

1 May 2009

Dr Ken Henry AC  
Chair  
Review Panel  
Australia's Future Tax System  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Dear Dr Henry

**Review of Australia's Future Tax System (RAFTS)**

The Group of 100 (G100) is an organisation of Chief Financial Officers (CFOs) from Australia's largest business enterprises with a purpose of advancing Australia's financial competitiveness.

We appreciate the opportunity to make a further submission (our submission of 17 October 2008) and would welcome the possibility of meeting with you to discuss the issues we have raised.

The G100 urges the committee to use this once in a generation opportunity to review, redesign and better support the institution of the ATO so that it can perform its functions efficiently and effectively.

Please do not hesitate to contact me on 02 9239 6622 should you have any comments or questions.

Yours sincerely



**Tony Reeves**  
National President

## **INTRODUCTION**

In our earlier submission, we identified three essential criteria that the G100 considers to be of critical importance to the future success of Australia's tax system.

These three criteria are:

1. the importance of having an Internationally Competitive Tax Policy landscape;
2. the importance of maintaining Simplicity and Certainty in the tax law; and
3. the importance of having a World Class Tax Administrative Institution in the form of the Australian Taxation Office (ATO) fit for the 21<sup>st</sup> century.

The G100 is encouraged by the focus of the Review and dialogue with members, especially in relation to the need for a competitive corporate tax rate, affiliated dividend taxation system and incentives for investment and savings.

In this submission the G100 explains its belief that emphasis should be placed on the second and particularly third criteria noted above; namely, that of Simplicity and Certainty and the World Class status of the ATO as an Institution.

The G100 considers that these have significant overlaps. A World Class Administrative Institution focussed on enforcing the tax law in a consistent, timely and objective manner will address many of our concerns about Simplicity and Certainty.

Accordingly, the focus of this submission is on how to meet the objective of having a World Class ATO Administrative Institution and how this overlaps with the Simplicity and Certainty objective.

## **BACKGROUND**

### **➤ Complexity is a given and requires administrative excellence**

The G100 acknowledges that achieving a simpler tax will involve a trade-off between equity and/or a competitive policy setting.

The following examples illustrate circumstances where such trade-offs have necessarily occurred:

- (a) The introduction of capital gains taxes and fringe benefits taxes (FBT) in the 1980's which resulted in a more comprehensive tax system covering many forms of wealth and benefaction involved a trade-off between equity and complexity. The comprehensive nature of the FBT system and the capital gains system increased the complexity and compliance burden of our tax law;
- (b) The adoption in 1981 of a Transfer Pricing system so that dealings with related cross-border parties should be at (or deemed to be at) market value. This requirement creates the need to often hypothecate as to what such arm's length dealings would be between related parties. While a robust 21<sup>st</sup> century tax system should contain such a principle, it creates complexity and adds to the burden of compliance; and
- (c) The recent introduction of a Taxation of Financial Arrangements (TOFA) regime to avoid timing mismatches on financial arrangements will add, for many taxpayers, further compliance (even though it is expected to reduce compliance burdens for those choosing to use book outcomes as a surrogate for tax outcomes).

These are examples of new laws which have been developed in response to economic and social trends which will keep pace with global business developments. New laws bring about the proliferation of new and untested statutory concepts, along with complex integrity measures (often including Administrative Discretions which further complicate matters). All these actions increase the level of uncertainty in our tax system.

Accordingly, as Australia has progressed and as tax systems internationally have advanced with globalisation, tax regimes have naturally become more sophisticated and more complex.

Moreover, whilst seeking to 'write' a country's tax system in plainer English, or in fewer pages, may provide some solace to professionals, politicians and commentators, the reality is that sophisticated tax systems are becoming increasingly complex, regardless of how they are articulated.

A consequence of this increasing complexity is that the Administrator of such a system needs to be capable of dealing with the complexity in such a way that enables the system to operate efficiently and effectively.

