. This service will now be rolled out with a staged implementation from July 2008.

The Professional to professional service enables a direct service for agents to discuss complex technical issues. The benefits include:

- direct and personalised access to a senior tax officer
- assistance to identify the appropriate source of information to resolve the issue
- the ability to discuss complex issues which may reduce the need for tax agents to write to us for advice
- enhanced tax agent confidence in the answers provided
- developing a professional to professional relationship.

The perceived savings in time and cost was also one of the reasons given for support of this service. Some tax agents indicated that not having to rely on a private binding ruling in some instances was also a benefit.

During the rollout of the service, tax practices will be invited to participate in the service through a registration process using a nominated senior agent from their practice. Those tax practices being offered the Professional to professional service will be required to agree to a set of service guidelines during the registration process.

## SERVICES FOR BOOKKEEPERS

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We are working with the bookkeeping industry to develop suitable services and assistance to support them in their role as intermediaries in the tax system.

Last year we introduced limited access to the Tax Agent Portal for eligible bookkeepers who are providers of business activity statement (BAS) services. In the nine months of operation some 800 applications to access the portal had been approved, enabling BAS service providers (BSPs) to prepare, lodge, view and revise activity statements online. Other motivating factors include having the ability to access their clients' registration details, communicate with us via secure messaging, and generate BAS payment slips for their clients.

To further support approved portal users, a new BAS Service Provider Helpline was implemented to provide priority access for portal and BAS account enquiries.

The Bookkeeper Advisory Group, with industry representatives, provides input for the design of administrative interactions between bookkeepers and the ATO. In particular, the group has helped us develop and improve products and services, including newsletters, web products, portal access, improved telephony and seminars.

There are currently 4,200 email subscribers to the monthly *BAS service provider* newsletter. In addition, a new seminar was successfully delivered in May and June 2008, with some 26 sessions attracting over 1,400 bookings and very positive feedback from participants.

Engagement with BAS service providers is important as we progress towards their inclusion, subject to legislative approval, in the new tax practitioner regulatory environment. This may come into effect through the Tax Agent Services Bill 2008, which is currently being considered by the Government.

## ASSURANCE AND INTEGRITY

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Through the Tax Practitioner Integrity Service information line, tax agents and other tax practitioners continue to provide us with valuable intelligence on potentially improper behaviour of some agents as well as on the activities of unregistered agents.

Since its creation in February 2007, information provided has resulted in 324 referrals warranting further action by us. As at 30 June 2008, of these referrals:

- 104 have been finalised
- 125 are under investigation
- 40 have been risk assessed for investigation
- 55 are awaiting risk assessment.

Of the 104 referrals finalised:

- 19 registered tax agents were referred to the relevant state Tax Agents' Board
- 11 unregistered tax return preparers were referred for prosecution
- 1 tax agent was investigated for a potential criminal offence
- 49 formal warnings were issued to ensure future compliance with the law or provided with direct help to better understand their obligations
- 24 related to non-lodgment, cash economy and allegations of fraud.

We continue to improve our processes to resolve matters as quickly as practical. Some 63% of calls received came from registered tax agents. Of all calls, approximately:

- 37% related to the conduct of registered tax agents
- 25% related to unregistered preparers
- 38% related to compliance problems with individuals or systemic problems in the industry.

We monitor the compliance of tax agents and their practices and follow up where necessary with reviews and audits of their clients' affairs as well as their own tax obligations. The vast majority of agents exhibit a high level of compliance. For example, the number of tax agents with multiple outstanding lodgments fell from 11.3% to 5.6% in the year to April 2008. We will continue to actively monitor lodgment performance in the coming years with the aim of continuing this positive trend. In spite of this improvement, 62 agents were prosecuted for 73 non-lodgment administrative offences in 2007–08. A further 51 agents prosecuted over multiple outstanding returns were referred to the relevant state Tax Agents' Board.

The identification and pursuit of unregistered tax return preparers and ineligible BAS preparers is a key focus, as they impact negatively on the profession by undermining professional standards and expertise. In 2007–08, 60 unregistered agents were referred for prosecution action. There were 15 successful prosecutions of unregistered agents, of which six were referred during the 2007–08 year and the other nine related to referrals under action from the previous year. A further three referrals were received in 2007–08 and deemed unsuitable for prosecution action. There are 51 referrals either under current prosecution action or awaiting further action before proceeding to prosecution action.

