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Performance Audit

Administration of the Luxury Car Tax

Australian Taxation Office

Australian National Audit Office

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Executive Director
Corporate Management Branch
Australian National Audit Office
19 National Circuit
BARTON ACT 2600

Or via email:
webmaster@anao.gov.au

Canberra ACT
31 May 2011

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Australian Taxation Office with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit and the accompanying brochure to the Parliament. The report is titled *Administration of the Luxury Car Tax.*

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's Homepage—http://www.anao.gov.au.

Yours sincerely

Ian McPhee
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

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For further information contact:
The Publications Manager
Australian National Audit Office
GPO Box 707
Canberra ACT 2601

Telephone:	**(02) 6203 7505**
Fax:	**(02) 6203 7519**
Email:	**webmaster@anao.gov.au**

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Audit Team
Jane Whyte
Rhiannon Stanley
Danielle Sheehan
David Crossley

Contents

Tables

Figures

Abbreviations

ABN	Australian Business Number
ANAO	Australian National Audit Office
CRMs	Customer Relationship Managers
CPI	Consumer Price Index
Customs	Australian Customers and Border Protection Services
FCAI	Federal Chamber of Automotive Industries
GFC	Global Financial Crisis
GST	Goods and Services Tax
HOTSA	Health of the System Assessment
ICS	Integrated Cargo System
ITX	Indirect Tax Business Line
LCT	Luxury Car Tax
MoU	Memorandum of Understanding
RAB	Revenue Analysis Branch
SUVs	Sports Utility Vehicle
Tax Office	Australian Taxation Office
VFACTS	Vehicle Facts
WET	Wine Equalisation Tax

Glossary

Luxury Car	A car with a Goods and Services Tax (GST) inclusive value above a specific threshold that is designed to carry fewer than nine passengers and a load of less then two tonnes.
Luxury Car Tax (LCT)	An Australian tax imposed specifically on the taxable supply or importation of a luxury vehicle.
Primary producer and tourist operator rebate scheme	A rebate scheme which entitles eligible taxpayers to claim a refund of a portion of the LCT, relevant to specific business activities.
Private Binding Ruling	A key mechanism in Australia's self-assessment tax system to provide taxpayers with certainty of tax treatment in respect to specific transactions or arrangements.
Quoting	Quoting is a mechanism to defer LCT to a later assessable dealing or to give effect to exemption from the tax for a particular type of vehicle.

Summary and Recommendations

Summary

Introduction

1. Australians purchase approximately one million new motor vehicles each year, including both imported and domestically manufactured vehicles. Around 100 000 of these vehicles are luxury cars.[1]

2. The Luxury Car Tax (LCT) is the only Australian Government tax imposed on the taxable supply or importation of goods or services designated as luxury. For LCT purposes, a 'luxury car' is a car with a Goods and Services Tax (GST) inclusive value above a specific threshold that is designed to carry fewer than nine passengers and a load of less than two tonnes. For 2010–11, the applicable threshold for a luxury car is $57 466, and $75 375 for those vehicles meeting defined fuel efficiency standards. The portion of the value of a luxury car above the LCT threshold is currently taxed at 33 per cent.

3. The LCT was introduced from 1 July 2000 under the framework of *A New Tax System*, which also introduced the GST. Entities registered or required to be registered for GST purposes are typically liable to pay the LCT, and this is recorded and paid via a taxpayer's Business Activity Statement (BAS).

4. A rebate scheme for primary producers and tourism operators was introduced on 1 July 2008. The rebate entitles eligible taxpayers to claim refunds of a portion of the LCT to a maximum of $3000 per car. Primary producers may claim for one car per year and tourism operators for all eligible vehicles.

Context for the luxury car tax administration

5. The LCT was introduced at the time of the introduction of the GST and abolition of the Wholesale Sales Tax in 2000 to maintain the substantially higher rate of taxation applied to luxury cars. The LCT threshold is indexed annually using the motor vehicle purchase component of the Consumer Price Index (CPI). Compared to overall CPI changes, the increase in the price of motor vehicles has been relatively small. The proportion of vehicles now

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[1] Parliament of Australia, Department of Parliamentary Services, *Bills Digest*, 13 June 2008. Nos 131–134.

subject to the LCT has quadrupled from around 2.5 per cent in 1979 to more than 11 per cent in 2010.