**A complex system without someone capable of administering that system objectively, consistently and in a timely manner will fail irrespective of how well the policy settings have been calibrated.**

Revenue authorities globally (including the ATO) have recognised the importance of building enhanced relationships with taxpayers. They have recognised that they must develop capabilities in several key attributes to achieve increased commercial awareness, a high level of impartiality and consistency in resolving issues, a balanced and proportionate approach in dealings with taxpayers, openness and transparency in risk identification and professionalism, certainty and efficiency (OECD Forum on Tax Administration, Cape Town Communiqué, 11 January 2008).

**Whilst we welcome this approach, we believe this needs to be actively supported by well developed strategic principles, values and strong leadership exercised through a governance process that has the robustness, expertise and integrity to support a CEO running the day-to-day operations of the Revenue agency.**

The complicated nature of Australia's tax system places an onus on those who deal with the ATO and who can influence its design and functionality – and especially a Review committee such as your own – to ensure that the ATO is world class both in its operation as well as in its governance and oversight.

**For an administrative system to operate at a world class standard, a world class system of governance and oversight is necessary.**

The G100 believes there is much to learn by looking at the ongoing development of the Internal Revenue Service (IRS) in the United States, which is often cited as the world class benchmark for tax administration. Particular attention should be paid to the creation of the IRS Oversight Board following a very comprehensive review of IRS functionality in the late 1990's.

“Let me just make an observation, which is – I think we would all agree – that the IRS is viewed as a very competent tax agency. In fact, as I've gotten to know commissioners from around the world in the tax arena, I would say the US tax system and the US tax administration is known as the gold standard.”

(Douglas H. Shulman, IRS Commissioner - 2008 Tax Analysts Conference, the IRS Restructuring and Reform Act of 1998, 10 years After Reform: what's working, what's not, what's next – 18 July 2008).

Up until the creation of this Oversight Board the level of oversight of the IRS was patchy, to say the least.

“[During the IRS review] we found that oversight tended to be disjointed, redundant, often superficial. That it focused on the mess of the day, sort of the political hubbub. Very little strategic direction, very little focus on how do we help the Agency be successful.”

(Jeff Trinca, Ex-Chief of Staff to the National Commission on Restructuring the IRS – 19 July 2008.)

An overview of how the US IRS Oversight Board operates is included in Appendix A.

➤ **The scope of ATO activities continues to increase**

In addition to a complex tax system, the ATO has over the years been given a number of duties in addition to its responsibilities for the collection of income tax. These responsibilities include administering social welfare programs, superannuation and pension programs, the administration of certain aspects of charitable institutions, and other support services to various government agencies etc – a recent public example is its work with the Australian Federal Police and other agencies on Project Wickenby.

This increase in the scope of its activities, places additional stresses and strains on its resourcing, human capital needs, managerial capability and, of course, governance and risk management framework.

➤ **The Human Capital demands have become more onerous**

Whilst this has been occurring the market demand for human capital talent with accounting and commercial training has grown significantly. In Australia, those with strong skill sets in this area tend to gravitate to the private sector rather than the public sector because of better remuneration and career prospects.

The ATO has acknowledged that a highly skilled, well managed, valued and committed workforce is critical to the ATO meeting its commitments to the community and government (ATO Strategic Statement 2006-2010). The ATO is to be applauded for much of what it has achieved in the human capital space, especially around the support of part-time study, on-the-job training and workforce diversity. It is encouraging that the ATO has continued to develop and invest in training facilities to enhance its staff's technical and commercial capabilities with appropriate support from external consultants and businesses. It is also pleasing to see that the ATO in recent times has hired a small number of senior resources with commercial experience from the private sector.

**However, the operation of market forces means that the great majority of ATO staff, including those in senior ranks and managerial positions, have little or no experience in the private sector and their entire cultural upbringing and corporate mindset has been fashioned by a public sector outlook and upbringing.** It is therefore not surprising that there is often a disconnect between the attitude of the ATO and the private sector which, unfortunately, often leads to a sense of corporate distrust and lack of empathy with the business sector.

