(1991) 21 VUWLR 59

Contagious trends in Australian tax administration

Philip Burgess*

This paper discusses the more important aspects of administrative reform in the Australian Tax Office over the last decade. The author suggests that there are here some lessons for the New Zealand Inland Revenue Department as it faces its own period of change.

My title may suggest that New Zealand is in danger of catching some debilitating fiscal disease from across the Tasman so I should start by saying that I mean contagious in the sense used by Milton in "Paradise Lost":[1]

> "Well understood of Eve, whose eye darted contagious fire".

Or as someone else put it in 1689 "I see this Folly is contagious".[2] Time will tell how much folly has been indulged in, but it is ironic that several of the major substantive tax reforms now carried out in both countries originated in New Zealand, fringe benefit tax and the controlled foreign corporation regime for example. Yet in some aspects of administrative reform Australia is definitely out in front. I thought it might be useful to look at what has happened in Australian tax administration in recent years and try to visualise the effect those developments will have in New Zealand to the extent that they have not had some effect already. By "tax administration" I mean the running of the Tax Office, but I also include what is termed "tax procedure," the process by which tax liabilities are determined and tax disputes are settled.

I THE AUSTRALIAN TAX OFFICE AS IT WAS

Once upon a time (circa 1972) the Australian Tax Office (the "ATO" or "Tax Office") was a quiet, sleepy part of the Commonwealth bureaucracy with the reputation for being a good place to join if you were a bright boy from a Melbourne Irish working class background who did not want to be a policeman or a customs officer. Most of the resources of the Office were engaged in routine paper-processing (computers were used only for accounting) and the major task was the checking of an ever-growing multitude of tax returns. The Office was large (12,000 staff in 1973) but the average educational and skill level was low. Even amongst the 100 or so executive staff there were few who

---

* Senior Lecturer in Law, University of New South Wales; Visiting Lecturer, Faculty of Law, Victoria University of Wellington, 1990. This paper was originally given as a Spring Seminar Talk to the Wellington District Law Society, 18 October 1990.

1 Ch. 9, v. 1036.

2 Shadwell, Bury Fair, Act ii, scene i.

had had the benefit of a full time university education, and those who had attained tertiary qualifications had done so in accounting or law. Most had started as junior clerks at the age of 16, obtaining their professional qualifications part-time. Very few of the senior staff had worked anywhere other than in the Tax Office. There were no women in the executive group (until 1964 women who married could not be permanent Commonwealth public servants) and the ethos was clannish and inward-looking. The pressures of the late 1970s saw this develop into a full-scale siege mentality. Needless to say, post war migrants (except for the occasional Briton) were absent from the upper echelon. The pattern was that of a small office set up to do simple tasks in the 1920s which in the 1940s become a large office doing simple tasks as a result of the rapid wartime extension of income tax's ambit, and which had then grown steadily along with income tax revenues for the next 25 years. It is a curious fact that the costs (to the government) of income tax collection have remained almost constant at about 1% of revenue for the past 30 years. This is despite the fact that significant amounts were spent on automated data processing from the 1960s onward. I was surprised to discover, on a tour of the Sydney Tax Office as late as 1985, how labour-intensive the assessment process was and how primitive the Tax Office computing systems were. Essentially, computing capacity was still being used only for accounting and pay-roll. There was not an expert system in sight. Matching of interest and dividend income was being done manually. Financial institutions supplied data in magnetic form but it could not be used with the Tax Office system. It was put to one side and the accompanying printout used. Of course only a small sample was ever matched. The Tax Office relied mainly on fear to get people to declare additional income. In the 1970s, however, taxpayers began to lose their fear.

II THE PRESSURES FOR CHANGE

"Pressures for Change" seems rather inadequate to describe what has happened to the Tax Office since the late 1970s. For many senior officers it has been like going over Niagara Falls in a barrel. Very noisy, can't get out (lose the super), dangerous to mental and even physical health, completely in the dark, no idea where we're going, and a nasty sinking feeling. The trials of the last 10 or 15 years help explain why the present Commissioner has had so little difficulty in implementing change; the members of the old guard have had the stuffing knocked out of them.