### Care in dealing with tax exploitation schemes

We monitor advertising and follow up intelligence leads on inappropriate schemes as soon as we become aware of them. This includes seeking intelligence from the tax profession. People appear to be now far more wary of schemes, especially those offshore.

The promoter penalty laws also seems to have curbed much of the inappropriate promotion. We urge tax agents not to get caught up in schemes and to be aware of their responsibilities under the promoter penalty laws, which provide for civil penalties to be imposed on promoters of tax exploitation schemes. Tax practitioners need to ensure that they have reasonable governance practices to reduce the likelihood of contravention of these laws.

This area will be a focus for us in 2008–09. Where tax practitioners come across a potential tax exploitation scheme we encourage them to contact us as soon as possible.

## SUPPORT FOR TAX AGENTS' BOARDS

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The registration of tax agents is administered through six state Boards which are independent of each other and of the Commissioner. However, we strongly support the Boards by providing administrative support and specialist staff to ensure the Boards are adequately resourced to carry out their important role.

We have increased our level of support over recent years, with an increase in staff, and have also worked with the Boards to introduce national approaches to registration and the complaints processes.

## TAX PRACTITIONER LEGISLATIVE FRAMEWORK

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The Government is yet to determine its final position on the release of the Tax Agent Services Bill 2008, which will move the registration of tax practitioners to a national system. In May 2008 the exposure draft of the Tax Agent Services Bill 2008 was released for public comment.

The responses are still being considered by the Government but the key proposed features are:

- a national Tax Practitioners Board to replace the existing state-based boards
- reinforcing the independence of the Tax Practitioners Board from the Commissioner
- a legislated code of conduct for tax practitioners
- a wider and more flexible range of sanctions which may be imposed by the Board
- the registration of both tax agents and BAS agents
- the introduction of a safe harbour from certain penalties when an error is due to carelessness by the tax practitioner rather than the client
- civil penalties and injunctions to replace criminal penalties for certain misconduct by agents and unregistered entities.

## SNAPSHOT OF OUR 2007–08 ACTIVITIES

### Tax practitioners

#### Working with the tax profession

- Results from our tax agent perceptions survey 2008 show that 89% of tax agents were satisfied with the way we manage tax compliance. Results also showed that 80% are satisfied with how we consult with them; and 91% agreed that the products and services we provide have improved our relationship with them.
- We consulted with accounting professional associations and bookkeeper representative organisations through avenues such as the CEO Forum, NTLG, ATPF and their various advisory groups and sub-committees. This ensures that strategic issues affecting administration of the tax system and the relationship with the tax profession are effectively managed.
- We continued to consult tax practitioners on a wide range of projects.
- We reviewed the performance of 670 SMSF approved auditors. We also consulted and worked closely with the professional associations, the Auditing and Assurance Standards Boards and SMSF audit practitioners, on a number of initiatives to support and improve the overall performance of SMSF auditors.

### Service and advice

- Our consultation with tax practitioners extended through a wide range of ATO projects. We have invited 3,700 tax and accounting professionals and 2,000 bookkeepers to participate in our survey. Another 900 people participated in other activities such as user testing, focus groups and pilots.
- We made presentations to 212 tax practitioner groups.
- We held the annual June tax seminar at 197 venues attracting 14,500 tax agents and their staff. Feedback from the participants indicates very high levels of satisfaction with the seminar, with 97% finding the information relevant.
- We also produced three online presentations:
  - the November Online Bulletin and two Tax Practitioner webcasts in 2008 (February and April). The February webcast received 13,500 hits.
- We continued to maintain and improve other marketing and education products tailored for tax practitioners, including our weekly email subscription newsletter 'eLink', which has over 21,000 subscribers, our priority online broadcasts and the tax professionals segment of our website.
- To assist BSPs to support their clients, we developed and implemented limited access for BSPs to the Tax Agent Portal. Some 800 applications have been approved from eligible bookkeepers to access this service.