This does not mean that the ATO should take a 'soft' line towards the private sector. Indeed, the G100 applauds the recent focus of the ATO on the misuse of tax havens by either private individuals or corporates in furtherance of evasion or avoidance, as well as the tough stance taken in the past in areas such as "Bottom of the Harbour" schemes or "Blatant and Artificial" tax contrivance.

**However, the G100 believes that, because of the different culture sets between the private sector and the human capital upbringing within the ATO, there is a "disconnect" which results in a sense of distrust and lack of empathy and which can only be systemically addressed by introducing oversight, including external guidance and as part of an overall risk management and governance framework so as to lead to an improvement in ATO "culture" and performance.**

The US experience as reviewed in the late 1990's illustrated similar concerns:

"Clearly the top of the agency, when we looked at the executives...they all came home grown from the IRS. ....We went all the way down into the workforce. We did a number of studies. We had folks come in. Once again, a great workforce. But trained from the minute they get there to be afraid of change, be afraid of sticking your neck out of the shell, and really just sort of beaten down if you stepped outside the lines. So there wasn't a desire to sort of try something new because that would only result in something negative."

(Jeff Trinca, Ex-Chief of Staff to the National Commission on Restructuring the IRS – 19 July 2008.)

➤ **A Bias to Revenue Collection**

**The G100 is particularly concerned that the perceived culture within the ATO is to collect the greatest amount of tax that the law can be interpreted to allow.**

The G100 believes that the primary function of the ATO is to enforce and administer the law based on a 'rule of law' and in a manner which advances the objectives of timely, consistent and objective administration of the law. We have no doubt that both the Government and the Commissioner of Taxation also believe this. However, we believe that the ATO culture is not consistent with this.

The ATO has recognised in its values that it should apply the rule of law because it provides security, redress and certainty for taxpayers (ATO Strategic Statement 2006-2010). However, having values is one thing; living and executing on such values is another thing altogether; and the latter invariably involves robust governance and risk frameworks capable of overseeing management to ensure desired outcomes.

A high level survey of our members demonstrates our belief that there is a strong culture within the ATO, manifested in senior executives as well as through the ranks, whose sense of public duty, or perhaps for other systemic reasons, results in a culture whereby maximising the revenue wherever possible should be a key, if not primary, objective.

The high level results of our survey are summarised in Appendix B.

➤ **Impact of media focus**

This view of the ATO's culture view is reinforced by media and external scrutiny such that any publicity suggesting that wealthy individuals or large corporates who have settled tax cases are prima facie treated leniently by either the ATO and/or, in some way, by the government.

**Therefore, the 'publicisation of the ATO' and the resulting need for the Commissioner of Taxation to defend such accusations has served to further harden the cultural resolve of the ATO, its executives and staff against any suggestion of having a 'light touch' on large corporates.**

Another consequence of this publicity is that corporate settlements are now subject to scrutiny by external parties such as the Auditor General, Inspector General of Taxation etc. This development has made dispute resolution with the ATO a "goldfish bowl" exercise. In this environment it is more difficult to arrive at sensible and timely administrative outcomes in the enforcement of the tax law devoid of contradictory forces.

The impact of these influences is not limited to dispute resolution matters. They are also manifested in the interpretation of either private or public Ruling matters. Some examples of actual or proposed Rulings, driven by a desire to correct apparently more lenient ATO practices in the past, are to be found in some of the so-called 'U-turn' matters that the Inspector General of Taxation is currently examining. For example, industry practices around the distinction between Capital and Revenue in the funds management industry; practices around the interplay between Thin Capitalisation and Transfer Pricing etc.

The G100 is not suggesting that the ATO cannot change its view in these areas. However, the way in which the ATO has sought to do so and the significant retrospective application that often arises as a result, appears to demonstrate a lack of empathy and commercial understanding of the nature of such actions in a private sector environment. The effect of this is amplified in an environment of increasing public scrutiny on a real time basis of corporate financial disclosures and possible financial misstatements.