The greatest headache to the Tax Office in the 1970s was the rise of paper tax avoidance schemes, such as the one in *FCT v Curran*[3] which, through government neglect, were allowed to run on unchecked until 1978. Schemes of this kind made income tax optional for anyone except wage and salary earners. But these legal schemes were supplanted by a new horror, the "bottom of the harbour" schemes, which were nothing more than outright evasion disguised as legal avoidance. Closing up these complex legal and illegal schemes required complex legislation, and the Tax Office was short of the resources to administer it. Then the election of the Australian Labor Party Government in 1983 brought new pressures, for the new Treasurer, Paul Keating, was

---

3 (1974) 131 CLR 409. The High Court, 15 years later, admitted it had been wrong in *Curran* and reversed its holding; see *John v FCT* (1989) 20 ATR 1.

determined to leave his stamp on the tax system, and so was David Morgan, his chief tax adviser. The Tax Summit held in June 1985 resulted in broad endorsement for sweeping changes - capital gains tax, fringe benefits tax, a new foreign tax system, imputation for companies and many minor reforms .

With all this the ATO had to change, or go under. Fortunately, in 1984 a new Commissioner had been appointed who has proved equal to the task. On his track record Trevor Boucher was an unlikely revolutionary. A farmer's son from Victoria, he had spent all his working life in the Tax Office, though he had acquired a law degree on the way. His last post before becoming Commissioner was Second Commissioner in charge of the rather esoteric area of International Tax Treaty negotiations. But Mr Boucher saw himself not as a "taxman" but as a manager. At last the Tax Office was subjected to changes designed to cut its workload and improve its output, instead of being expected to cope with an increased workload in the same old way.

III CHANGING MIND-SETS

One of Mr Boucher's first priorities was to change the way taxpayers thought and felt about the tax system and to improve Tax Office morale. As he puts it, he wanted to make it no longer smart to stand around a barbecue boasting about the tax you have avoided or evaded. He also wanted to make Tax Office jobs more interesting and to give back to the Tax Office its sense of mission. This was not to mean a reincarnation of the Gestapo but a commitment to service to the public. Overzealousness was out.

His timing was good. The trials of the "bottom of the harbour" promoters brought home to many people that tax evasion could get you into jail. Artificial tax avoidance schemes disappeared once the courts changed their stance on them, a process that had begun in the late 1970s. It was no longer chic to avoid tax. The Tax Office began hiring more graduates and training them more thoroughly. But the first important internal change was the move to self-assessment from 1986 onwards.

Because of the large number of deductions, particularly for work-related expenses, and rebates allowed individual taxpayers under Australian tax law,[4] almost every return required some checking by the Tax Office. Large roomfuls of assessors, nearly 1000 people in the Sydney Office alone, spent their working days deciding, say, whether overall expenses for a child care worker or a doctor's trip to Bali for a neurosurgeons' conference were deductible. There was very little checking for additional income. The workload was heavy - perhaps 15 returns an hour - and the way for an assessor to cut stress was to graduate to more complicated returns on which it was justifiable to spend more time. The output was checked by more senior staff who graded the assessors on speed and accuracy. Mature consideration did not win points, still less did initiative.

Under self-assessment, which has been practised in the United States for many years, the taxpayer lodges a return which is, essentially, accepted on its face value. Only the

---

4 Cf New Zealand which allows very few deductions, at least to wage and salary recipients.

basic arithmetic is checked by the Tax Office computer. But the taxpayer accepts responsibility for the contents of the return, not merely the factual statements, but also the categorisations made. If a receipt is declared and claimed to be capital the taxpayer is responsible if it turns out to be income. That is, the taxpayer must pay additional tax at 20% per annum if the characterisation in the return is found to be wrong. In other words the task of legal decision-making at first instance has been given to taxpayers. There is a provision[5] which allows taxpayers to draw questions to the attention of the Commissioner but this section does not affect the taxpayer's basic responsibility for the legal categorisations made in the return. The assessors are no more, so the job cannot be handed back to them.