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### Assurance and integrity

- Our premium phone service for registered tax agents received more than 1.4 million calls, of which 92% were answered within two minutes.
- 401 tax agents were personally assisted through a tailored lodgment program where circumstances beyond their control caused a lag in their lodgment performance.
- We investigated and reviewed almost 180 registered agents, with 149 agents being referred to one of the six Tax Agents' Boards for review. The boards have advised that, among other actions, 13 registrations have been cancelled and three agents have been suspended. A further 11 agents were issued with a compliance warning or have given formal undertakings that they have modified their work practices.
- We have prosecuted 62 tax practitioners for 73 non-lodgment administrative offences.

## PROMOTER PENALTY LAWS YIELD RESULTS

A measure to restrain the promotion of tax exploitation schemes is delivering tangible results, with several promoters offering to enter into enforceable voluntary undertakings to curb their activities.

The promoter penalty laws provide for a graduated set of legal responses to the development and marketing of tax exploitation schemes – that is, aggressive arrangements with little or no economic substance that are created mainly to obtain a tax benefit not intended by the law. The laws also enable us to respond where a scheme promoted on the basis that it conforms with a product ruling is implemented in a way that is materially different to the ruling.

The aim of the promoter penalty laws is to deter the promotion of such schemes. They enable us to intervene early when we get information on promoter behaviour – to prevent the schemes from going ahead in the first place.

Options available to us include the ability to enter into enforceable voluntary undertakings with promoters. We can also apply to the Federal Court for injunctions to stop the further promotion of schemes to others.

The Federal Court can impose a civil monetary penalty. Where it has been established that a promoter has marketed a tax exploitation scheme and received commissions, we can seek a civil penalty of the greater of double the commissions received, or \$575,000 for an individual, or \$2.75 million for a company.

### Current areas of concern

During 2007–08, we established an ongoing program to identify and investigate potential contraventions of the promoter penalty laws. This has identified several areas of concern, including:

- high-risk variations of employee benefit arrangements and employee remuneration schemes
- managed investment schemes that are not implemented in accordance with product rulings
- high-risk financial products and financing of other schemes
- aggressive capital gains tax planning
- aggressive trust and partnership planning
- high-risk superannuation and GST arrangements
- schemes that involve arbitraging different odds when betting on sports competitions.

Promoters are identified from both external and internal sources.

Individuals, businesses, tax professionals and financial planners tell us about arrangements they are encountering in response to our efforts to alert the community through media releases, taxpayer alerts, industry newsletters and seminars. We also monitor external sources such as investment seminars, websites and the media.

We analyse information reported in tax returns and generated through our compliance activities, such as risk reviews and audits.

Current investigations include several cases where we are considering whether to accept offers by promoters to enter into enforceable voluntary undertakings or apply to the court for a penalty to be imposed.

We are also having discussions on good governance with some major firms who create or distribute financial products that may be affected by the promoter penalty laws. In consultation with the NTLG Promoter Penalty Subcommittee, we are developing a best practice guide that will help providers of financial services to avoid contravening these laws.

### Practice statements guide administration of the laws

We have issued two law administration practice statements dealing with the practical administration of the promoter penalty laws.<sup>1</sup> These clarify our decision-making process and establish guidelines on how and when we take action, to ensure the law is applied in a fair and proper way. The practice statements were developed in consultation with the NTLG Promoter Penalty Subcommittee and the public.

<sup>1</sup> Law Administration Practice Statement 2008/7: *Application of the promoter penalty laws (Division 290 of Schedule 1 to the Taxation Administration Act 1953) to promotion of tax exploitation schemes*; Law Administration Practice Statement 2008/8: *Application of the promoter penalty laws (Division 290 of Schedule 1 to the Taxation Administration Act 1953) to schemes involving Product Rulings*

## Failure to implement in line with a product ruling

Based on other horticulture projects, a promoter designed a managed investment scheme under which investors established and maintained an olive grove of at least one hectare.

Investors would lease the allotment from the promoter and engage the promoter as manager to undertake all capital works and plant the trees by a specified date.

