

Confidence in the operation of the tax system

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Introduction

I would like to thank the Tax Institute for the opportunity to speak to you this morning. It is pleasing to see so many of you prepared to spend these early hours of the day reflecting on Australia's tax system.

My theme for this morning is drawn from recent reporting of a roundtable discussion between representatives of some of Australia's largest companies.¹ It was reported that uncertainty in Australia's tax system is damaging our international competitiveness. In particular, these business representatives expressed concern about their inability to get objective, timely and reliable advice from the Tax Office. They called for the tax law to be as clear as possible to minimise the need for Tax Office advice. They also suggested that the Tax Office's approach should take into account the attractiveness of Australia as a place to invest and do business. And they proposed a governance structure to support the Tax Office in this approach – specifically, a board of directors to oversee the Tax Office.

Confidence in the operation of the tax system is an important concern for the Australia's Future Tax System Review. These issues have been raised directly with the Review Panel and I would like to share with you some initial thoughts on them.

Review's approach

But, before I do so, I would like to touch briefly on the Panel's overall approach to the review, and in particular on a question I am asked regularly – what does the global financial crisis (GFC) mean for the tax review?

My response is this. While the GFC is certainly the most challenging economic environment any of us have experienced, it will pass. I expect that our final report will contain observations about the medium-term implications for government budgets of short-term macroeconomic shocks of the sort we are presently experiencing. This is likely to be a topic of considerable interest to all governments around the world for years to come. But the task of the review is, principally, to look beyond the immediate downturn and to redesign our tax-transfer system to meet the profound demographic, social, economic and environmental challenges of the coming decades. We are not simply developing a package of initiatives for the next Budget. We are developing a long-term blueprint for a tax-transfer system that is focused on sustainable prosperity for Australia. Naturally, our proposals should also support recovery from economic downturns by ensuring that when resources become available they are directed to their most productive use.

¹ *Australian Financial Review*, 23 February 2009, pp 1, 9, 52 and 53.

Given the broad scope of the review, and the high level economic, social and environmental challenges to be addressed, it might be tempting to avoid more practical issues about the operation of the system – but we know that we must understand these dimensions to properly comprehend and adequately address the impact of complexity. This is a focus for the Review Panel.

Of course, it is wrong to assume that all complexity can be eliminated. That would not be realistic or even desirable – taxes serve sophisticated objectives in an increasingly complex world. Ultimately, the challenge is to deal with the inevitable uncertainty in a fair and efficient way. This morning, I am going to focus on the role of tax administration in addressing this challenge, particularly for businesses.

Certainty and self-assessment

The administration of the tax system is an important way in which the costs of uncertainty are allocated between government and taxpayers. The income tax system principally distributes the costs of uncertainty through a process of self-assessment.

Self-assessment was introduced in 1986 to improve system efficiency – it shifted the Tax Office’s focus from processing returns to helping taxpayers to comply with the law and taking enforcement action against those who do not. The introduction of self-assessment shifted the distribution of cost and risk between the government and taxpayers, exposing taxpayers to more risk by removing some of the finality of the assessment process.²

To address concerns about the imbalance of risk created by self-assessment, a system of binding rulings was introduced in 1992 to give taxpayers greater certainty about the application of the law. Further refinements have been undertaken since. For instance, Treasury’s 2004 review of self-assessment led to changes that made even more Tax Office advice binding; reduced the periods in which the Tax Office can amend assessments; and reduced penalties.³

Interestingly, there have not been any serious calls for self-assessment to be abolished. But there have been calls for changes that would further rebalance costs and risks in favour of taxpayers. In thinking about these proposed changes, it is important to look critically at where these risks can be borne at least cost – remembering, of course, that the costs borne by government are ultimately met by taxpayers.

2 The Treasury 2004, *Review of Aspects of Income Tax Self Assessment Discussion Paper*, Commonwealth of Australia, Canberra.

3 *Tax Laws Amendment (Improvements to Self Assessment) Act (No. 1) 2005* and *Tax Laws Amendment (Improvements to Self Assessment) Act (No. 2) 2005*.

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Certainty and tax administration

The move to self-assessment confirmed the dual roles of the Tax Office – to advise taxpayers about their obligations and to collect revenue. Self-assessment heightened the importance of voluntary compliance and of taxpayers properly understanding the tax law in order to meet their obligations.

As the tax system has become more complex, Tax Office advice has arguably become even more important. The simple fact is that fewer taxpayers now have the capacity to understand their obligations without that advice. Over time, the certainty offered to taxpayers by a tax ruling seems to have become more highly valued. Large businesses are telling us that they are increasingly looking for the comfort of a ruling before they will enter into transactions and arrangements.

In response to the desire of large businesses for more certainty and more timely advice, the Commissioner has initiated a number of administrative changes, in partnership with the business community. This work was motivated by a desire to see the tax administration support business: to make Australia a more attractive place to invest and do business.