What, then, is there to stop taxpayers from writing their own refund cheques? The Tax Office has always relied on fear, as noted earlier, but fear is now backed up with a greatly enhanced audit programme. Many former assessors have retrained as auditors, though not all have proved equal to that task. Much of this extra personpower has been employed in "desk audits." In this process, the taxpayer with rather a lot of deductions for someone in their occupation or in their salary range receives a polite letter asking him or her to arrange a time for an interview at the local ATO and to produce documents evidencing the spending of the amounts claimed. Naturally, a form also needs to be filled in. At the interview the auditor scrutinises the documents to see whether they support the amounts claimed. Under a particularly vicious provision,[6] wage and salary earners cannot claim deductions for work-related expenses unless they obtain at the time of the expense a receipt or other document from the provider of the goods or services. This document must meet strict criteria. All the auditor has to do is to find a wrong date or an insufficient description of the expense and the amount is disallowed and a penalty added. Self-employed persons are subject to "substantiation" rules only in relation to motor vehicle expenses and some travel expenses. Some 20,000 of these audits were done in the last year for which there are figures, 1988-89. This may not seem a lot in a system which deals with 10 million returns a year, but the audits are highly selective. In that year the Tax Office concentrated on teachers and academics. At my University at least 7 out of 50 staff in one faculty were subjected to a desk audit.[7] I am pleased to say the auditors made little headway with my colleagues who tend to be meticulous in these matters but the average desk audit returns the Tax Office $700. Recently these provisions claimed a prominent victim when Dr Terry Metherall, Minister of Education in the New South Wales State Government, was forced to resign when it was revealed that he had failed to substantiate all but $6,000 of his $26,000 Ministerial expense allowance, which he had spent in full.[8]

Looking at the other end of the audit spectrum, the Tax Office is doing its best to get rid of its reputation as being a good buster of little guys but hopeless at catching large companies and multinationals. Corporate audit is still selective but based on highly developed criteria. These pay particular attention to unusual financial features and

---

5 Income Tax Assessment (ITA) Act 1936, s 169A.
6 ITA Act 1936, s 82KZ.
7 There may have been more; I count only the ones who consulted me.
8 *The Australian* 19-9-90.

overseas transactions. So far, the deductibility of interest, financial "round robins" through tax havens involving redeemable preference shares, and the claiming of the same deductions in more than one jurisdiction, have emerged as issues. The eventual aim is to place an ATO audit team in all of the largest 100 private sector companies. The team will remain in the company more or less permanently, so that the personnel become familiar with the company's operation.

I understand that the New Zealand Inland Revenue Department's audit policy is less selective than the ATO's and contemplates attention being paid to relatively low risk groups. This is apparently on the theory that if left alone they may develop into high risk groups. One would have thought that the rational tax administrator would worry about that when it happened, rather than waste scarce resources on discovering that the honest (or cowed) are indeed honest (or cowed).

The most controversial aspect of the Tax Office operations in the audit and investigation area has been the more aggressive use of search and entry powers. Oddly, these are weaker in one respect than those of the New Zealand Commissioner since the ATO does not have power to retain documents found in a search, but may only copy them. The search and entry powers have become an issue in Australia partly because the effect of legal professional privilege on them was not considered by the courts until the early 1980s[9] and not really settled until the *Citibank* and *Allens* cases of 1988.[10] In New Zealand, on the other hand, the matter was litigated in the early 1950s, negotiated with the profession and remedial legislation passed.[11] It is now settled in Australia that a legal practitioner must be given a reasonable opportunity to claim the privilege on behalf of the client, and this means that the matter may need to be determined by a court. After the *Citibank* and *Allens* cases the 90% or so of tax agents who are not lawyers protested that their legal colleagues had an unfair marketing advantage in the form of legal professional privilege. The government decided to give something like it to them too, though the exact form this will take has not yet emerged.