The promoter applied for a product ruling for the scheme in the 2007–08 year. The scheme included the provision of finance to investors by the finance entity related to the promoter. We determined that, in terms of [former] Taxation Ruling TR 2000/8, investors would be carrying on a business, the fees are reasonable, and there was sufficient water entitlements and land to carry out the project. Based upon the information provided, we also determined that the finance entity related to the promoter had sufficient funds to lend to the investors, the loans were full recourse and that these funds will be made available to the scheme. A product ruling issued before 30 June 2008 and the project was marketed as being in conformity with the product ruling and was fully subscribed.

Later, we contacted the promoter, informing them that the project had been selected for a review to ensure it complied with the product ruling and that a site visit would be carried out.

The review found, contrary to information provided earlier, that the finance entity related to the promoter did not have capacity to lend funds to the investors. Evidence also indicated that action would not be taken against defaulting borrowers and, in fact, funds had not been transferred to the scheme manager by the finance entity. The scheme was implemented but questions arise as to whether the scheme has been implemented in a way that is materially different from that described in the product ruling. The promoter penalty laws may apply in such a case.

## Scheme promoter offers voluntary undertaking to stop prohibited conduct

We identified a potential tax exploitation scheme from a website advertising financial products. Among other things, the website carried misleading information on the tax consequences of entering into certain transactions.

The promoter received an upfront subscription fee when clients entered into the arrangement, which was not covered by an ATO ruling.

Having assessed the risk as high, we contacted the promoter and advised that their conduct was potentially prohibited under the promoter penalty laws on the grounds that the promotional material clearly stated an incorrect view of the arrangement's tax consequences.

The promoter agreed to remove the incorrect information from their website. They fully cooperated with our enquiries and offered to enter into an enforceable voluntary undertaking with the Commissioner under the promoter penalty laws. This would involve agreeing in writing to both remedy their past prohibited conduct and take preventative action to ensure it did not re-occur.

They offered to:

- remove from the website and all promotional material any references to the incorrect tax consequences
- not represent verbally or in writing that the relevant tax consequences would arise
- if asked by a client about the tax consequences of the arrangement, advise the client to seek advice from us, their own adviser or another independent source.

An enforceable voluntary undertaking would allow us to restrain the promoter's past and future behaviour in a timely and cost-effective manner while potentially dispensing with the need to institute Federal Court proceedings. It would allow them to continue operating and avoid a potentially costly and lengthy court action.

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## ***Serious abuse of the tax and superannuation systems***

WE DEAL WITH SERIOUS ABUSE OF THE TAX AND SUPERANNUATION SYSTEMS BY USING A RANGE OF POWERS AND RESOURCES AND IN 2008-07 APPROXIMATELY:

AUDITS CONDUCTED

314

LIABILITIES RAISED

\$330 MILLION

INVESTIGATIONS

178

SUCCESSFUL PROSECUTIONS

67

A small number of people deliberately abuse the tax and superannuation systems to evade their obligations or otherwise attempt to defraud the Commonwealth.

Fraud and evasion threaten the integrity of these systems – directly because of the threat to revenue and retirement income, and indirectly through the impact this behaviour has on community confidence in the systems.

We respond vigorously to these threats. As well as using our own powers and resources, we collaborate with law enforcement agencies and the Commonwealth Director of Public Prosecutions and, increasingly, with foreign tax administrations.

## HEADLINE ISSUES

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### **Tackling cross-border tax crime**

We have formed continuing partnerships with law enforcement agencies and our foreign counterparts to tackle cross-border tax crime, including Project Wickenby (see page 85).

### **Refund fraud**

Stolen identities continue to be used to commit tax fraud (see page 85).

### **Tax implications of criminal activities**

Organised groups accumulate wealth from illegal activities and invest it in the financial system through legitimate channels, such as share trading, to create further wealth (see page 86).

## OUR GENERAL APPROACH

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Serious abuse of the system involves both opportunistic individuals and organised groups, often associated with other forms of crime. Their techniques are constantly evolving and becoming more sophisticated, as is our enforcement response.

We tackle serious evasion and fraud by:

- gathering and analysing intelligence on risks and threats to the tax system, both directly and through other agencies, including the federal and state police, AUSTRAC and our overseas counterparts
- investigating suspected cases, often jointly with law enforcement agencies, with a view to prosecution, usually by referral to the CDPP
- working in conjunction with the CDPP and the AFP, using powers available under the Proceeds of Crime Act to confiscate assets obtained from serious abuse of the tax system
- complementing our criminal investigation work with civil audit work and the application of tax penalties
- publicising the outcomes of this work to raise community awareness.