6. While the volume of motor vehicle sales subject to LCT has increased, the number of taxpayers liable to pay the tax on vehicle sales has remained relatively stable. At September 2010, 1692 taxpayers had registered an LCT account with the Tax Office since the implementation of the tax. However, total annual LCT revenue is typically paid by less than 1000 taxpayers, (approximately 59 per cent of those taxpayers with an LCT account). The tax is also relatively concentrated, with almost 84 per cent of the total LCT revenue collected being paid by the top 100 LCT taxpayers in 2009–10.

7. Since its introduction in 2000, the LCT has raised almost $3.2 billion in net revenue. This figure included $472 million for 2009–10, with further increases expected in subsequent years in line with the overall increases expected in motor vehicle sales.[2]

Administrative arrangements

8. The LCT is predominantly administered by the Australian Taxation Office (Tax Office) which collects LCT on assessable dealings in Australia, including for most imported luxury vehicles. Within the Tax Office, responsibility for administration of the LCT is centred in the Indirect Tax (ITX) business line. The Australian Customs and Border Protection Service (Customs) collects, on behalf of the Tax Office, LCT on some imported vehicles under a Memorandum of Understanding (MoU) between the two agencies.

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2 New motor vehicle sales in 2009 fell by 7.4 per cent to 947 328, reflecting the general downturn in the overall car market during the global financial crisis (GFC). Sales for 2010 reached 1.04 million, an increase of 10.5 per cent from the previous year, indicating a recovery in the volume of sales to pre-GFC levels and only the third time the volume of sales in a calendar year has exceeded one million. Federal Chamber of Automotive Industries (FCAI), available from <www.fcai.com.au> [accessed 23 February 2011].

Audit objective and scope

9. The objective of the audit was to assess the effectiveness of the Tax Office's administration of the LCT, including aspects of the tax administered by Customs on behalf of the Tax Office. Particular emphasis was given to the Tax Office's:

- governance arrangements for the LCT; and
- approach to managing taxpayers' compliance with their LCT obligations.

Overall conclusion

10. The LCT has been in place for almost eleven years. It is a mature tax that is well understood across the motor vehicle industry; is relatively concentrated in a small number of taxpayers; and contributes less than one per cent of total taxation revenue each year. The tax is relatively simple to administer and both the Tax Office and Customs currently apply an overall low rating to the risk of taxpayers not complying with their LCT obligations.

11. The administrative arrangements for the LCT reflect its low risk rating and the low priority it is given against other administrative demands. There is scope to improve the co-ordination of governance arrangements for the LCT. No compliance strategy has been developed or implemented, rather, the Tax Office relies on compliance by the larger taxpayers, and identification of actual or emerging issues associated with the LCT through the compliance activities undertaken for other taxes. It also relies on specific intelligence about individual entities being reported to it. Revenue analysis provides an indicator that actual amounts of LCT revenue collected are within acceptable margins of budget forecasts and estimates. Overall, the tax has low visibility for planning, reporting and compliance purposes across all areas in the ITX business line, and other business lines that manage elements of the tax.

12. While there are processes and mechanisms in place to administer this relatively small, low risk tax, there is still scope to better target and coordinate the Tax Office's administrative arrangements for planning, operational, reporting and compliance purposes. This could be achieved through process review and without necessarily applying additional resources to administering the LCT.

13. To this end, in March 2011, the Tax Office advised it is currently planning several changes to its future administrative arrangements supporting the LCT. These include transferring responsibility for managing LCT risks within the ITX business line; enhanced documentation of LCT discussion at the GST Product Committee; additional analysis of LCT revenue performance and reviewing aspects of the arrangements with Customs.

14. These measures have the potential to better coordinate the Tax Office's administration of the LCT and improve key compliance approaches. The ANAO has made one recommendation aimed at improving the planning and reporting of the LCT.