For example, last year the Commissioner launched a new process where the Tax Office reviews – and ticks off – transactions as they happen. Initially, these arrangements are being offered to top 50 companies. This initiative potentially offers real-time certainty that will allow businesses to plan their arrangements with confidence about the tax risks involved, while also providing the revenue with an assurance that these risks are being managed appropriately.⁴

Another initiative to help businesses manage commercially significant and time-sensitive transactions is the Tax Office's priority rulings process. The process features greater openness and commitment by both parties to ensure the facts are identified and the right experts are involved to resolve the issues quickly.⁵

Despite these improvements, there is obviously some discontent with the performance of the Tax Office in helping businesses manage the complexity and uncertainty of the tax system. In particular, large businesses have told us they are concerned there are inadequate checks against the Tax Office's compliance responsibilities influencing their

4 These 'annual compliance arrangements' were announced in A New Dimension, a speech by Michael D'Ascenzo, Commissioner of Taxation to the Corporate Tax Association Convention, Sydney, 12 May 2008.

5 The Tax Office's *Law Administration Practice Statement PS LA 2005/10 Priority private binding rulings*.

advice. In other words, they are concerned that the Tax Office's advice is motivated, at least at the margins, by a pro-revenue bias.

Perceptions of a pro-revenue bias seem to be based on an assumption that the Tax Office is out to maximise collections, rather than to administer the law objectively. If this were true, it would undermine the efficiency and equity of the tax system. Large numbers of disputes would be created and, for those who could afford to contest the Tax Office opinion, it would be necessary to resolve issues by getting an impartial view of the law through the courts. Obviously, this would impede business and detract from our ability to attract international investment.

This perception, of a pro-revenue bias, has persisted for at least as long as I have had any involvement in tax. Yet it seems at odds with the reality of those Tax Office initiatives I have just mentioned.

The Inspector-General of Taxation examined allegations of a pro-revenue bias last year and found no evidence of bias in private rulings involving complex matters.⁶ Even so, it is clear that perceptions of bias are firmly held in some quarters.

In response to similar concerns, several countries have separated the interpretation of the law from the mechanical aspect of revenue collection. In Sweden, private rulings are given by a judicial body. Taxpayers and the tax administrator can request a ruling, which is binding only when the taxpayer chooses to apply the ruling. The body seems to be respected for the quality of its decisions. However, it has been criticised for the time it takes – the average ruling takes six to eight months.⁷ If timeliness of rulings is a driving concern, this might not be the path to follow.

It seems likely also that an independent rulings body might not be as flexible and responsive as taxpayers have demanded the Tax Office to be. While the Tax Office is sometimes criticised for being too legalistic and pro-revenue, it needs to be recognised that the Commissioner often exercises his powers to make it easier for taxpayers to comply. Arguably, a more independent body – divorced from the practical implementation of its rulings – would have less of an appreciation of the impacts of its decisions.

Obviously, we need to know more about the nature of the problems before we go too far in thinking about the solutions. For some, the problems seem to be about getting better access to decision-makers in the Tax Office. The Commissioner's initiatives I

6 The Inspector-General of Taxation 2008, *Review of the potential revenue bias in private binding rulings involving large complex matters*.

7 *ibid.*

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have just outlined might satisfy these concerns. However, for others there are deeper issues that go to the accountability and independence of tax administration.

Accountability and independence of tax administration

As I mentioned at the outset, there was some reporting a couple of weeks ago that covered a suggestion from the Group of 100 that the Tax Office should be overseen by a board, which would include directors drawn from the private sector. The Corporate Tax Association has made similar submissions to the Review Panel.

These groups suggest that the level of uncertainty in Australia's tax system is damaging our international competitiveness and inhibiting domestic business decisions. They allege the Tax Office fails to provide timely and reliable advice and argue that this is evidence of the Tax Office being out of touch with the needs of business for practical certainty in the tax system. It is maintained that this is a problem of culture, focus and governance of the Tax Office.

These are serious matters.

I would like to take a moment to outline some of the governance arrangements that currently apply to the Tax Office and to consider some other options.

The Commissioner of Taxation has statutory independence to administer the principal Australian taxes. Independence means that he is responsible for making decisions about how to implement and apply the tax laws. This independence has been supported by successive parliaments and is founded on strong equity arguments – namely, that it would be undesirable for the day-to-day administration of the tax laws to be influenced by political or other forces.

However, independence does not mean there are no accountabilities. The Tax Office is an agency in the Treasury portfolio. As such, Treasury ministers are accountable to the Parliament for the performance of the Tax Office in line with the principle of responsible government. As part of this relationship, ministers get information from the Tax Office to fulfil their parliamentary responsibilities.

Parliament also requires the Commissioner to report annually on the operation of the Tax Office. Of course, the Commissioner also appears before Parliamentary committees to explain his administration of the tax laws. In addition to the normal Senate estimates hearings, the Tax Office attends biannual hearings of the Joint Committee of Public Accounts and Audit.

A number of executive government agencies complement these parliamentary accountabilities by scrutinising different aspects of the Commissioner's work. The

Inspector-General of Taxation looks at systemic tax administration issues; the Ombudsman investigates specific taxpayer disputes; and the Australian National Audit Office carries out performance and financial statement audits.

In addition, the Board of Taxation provides a business and broader community perspective on the tax system. While the focus of the Board is on the quality and effectiveness of tax legislation, it also advises the Treasurer on improvements that may be made to the implementation of those laws.