In recent years we have greatly improved our intelligence capabilities to enhance our understanding of threats, detecting attempts to use technology to abuse the system, and in our understanding of cross-border arrangements.

During 2007–08, we worked with the Commonwealth Director of Public Prosecutions to bring 67 cases before the courts. These resulted in 67 convictions, including custodial sentences ranging from 6 weeks to 8 years. The 8 year sentence related to a company director who had sought financial benefit through lodging activity statements containing fictitious claims.

## WORKING WITH OTHER AGENCIES

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As serious abuse of the tax system is often associated with other forms of crime, we work with other agencies to investigate serious breaches.

Cross-agency working arrangements are now entrenched at strategic, intelligence and operational levels. As well as the ATO, they involve the Australian Crime Commission (ACC), AFP, Australian Customs Service, ASIC and AUSTRAC. We have strong relationships with the Australian Government Solicitor, Attorney-General's Department and CDPP.

In the past 12 months we have further strengthened our partnerships with other domestic and foreign agencies, particularly through multi-agency taskforces such as Project Wickenby and organised crime activities. For example, we call on law enforcement agencies for support to obtain evidence.

Recent changes to the law, coupled with new cross-agency governance and information technology solutions, enable us and other agencies to share information more effectively for the purposes of Project Wickenby.

We also cooperate with foreign tax administrations to target evasion and fraud, sharing information with them under tax treaties.

## PROCEEDS OF CRIME ACT

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The *Proceeds of Crime Act 2002* allows for the restraint and confiscation of assets derived from tax-related criminal activity.

Changes to the Proceeds of Crime regulations in 2006–07 gave us powers under the Act to investigate criminal asset matters.

## SPECIFIC COMPLIANCE ISSUES

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### Refund fraud

Refund fraud is perpetrated through fraudulent registrations and claims, and the use of complex structures and transactions. We are seeing coordinated attempts at fraud using high volumes of low-value transactions through tax returns and activity statements. Those involved try to slip under the radar of our risk-identification systems.

Before we issue refunds, they are automatically checked against risk criteria based on intelligence from our compliance activities. Our risk-identification filters are being refined with the help of intelligence from law enforcement agencies and financial institutions. We have been successful in reducing the number of identities created for the purposes of defrauding the tax system by improving our proof of identity processes.

Where we have identified refund fraud, we have worked with partner agencies in conducting investigations that have led to successful prosecutions.

The threat in relation to refund fraud now comes from opportunistic individuals and organised groups exploiting the growth in online transactions to steal personal identity data. This can then be used to take over an identity and conduct fraudulent transactions within the tax system.

In response we are:

- strengthening proof-of-identity requirements
- undertaking a community education program on the security of the tax file number and its link to personal security, and providing information to tax practitioners on ways to protect their client data
- investing in our intelligence capabilities, including the analytical capabilities of our staff and more sophisticated analytical tools and techniques, to identify and respond to suspect transactions
- investigating and prosecuting cases of tax-related refund fraud.

Our efforts are part of a whole-of-government response to this issue involving greater inter-agency cooperation.

### **Organised crime and the tax system**

We are seeing evidence that organised groups that have accumulated wealth from illegal activities are investing in the Australian or overseas financial systems through legitimate channels, such as share trading and investing in the acquisition of business or property, to create further wealth. Generally, such groups are not paying the appropriate taxes.

Given the nature of the groups and their generally criminal behaviour, we are collaborating with a range of law enforcement and regulatory agencies in Australia and overseas to tackle this issue.

### **Secret offshore dealings**

The improper use of tax havens and, in some countries, bank secrecy provisions to conceal assets and income continues to be a risk. This sometimes involves the use of credit and debit cards to return hidden funds to Australia.

### **Risks to the superannuation system**

We are seeing evidence of promoters acting individually or through a business front to encourage people to illegally obtain early access to their superannuation funds. We are developing appropriate responses including prosecution.

We are working with law enforcement agencies to better understand the risk and to develop deter, detect and deal with strategies relating to the potential for criminal groups to exploit the provisions in the tax law relating to superannuation.