Another central plank in the reform of the Tax Office has been better public relations. Previously, ATO public relations consisted of a few pamphlets on how to fill out tax returns, the occasional uninformative speech by the Commissioner or one of his deputies at a tax agents' conference and an equally uninformative annual report to Parliament. The Tax Office is, of course, bound by secrecy provisions which are designed to prevent information about the affairs of individual taxpayers from leaking out, but the Office was not used to communicating with the public. It was sly but shy. The first real change was forced upon the Office by the introduction of the Freedom of Information Act in 1982.[12] The Tax Office internal rulings were (largely) made public and individual taxpayers could, at little cost, get access to their own files. At first the

---

9 See *Baker v Campbell* (1983) 14 ATR 713.

10 *Citibank Ltd v FCT* (1988) 88 ATC 4714; *Allen, Allen and Hemsley v DFCT* (1988) 88 ATC 4734.

11 *CIR v West-Walker* [1954] NZLR 191. See now Inland Revenue Department Act 1974, s 20.

12 Equivalent to the NZ Official Information Act 1982.

Tax Office did not enter into the spirit of the new bureaucratic glasnost and took the view that everything other than information originally provided by the taxpayer was either an "internal working document"[13] or "subject to legal professional privilege,"[14] two of the exceptions in the Freedom of Information Act. One would thus get back from the Tax Office the taxpayer's returns with all the assessor's comments carefully whited out. Eventually reason prevailed, and the Tax Office is now no more recalcitrant in complying with Freedom of Information requests that the average Department.

There have, however, been some new developments in Tax Office public relations which have caused some concern, particularly to those who have been on the receiving end of "high profile" investigations. In the *Citibank* case[15] the Commissioner decided that about 30 auditors, complete with power generator, portable photocopiers and a locksmith should visit the Sydney offices of Citibank Ltd, unannounced, to enquire whether any of Citibank's clients had been engaged in redeemable preference share financing, which was thought to presage tax avoidance. Fair enough, and within the powers contained in section 263 of the Income Tax Assessment Act 1936, but what enraged the private tax lobby was the press statement put out on the day, announcing that the raid (called an unannounced visit) had taken place. The statement did not name the subject of the raid, but within a day it became generally known that the subject was Citibank.

A rather trivial incident occurred in August 1989 when tax auditors from the Chatswood, Sydney , branch of the Tax Office took a reporter and photographer out on their rounds. Details of interviews with taxpayers and many general comments by the tax auditors were given in a story in the *Sydney Morning Herald Weekend Magazine*. This particular frolic was disowned by the Deputy Commissioner concerned.

Perhaps the most curious Tax Office publicity stunt was that involving Elders IXL Ltd in June 1990. Michael Gill of the *Australian Financial Review* wrote a story on how one big Australian company being investigated by the Tax Office Complex Audit team had gone to elaborate lengths to establish the company's international operations as an anti-avoidance device. The information about this company had been obtained, it was said, through a Freedom of Information request. The company was unnamed, but to the knowledgeable outsider it was obvious that only one large company in Australia fitted the facts given in the article, Elders IXL Ltd. Two days later, in the *Sydney Morning Herald*, the veteran business journalist Max Walsh, proclaimed what everybody already knew, that the company was Elders, and accused the Tax Office of over-assisting Mr Gill in his expose of Elders' tax affairs. Mr Walsh hinted that the Tax Office had picked on Elders because its chief executive, John Elliott, was president of the Liberal Party and the Treasurer, Mr Keating, would not be too upset about an attack of this nature on one of his political opponents.[16] This was duly denied by the Tax Office and

---

13 Freedom of Information Act 1982, s 36.

14 Above n 14, s 42.

15 Above n 11.

16 See *Australian Financial Review*, 12-6-90, p 14 (Gill); *Sydney Morning Herald*, 14 -6-90, p 13 (Walsh).

Mr Keating. The affair then died down, but it serves as an example of the damage that can be done. The Tax Office has traditionally fought to preserve secrecy on the basis that only if taxpayers are sure the information they provide about their affairs is kept secret will they be prepared to tell enough for the Office to tax them fully. In the case of an audit where the taxpayer is not co-operating this is not a consideration, but after the Elders case even a co-operative taxpayer might be forgiven for thinking that details about himself or herself might leak out if it happens to suit the Tax Office's interests. I am not meaning to suggest that the Tax Office has deliberately set out to use publicity about its critics (who certainly include Mr Elliott) as a weapon. It is simply that an active use of publicity carries some risk. A hitherto tongue-tied organisation needs some practice before it can operate effectively in public debate.