While these arrangements are numerous, they are sometimes criticised for not including a power to direct the Commissioner in his administration. In considering this criticism I think it is important to look at how things are working in practice. For instance, while the Inspector-General has no power to compel the Commissioner to accept and implement his recommendations, in practice we can see that the Inspector-General has had a significant impact in the areas he has examined.⁸ There is clearly support in the community for the work being performed by the Inspector-General.⁹

In several other countries, a board of directors oversees the revenue body to provide the government with a further source of independent advice on the performance of the revenue body. The revenue authorities in Canada,¹⁰ the United Kingdom¹¹ and the United States¹² are all overseen by boards that include representatives with backgrounds outside the bureaucracy.

A key function for these boards is to inject a range of experiences and perspectives into the management of those tax authorities. In line with this objective, all of these boards have a role in developing corporate strategies and plans. Importantly though, in all cases, board members are not involved with the affairs of specific taxpayers and do not have access to taxpayer information.

8 Of the 73 recommendations made by the Inspector-General in his first three years, the Tax Office accepted 65 of these and has implemented 62. *Follow up review into the Tax Office's implementation of agreed recommendations included in the six reports prepared by the Inspector-General of Taxation between August 2003 and June 2006*, publicly released 5 March 2008.

9 Media release of Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, the Hon Chris Bowen MP, No. 022, 9 April 2008, *Inspector-General of Taxation to be Retained as a Stand Alone Office*.

10 See: <http://www.cra-arc.gc.ca/gncy/brd/menu-eng.html>

11 See <http://www.hmrc.gov.uk/board/index.htm>.

12 See <http://www.treas.gov/irsob/>

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Similar suggestions have been considered in Australia, though the case for change has never been found to be compelling.¹³ Instead, the Tax Office has established a large number of consultative forums to ensure that it understands external perspectives. It also discusses its strategies and plans with parliamentary committees, such as the Joint Committee of Public Accounts and Audit.

The governance models used in the private sector can provide some insights about appropriate arrangements for the public sector. But it is important not to lose sight of the public sector context and to think about how this might limit the usefulness of private sector models.

In large public companies, dispersed ownership means it is impractical for shareholders to be directly involved in management. A board of directors is delegated the power to manage the company in shareholders' interests. A critical feature of this governance arrangement is that the board has the power and responsibility to act, including the ability to appoint and remove the chief executive officer.¹⁴

In relation to the Tax Office, the ultimate 'owners' are the Australian community, whose interests are represented through the Parliament. This institution might be thought of as the ultimate board of directors. Of course, Parliament leaves to the Executive the powers of appointment and dismissal. But it insists that the Commissioner is accountable to it – that is, the Parliament – for the administration of his office. Given the importance of the Commissioner's role in the relationship between the Executive and taxpayers, governments would properly be uncomfortable with delegating to anybody else their power to appoint and remove the Commissioner. It is not surprising that the boards that oversee other tax authorities do not have this power to directly appoint or dismiss the CEO.¹⁵

Similar arrangements are in place for a number of Australian regulators, including ACCC, APRA and ASIC – which, incidentally, are all in the Treasury portfolio. Like the Tax Office, these regulators are independent statutory authorities, led by commissioners, appointed by the government. However, a key difference between the Tax Office and these other bodies is that tax commissioners have largely been appointed from within the ranks of the Tax Office. To some extent, this may have contributed to perceptions that the Tax Office could be more 'outward looking'.

13 Joint Committee of Public Accounts and Audit, Report 410: Tax Administration (2008); Review of Business Taxation, *A Tax System Redesigned* (1999); Joint Committee of Public Accounts, Report 326: *An Assessment of Tax* (1993).

14 Uhrig, J, *Review of Corporate Governance of Statutory Authorities and Officeholders*, Commonwealth of Australia, June 2003.

15 Although, in the United States the IRS Oversight Board recommends candidates to the President to serve as IRS Commissioner, and can recommend a commissioner's removal.

More facts are needed

Confidence in the administration of the tax system is clearly important. The Review Panel is examining the concerns that have been expressed, seriously and critically.

I have intended, with my remarks this morning, to illustrate three features of the Panel's approach to these, and indeed other, issues we are addressing.

First, we need to be clear about the nature of the problem. We need to be fully apprised of the facts driving perceptions about the Tax Office. It is important that we test the assertions being made and make sure we have quality information about what is really going on. If we are to address these concerns, we need to be sure about the underlying problem.

Second, we need to understand the features of the current system that have been developed in the past to respond to these types of concerns. The existing governance arrangements for the Tax Office were developed in response to the changing nature of the tax system and the changing expectations of the Tax Office. It is important to acknowledge these features of the current system and understand how they are performing before we make changes.

Finally, we should recognise that proposed solutions may also have some problems of their own, and these need to be explored before we can settle on any particular path.

The Review Panel is far from settled on its response to specific suggestions to change our tax administration. We are continuing to consult and, over the coming months, we will be looking for more facts about the difficulties facing business. As in all areas of our work, our goal is to best position the tax administration so that it can support the tax system that Australia needs.