### **Risks to the excise system**

Following the expansion of the Fuel Tax Credits Scheme on 1 July 2008, we are increasing our focus on ensuring that eligible clients fully comply with their obligations and that ineligible claimants are prevented from making fraudulent claims.

We continue to monitor illicit tobacco importation and growing, and will undertake joint enforcement action with the Australian Customs Service as required.

## **Verification checks lead to prison sentence**

A Sydney man was sentenced in August 2007 to eight years jail for GST fraud of \$1.75 million and attempted GST fraud of a further \$1.1 million. This followed our investigation of anomalies discovered during a GST verification check.

The former company director was found guilty on all charges, including nine counts of defrauding the Commonwealth and three counts of attempting to obtain financial advantage by deception.

After lodging nine activity statements for three different companies, the offender obtained refunds of \$1.75 million. He then tried to claim further refunds worth \$1.1 million, but our verification checks revealed the tax invoices were false and all of the purchases were fictitious. The refund payments were immediately stopped.

A reparation order was made for the \$1.75 million already received. The offender will serve a minimum of five years before being eligible for parole.

## Project Wickenby

Project Wickenby is a major multi-agency initiative, funded by a special allocation from the Government, focusing on the abusive use of tax havens and banking secrecy jurisdictions. At 30 June 2008 it involved:

- over 20 criminal investigations led by the ACC, AFP and ASIC
- the finalisation of 109 tax audits.

In dealing with these types of activities, we take firm action against those involved in the promotion of such arrangements while encouraging participants to come clean and get back on track. More broadly we are raising awareness in the community of the risks of becoming caught up in such actions. We have:

- raised total additional tax, including penalties, of \$140 million from 200 amended assessments and collected \$53 million in tax and penalties (the total includes 17 completed voluntary full disclosures), with a further \$60 million restrained under the Proceeds of Crime laws
- issued about 500 notices under section 264, and undertaken 6 access visits with notice and 5 access visits without notice.

Our preliminary analysis suggests there has been substantial improvement in tax compliance by Wickenby participants, with additional revenue exceeding \$44 million. In addition, there is evidence that some individuals and businesses have chosen not to proceed with proposed arrangements.

People who use offshore structures to generate false deductions or to deliberately hide assets or income in tax havens like Vanuatu can face serious penalties, including criminal prosecutions. For example, in April 2008 search warrants were executed in Australia, Vanuatu and New Zealand aimed at addressing tax evasion and money laundering linked to Vanuatu.

An individual linked with the movement of over \$100 million through foreign entities or accounts was arrested in April 2008 and charged with conspiracy to defraud the ATO and money laundering. Around 16 other people have faced court on similar charges, with some indicating their willingness to plead guilty, cooperate with authorities and make full restitution.

We are conducting over 80 audits examining allegedly false deductions exceeding \$90 million, and writing to several hundred people to clarify their tax compliance.

An intended benefit for all the agencies involved has been increased capability in areas such as information technology, legislative infrastructure, skills and multi-agency taskforce management and operations.

Internationally, we are working with our foreign counterparts at both bilateral and multilateral levels to strengthen the international framework of tax information exchange agreements. We are also cooperating on specific compliance risks such as those relating to Liechtenstein.

On Liechtenstein, we are working with revenue authorities including Canada, France, Italy, New Zealand, Spain, Sweden, United Kingdom and the United States. In Australia, 20 audits are underway relating to amounts ranging from \$200,000 to millions of dollars.

## SNAPSHOT OF OUR 2007–08 ACTIVITIES

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### Serious abuse of the tax and superannuation systems

#### Serious non-compliance

During 2007–08 we:

- completed 314 audits, raising liabilities of \$330 million (over one-third came out of Project Wickenby)
- completed 178 investigations, resulting in 67 prosecutions before the courts, all of which were successful
- issued 21 excise penalty infringement notices.

#### Project Wickenby

As part of our Project Wickenby activities we:

- raised liabilities of \$140 million
- collected more than \$53 million in cash with a further \$44 million in collections as a result of improved compliance behaviour by Wickenby participants
- completed 109 audits, raising 200 amended assessments
- had \$60 million restrained under the Proceeds of Crime Act.