A more positive contribution to public information about the tax system has been the production of the "tax pack," a 100 page magazine-style booklet containing the 1990 tax return. Written in plain English, virtually all of the situations faced by individuals are covered. Most people will find only a small part of the pack applies to them, and perhaps there is a certain amount of overkill in it, but it will be interesting to see if there are less mistakes made by individuals (and even tax agents) in compiling their 1990 returns.

IV TAX FILE NUMBERS AND THE CASH TRANSACTIONS REPORTS ACT 1988

After an abortive attempt to introduce a universal identifier known as the Australia Card, the Australian Government settled for a limited no-frills version, the tax file number. It is only to be used for tax purposes, but must be quoted to banks and other financial institutions if the maximum rate of withholding tax is to be avoided. In fact, all taxpayers already have such a number and some have more than one. The process by which tax file numbers are issued is being tightened up and corporations are to be linked to their individual controlling taxpayers by means of the numbers system.

Similar developments have occurred in New Zealand. But one so far uncopied Australian innovation is the Cash Transactions Reports Act 1988. This legislation requires persons who deal with large amounts of cash in the course of their business (generally $10,000 or more) to keep a register of all their dealings and to report large and "suspicious" transactions to the Cash Transactions Authority set up for the purpose. It is not designed solely for tax purposes. A major justification for setting up the Cash Transactions Authority was the need to trace the proceeds of organised crime. So far, since it commenced operation in January 1990, the Authority has collected a lot of information, but it remains to be seen to what effect. The Act's worst feature is that inexperienced and untrained employees of cash dealers must decide what amounts to a "suspicious" transaction on pain of a fine for not doing so. It is a threat to civil liberties of quite substantial proportions and is unlikely to bear much fruit. The distinguished Canadian tax academic, Professor Neil Brooks, commented that it would make more sense to take the $100 note out of circulation than to set up the Cash Transactions Authority. It appears that the Authority is one Australian innovation the New Zealand tax administration does not intend to copy. This is not to say an ambitious police officer might not be pushing for it.

V TAX ADMINISTRATION AND ORGANISATION

I mentioned that around 10 million returns are filed in Australia each year . This may seem rather a lot in a country of only 16 million people, and recently the Tax Office has begun to wonder whether so many are needed. Two avenues are being explored. The first is electronic lodgement. Under this system a taxpayer or his or her agent would enter all the return details on a personal computer and send them in to the Tax Office by modem. Processing at the Tax Office would be virtually automated. The second, and to my mind much more attractive proposal, is to abolish the requirement for most people to file returns. With the use of withholding at source for most forms of property income as well as pay as you earn income, the abolition of tax returns is becoming easier. A stumbling block is the existing four tiered rate structure.[17] However as the maximum rate is reached at 1.2 times average earnings, the deduction of tax at that rate from additional income will not lead to the necessity for a refund for a large number of taxpayers. Doing away with returns will require some thought, but it is an attractive proposition. A factor militating against the abolition of returns is the growing use of the tax system for non-tax purposes. In Australia the ATO already collects maintenance payments from defaulting spouses. In New Zealand, where the number of income tax returns lodged (2.7 million) is even higher per capita than in Australia, the Inland Revenue Department collects accident compensation levies and administers the family income maintenance scheme. This has come about in both countries through the decline in the sacred cow status once accorded Tax Office secrecy, so that it is now quite common for other government agencies, duly authorised by legislation, to be able to obtain information about individual taxpayers. Also, the politicians have come to recognise the relative efficiency of the Tax Offices as collection and distribution agents for government funds.