➤ **Increased Regulatory Risk of financial misstatements**

The extent of regulatory scrutiny, on a real time basis, of corporate financial positions and the expectations of CFOs, CEOs and directors has increased enormously in recent years.

It is anticipated that the more recent round of regulatory scrutiny resulting from the impact of the Global Financial Crisis will only serve to heighten, rather than diminish, the scrutiny of corporate management and governance.

Existing examples of this include the US FIN48 standard and the proposed IFRS equivalent. Both these require “almost scientific” approaches to the determination of tax benefits and exposures and accordingly are hard to deal with in an environment of increasing complexity and administrative uncertainty.

**A complex law is always going to give rise to some uncertainty. However, as a country, Australia can ill afford additional uncertainty created by an administration that for reasons noted above, may be inadequately resourced by the Government.**

#### **SUMMARY**

**The G100 believes that a review of Australia’s future tax system must include a consideration of all the factors that are required in order for the ATO to become a World Class Administrator of the tax law.**

**As explained above, the G100 believes that it would be an unrealistic expectation of both Government and the Review Panel to expect that the current structure, resourcing and governance model of the ATO is fit for this purpose.**

The concentration of burden and responsibility on one individual – namely the Commissioner of Taxation (regardless of the quality of the individual), cannot possibly do justice to the importance of the ATO as a World Class Institution in the 21<sup>st</sup> century.

The Global Financial Crisis has demonstrated that the quality of our Institutions, in terms of transparency, independence, objectivity, professional expertise, market connectivity and a sense of commercial realism, will ultimately help us withstand many of the contradictory forces at play in the marketplace. The recent G20 London Summit recommended a new Financial Stability Board with a focus on a strategic approach to **long-term oversight and improved risk management** in relation to all systemic important financial institutions.

In a complex global environment with sophisticated players and products, an ATO with limited human capital capability and cultural upbringing, limited resources, an expanding scope of services and with press scrutiny around perceived maladministration, cannot develop into a World Class Institution without a strong and much more supportive governance and risk oversight framework.

This is not to say that the ATO should be somehow run by the private sector. However, it is to say the long-standing Board Governance model used in the private sector has features that can be extremely useful in supporting the governance and operational culture in the administration of the tax law.

The G100 recognises that the ATO is currently subject to various external oversight processes including through Parliamentary processes and Government sponsored bodies. We submit that while these processes are important they are constrained by their constitutions and mandates and operate with extremely limited resources, relative to the resources available to equivalent bodies in other major countries such as the US. Accordingly, they provide little ongoing strategic guidance and direction for the ATO in areas such as leadership development, performance management, resource management, commercial development, relationship management and overall “cultural” framing.

**For these reasons, the G100 strongly recommends that serious consideration be given to a governance model that has been the subject of a great amount of research and public debate and which was ultimately adopted by the United States Inland Revenue Service in the form of the US Oversight Board for the IRS.**

The role of the Oversight Board would not be to meddle in the specifics of taxpayer cases, or even in aspects of the interpretation of the law. Rather, the role of the Board would be to assist the Commissioner of Taxation in developing a strategy and in setting controls and processes that will lead to better and more consistent long-term outcomes around actual (and perceived) independence and objectivity, taxpayer service, agency culture and better compliance.

".....in my time as Commissioner, I found the Board to be a valued resource. I'm very grateful for their support and guidance and I look forward to working with them on strategic issues going forward, which was really the genesis back at the time of the Commission of the reason to create a board.....I sometimes worry that to use the word oversight may not have been exactly the right word. Board of Directors is also not the right word. It's a public – private entity that is really not found precisely anywhere else in government. But it was more about strategic direction, which I think the Oversight Board has provided and can continue to provide – than it was about the oversight of every function of the IRS."

(Douglas H. Shulman, IRS Commissioner - 2008 Tax Analysts Conference, the IRS Restructuring and Reform Act of 1998, 10 years After Reform: what's working, what's not, what's next – 18 July 2008).