Key findings by chapter

Governance (Chapter 2)

15. The ITX business line has primary responsibility for the management of the LCT, although other business lines also have responsibility for some aspects of the tax. For governance and operating purposes, the GST and Excise business lines were amalgamated in July 2010, creating the Indirect Tax (ITX) business line. While there has been little immediate change as a result of this re-structure, the new business line aims to better align the Tax Office's administration of indirect taxes over the longer term.

16. The Tax Office has adequate structural arrangements to undertake all aspects of LCT administration, but lacks a coordinated approach to the overall management of the end-to-end process. The LCT has low visibility for planning and operational purposes, and there is minimal or no reference to the tax in the majority of planning documents prepared by the various functions and segments in the ITX business line.

17. Similarly, the LCT has minimal profile for reporting purposes with only one aspect of the tax, revenue performance, reported on a regular basis. LCT revenue performance is reported on a monthly basis to the GST Product Committee, the ITX Executive; and was included in the GST 2009–10 HOTSA.[3] The amount of LCT revenue collected each year is included in the Tax Office's annual report.

[3] Compliance Sub-plan Health of the system assessment (HOTSA).

18. Responsibility for ensuring a co-ordinated end-to-end process for LCT administration rests with the GST Product Committee. While the committee may give appropriate attention to the administration of the tax, more explicit reference to and documentation of discussions relating to LCT matters at these meetings may be beneficial.

19. In relation to LCT, the risks associated with taxpayers' non-compliance with their tax obligations was most recently assessed in November 2009, and resulted in a 'low' rating. The risk assessment considered LCT taxpayers' profiles, revenue performance analysis, and audit results. While the assessment acknowledged that some taxpayers were engaging in behaviour to minimise or avoid their LCT obligations, the residual risk was not considered material to either loss of revenue or reputational risk to the Tax Office. It was considered appropriate for this residual risk to be managed by the then Complex Audit area as part of the serious evasion risk. This risk assessment has shaped the Tax Office's current approach to LCT compliance. However, previous work undertaken by the motor vehicle industry teams suggested the risk may be higher.

Administrative arrangements between the Tax Office and Customs

20. Customs collects a small percentage of total LCT revenue, but plays an important role in monitoring the importation of luxury vehicles and identifying importers with an LCT liability. The MoU between the organisations sets out arrangements for the administration of indirect taxes, including the LCT. The MoU is due to expire in June 2011, and arrangements between the organisations are currently under review. This will give both agencies the opportunity to identify the most efficient use of the data and information available to each of them.

21. Customs assesses compliance risks associated with LCT revenue collection through quarterly monitoring reports prepared by the Compliance Data Monitoring Team. The data shows a consistency in LCT collections over time, and in line with broader economic trends that impact on the importation and purchase of luxury goods, including luxury cars. Combined with profiling individual importations through its Integrated Cargo System, Customs applies a 'low' rating to both revenue and compliance risk in relation to the LCT it collects.

Managing compliance (Chapter 3)

Interpretative assistance and advice

22. Since the implementation of the LCT in 2000, the overall nature and low volume of requests for interpretative assistance, including for private binding rulings, infers that taxpayers have a good understanding of the tax and its application, including during the period of LCT legislative amendments introduced in 2008. The majority of the requests relate to new vehicle design features, or where modifications to a car may affect its classification for LCT purposes.[4]

23. Industry associations and taxpayers contacted as part of the audit were satisfied with the volume and timeliness of guidance material and information available about the LCT, from both the Tax Office and Customs. They were also confident about the application of the tax, and commented that it was well understood across the industry.

LCT risk assessment

24. As previously noted, the Tax Office has assessed the overall level of compliance risk associated with the LCT as 'low', and has undertaken minimal compliance planning and compliance activities in relation to the tax across all market segments. Rather, the Tax Office relies on actual or emerging risks about taxpayers' compliance with their LCT obligations being identified through intelligence gathering or anomalies in payment or refund patterns. Where appropriate, these issues are referred for follow-up by Active Compliance staff, or for consideration by the relevant risk committee. LCT revenue performance is reported monthly, and benchmarking is undertaken on a quarterly basis to monitor the higher level or 'macro' risk associated with the tax.