Ideas like these are being dealt with by the tax simplification project set up as a joint venture between the Treasury and the ATO, and headed by a First Assistant Commissioner of the ATO, Peter Simpson. Its brief is a good deal more ambitious than that of the N Z Consultative Committee which reported in September 1990.[18] After having paid $49 for that slim volume of 125 pages only to discover the most earth-shattering recommendations were the movement of a few payment dates I wanted my money back. In fairness the NZ Committee did call for simpler legislation. The Australian simplification project extends to simpler laws as well as better administration, but it will be some time before its results will be seen.

The Tax Office, pursuant to its Corporate Plan, has been reorganised both at head office and state branch office level to create smaller work units and to increase emphasis on its "helping" role. The management firm of McKinsey & Co reported early in 1990

---

17 21%, 29%, 39%, 47%, plus the 1.25% Medilevy.

18 *Tax Simplification: Final Report of the Consultative Committee* (Wellington, Sept 1990).

on how the Tax Office could improve relations with tax agents and large companies.[19] Steps are being taken to improve drastically the training given to Tax Officers through external tertiary courses designed for the purpose - "Tax Office University" in fact. Interestingly, these courses are not envisaged as narrow and technical; rather, the aim is to raise the general educational level of the staff, though in the context of Tax Office work. Perhaps to emphasise that skills other than those of the accountant and lawyer are required to run an institution such as the ATO, Mr Bill Godfrey, a management consultant, who was serving in a temporary capacity as chief of audit, was earlier this year appointed Second Commissioner and thus one of Mr Boucher's three immediate deputies.

VI APPEALS AND REVIEW

The most important change in this area in the last five years or so has been the switch to the Administrative Appeals Tribunal (AAT) as the review authority. The State Supreme Courts no longer have tax jurisdiction and appeals are heard in the Federal Court. It should be explained that under the Australian system, appeals against assessments can go either to the AAT or to the Federal Court at first instance. The change in judicial attitudes to tax avoidance[20] has led to a reduction of cases involving substantive questions of tax liability. But there has been an upsurge of procedural litigation, particularly on Administrative Law grounds, eg did the Commissioner have regard to all the relevant factors when he issued an order prohibiting the taxpayer (or non-taxpayer) from leaving the country? Knowledge of the Administrative Decisions (Judicial Review) Act 1977 is essential for an Australian tax practitioner these days despite the Act's limited scope in tax matters (it cannot be used to challenge the assessment process).

Although there has been an increase in the volume of litigation, particularly on procedural matters, the AAT and the courts seem destined to play a less important role in the Australian tax system. Administratively inconvenient decisions, and those which involve the loss of significant revenue, are now reversed quickly, if not immediately, by legislation. On occasion this has occurred retrospectively. The Federal Government is no longer prepared to tolerate the courts and the AAT pursuing their own ideas of tax policy. The Government is, after all, elected, and the courts and the AAT are not.

VII CONCLUSION

I have not made much comparison with New Zealand tax administration for the simple reason I am not familiar with its current state. However, I have made some enquiries and it appears that many of the same developments are in train here. New Zealand followed Australia into self-assessment and the Inland Revenue Department has this year produced its first corporate plan, a rather more financially oriented document

---

19 The text of the McKinsey report was published in 24 Taxation in Australia 757 (May 1990).

20 See G Lehmann "The Income Tax Judgments of Sir Garfield Barwick" (1983) 9 Monash UL Rev 115.

than that of the ATO. Both administrations are resorting to tax rulings to a greater degree than previously. Both administrations are spending huge amounts of money on computer systems and it seems that after the long delay in getting cabinet approval for the Australian purchase, New Zealand is further ahead in the design of the new systems which will run on the new hardware. There is considerable contact between the two administrations and some possibility that they will learn from each other's mistakes. But it is not sufficient that tax collectors talk only to each other. Perhaps what is needed above all in New Zealand is for the tax administration to lose its siege mentality and become more a part of the business and professional community. The corporate plan is an indication that it wishes to do so. The Australian experience has shown that a tax administration can do this and still maintain its integrity.