**The G100 urges the committee to use this once in a generation opportunity to review, redesign and better support the institution of the ATO so that it can perform its functions efficiently and effectively.**

## **OVERVIEW OF IRS OVERSIGHT BOARD**

### **What is the United States IRS Oversight Board?**

The nine-member IRS Oversight Board was created by Congress under the IRS Restructuring and Reform Act of 1998. The Board's responsibility is to oversee the IRS in its administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws.

### **Why was the Board created?**

The Board was created to provide long-term focus and specific expertise in guiding the IRS so it may best serve the public and meet the needs of taxpayers. The National Commission on Restructuring the IRS recommended the creation of the Board to provide "experience, independence, and stability" to the IRS so that it may move forward in a cogent, focused direction.

### **Who are members of the Board?**

Seven Board members are appointed by the President of the United States and confirmed by the Senate for five-year terms. These members have professional experience or expertise in key business and tax administration areas. Of the seven, one must be a full-time federal employee or a representative of IRS employees. The secretary of Treasury and the Commissioner of Internal Revenue are also members of the Board.

### **What does the IRS Oversight Board do?**

The Board operates much like a corporate board of directors, but is tailored to fit a public sector organisation. The Board provides the IRS with long-term guidance and direction, and applies its private-sector experience and expertise in evaluating the IRS' progress in improving its service. It reviews and approves IRS strategic plans and its budget requests, and evaluates IRS efforts to monitor its own performance. The Board reviews the evaluation and compensation of senior IRS officials. It also recommends candidates to the President to serve as IRS Commissioner, and can recommend (but not give effect to) a commissioner's removal.

**How does the Board interact with taxpayers and stakeholders?**

The Board reaches out to a wide variety of stakeholders to understand their views on tax administration and its impact on taxpayers. The Board interacts regularly with external groups that include tax professionals, taxpayer advocacy groups, representatives of state tax departments, IRS advisory committees, IRS employees, the National Treasury Employees Union, and other groups that have an interest in tax administration. The Board also conducts an annual survey of taxpayers' attitudes about compliance and other issues relating to tax administration.

## SOME INSIGHTS FROM G100 QUESTIONNAIRE TO CFO GROUP

Question/Proposition	Disagree Strongly 1	Disagree 2	Neutral 3	Agree 4	Agree Strongly 5
<b>Q1</b> On tax audit matters in dispute, the ATO appears to often take the view that a position taken by the company is not supportable at law, or not even reasonably arguable, even though you have had reputable professional opinions, often QC or Senior Counsel opinions to the contrary?	0%	8%	23%	38%	31%
<b>Q2</b> Once the ATO has obtained all the facts relevant to a matter in a tax audit dispute, it applies the law to those facts in a manner which appears to be calculated to give it the most Revenue Favourable position (i.e. high tax paying position).	0%	0%	15%	69%	15%
<b>Q3</b> The Commissioner of Taxation has often articulated the importance of the ATO administering the tax law in an objective and unbiased manner free from any hidden agenda to raise Revenue as opposed to enforcing 'the rule of law'. Do your own experiences with the ATO lead you to seriously doubt that this attitude is being properly cascaded through, and exemplified by the ATO in its dealings with you?	0%	0%	23%	46%	31%
<b>Q4</b> Do you and your company trust the ATO?	8%	15%	69%	8%	0%
<b>Q5</b> Do you believe that there are certain senior executives within the ATO that appear to lack a sense of commercial reality, or have a bias against business taxpayers, which leads to unreasonable positions being taken by the ATO?	0%	7%	21%	57%	14%

**Q6** Do you perceive that there is a lack of accountability through the ATO such that the Commissioner lacks sufficient power to properly hold accountable officers who may not be complying with the notion of applying the tax law in accordance with the 'rule of law'?

0%      15%      46%      31%      8%

**Q7** Do you believe that any concerns with ATO independence and objectivity are over stated and there should be little or no apparent concern about this?

29%      64%      7%      0%      0%