25. During the course of the audit, the Serious Evasion team finalised an intelligence plan outlining a number of activities that would enable the Tax Office to better understand and determine the extent and nature of the residual risk of taxpayers' non-compliance with the LCT. The plan details a number of measures to examine the extent of serious evasion behaviour

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4 A Private Binding Ruling (PBR) issued in July 2010 dealt with a four-wheel drive vehicle that had been modified with a drop-side body to accommodate commercial goods carrying, prior to sale, delivery and registration.

exhibited by prestige[5] or luxury motor vehicle dealers, and where individual taxpayers may be operating outside of the system with regard to their tax affairs, including their LCT obligations. The plan also provides a review of some LCT administrative and data collection processes. The Serious Evasion team is scheduled to present its findings to the GST Risk Management sub committee by June 2011.

LCT revenue performance analysis

26. LCT accounts for approximately 0.15 to 0.19 per cent of the Tax Office's total annual revenue collection, and the overall low level of specific compliance activity is justified primarily on the basis of revenue performance analysis. This analysis is based on an estimate of LCT revenue calculated from the Federal Chamber of Automotive Industries (FCAI) new vehicle sales data, VFACTS. Benchmarking VFACTS data against actual LCT collections enables an assessment of LCT revenue trends over time.

27. For the most recent LCT compliance risk assessment conducted in November 2009, the Tax Office also assessed the macro revenue risk associated with the tax by calculating a theoretical amount of LCT payable based on states' and territories' motor vehicle sales and registration data for the previous year. The estimates for 2007–08 were compared with accrued LCT liabilities, and indicated a two to three per cent variance between estimated and actual revenue collections for the year, which is well within the Tax Office's margin of acceptable risk.

28. The Tax Office advised that combined estimates calculated from VFACTS and states' and territories' sales and registrations data can provide both trend and point-in-time estimates, and enable a more reliable assessment of LCT revenue performance. However, the more detailed assessment undertaken for 2007–08 was not applied in subsequent years. Consequently, monitoring of LCT revenue performance for the past two years had been based solely on revenue estimates calculated using the VFACTS data. The Tax Office has now extended its analysis for 2009–10, based on both FCAI and states' and territories' data, and advised that this additional analysis will be undertaken in future years.

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5 For the purposes of this Intelligence Plan, prestige motor vehicle dealers are dealing in motor vehicles with a minimum value of $100 000 and less than two years old.

Managing LCT registrations

29. Over the life of the LCT to September 2010, a total of 1692 clients[6] had an LCT account with the Tax Office, of which approximately 58 per cent, or 1000 taxpayers, report an LCT liability on their BAS in any one year. In 2008–09, 904 taxpayers paid LCT, and 922 taxpayers did so in 2009–10.

30. The Tax Office applies four indicators to LCT registrations: active, inactive, cancelled and not reporting. However, it does not actively manage taxpayers' changing status, or undertake any analysis of why a taxpayer may register for LCT and then not make a payment.

31. Legislation pertaining to the LCT[7] sets out no requirements for registering for the tax other than the taxpayer having a current ABN and GST registration. In administering the LCT, the Tax Office does not apply any additional measures to verify the registration. A business entity with no prior or current dealings in motor vehicle sales can register for LCT.

32. Potential risks associated with LCT registrations have been identified in several Tax Office intelligence scans, including the December 2010 serious evasion intelligence plan. Potential risks primarily include: abuse of the quoting mechanism to avoid LCT obligations; entities registered for LCT but not reporting any transactions; and entities that should register for LCT but do not. The Tax Office acknowledged a 'weakness' in the system for the registering and managing of LCT accounts, and is investigating these matters in the process of implementing the December 2010 intelligence plan.

Pre-refund integrity checks

33. Compliance risks associated with the LCT are managed to a limited extent by the Pre-refund Integrity team within the ITX business line's Risk and Intelligence stream.

34. Pre-refund integrity checking for the LCT is 'low' on a hierarchy of general compliance tests applied in the pre-refund environment. A taxpayer's LCT liabilities may be reviewed if there is an anomaly in other fields of the BAS, for example with the taxpayer's GST amounts. Where no other issue with the BAS is identified, LCT refund checking is limited to a review of the two

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6 Tax Office statistics. Taxpayers engaging in a taxable supply of a luxury vehicle must register their liability for LCT.

7 *A New Tax System (Luxury Car Tax) Act 1999, sub-section 2-10.*

LCT fields in the BAS. Also, checking will only occur where a taxpayer has a net LCT credit, that is, when the LCT refund claim exceeds the LCT payable.

35. The Tax Office advised that accurate data on the number and value of LCT adjustments as a result of pre-refund checking and reviews on other fields of the BAS is not readily available, but estimated that those adjustments raised net LCT liabilities of $482 780 in 2008–09 and $83 367 in 2009–10.

36. While a low percentage of adjustments suggests few compliance problems, net refunds alone are not a meaningful indicator from a compliance perspective. Existing LCT refund checking focused on net LCT credits is therefore likely to overlook other instances of non-compliance, such as those that may be indicated by a substantial reduction in LCT paid compared to previous periods.

Active Compliance

37. Minimal compliance planning is undertaken for LCT, and the resulting compliance activity is relatively ad hoc in comparison to other taxes where specific compliance risks are identified and targeted. Limited data is available on the overall volume and type of compliance activity undertaken for the LCT across all market segments. However, the November 2009 risk assessment reported that 56 compliance audits undertaken across 17 industries resulted in $4.6 million in LCT liabilities.

38. The report also refers to compliance activities undertaken for the full year 2008–09 in relation to 75 taxpayers. During this period, 17 adjustments resulted in net LCT liabilities of $860 683 being raised. Figures published for 2009–10 report $7.2 million in adjustments was raised through active compliance activities.[8] However, this amount included one large transaction in excess of $5 million where a refund was calculated in error and re-assessed by the taxpayer to a net LCT payable amount.

[8] Tax Office, *2009–10 Commissioner of Taxation Annual Report*, p. 88.

Summary of Tax Office response

39. The Tax Office's summary response to the report is reproduced below. The full response is at Appendix 1.

> The Tax Office agrees with the ANAO recommendation to enhance planning and internal reporting processes for the LCT.
>
> The Tax Office is pleased with the audit findings that industry associations and taxpayers understand the tax and that they are confident about its application.
>
> The Tax Office's overall assessment of compliance risk relating to LCT is generally low, but we continue to monitor and investigate instances of egregious behaviour, particularly in relation to prestige motor vehicles.

Recommendation

Recommendation No.1

Para 2.14

To support a more co-ordinated approach to administering the LCT, the ANAO recommends that the Tax Office enhances its planning and internal reporting processes for the tax.

Tax Office Response: Agreed.

Audit Findings

1. Introduction

This chapter provides an overview of the Luxury Car Tax, and outlines the audit approach.

Background

1.1 The Australian Taxation Office (Tax Office) is the Australian Government's principal revenue collection agency, with responsibility for the effective administration of Australia's tax and superannuation systems. In 2009–10, the Tax Office collected $253.2 billion in net cash from taxpayers, incurred operating expenditure of $3.1 billion and had around 22 000 staff across 58 locations in Australia.[9] The Luxury Car Tax (LCT) is one of a range of taxes administered by the Tax Office.

Car market in Australia

1.2 Australians purchase approximately one million new motor vehicles each year, including both imported and domestically manufactured vehicles, with around ten per cent of these sales, or 100 000 vehicles, being luxury cars.[10]

1.3 For 2007 and 2008, 1.05 million and 1.01 million new vehicles were sold respectively, including passenger cars, sports utility vehicles (SUVs) and commercial vehicles. In 2009, sales fell by 7.4 per cent to 937 328, reflecting the general downturn in the overall car market during the global financial crisis (GFC). Total sales of new motor vehicles for 2010 were 1 035 574, a 10.5 per cent increase on 2009 sales indicating a recovery in the volume of sales to pre-GFC levels.[11]

1.4 The LCT is the only Australian Government tax imposed on the taxable supply or importation of goods or services designated as luxury.

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9 Tax Office, *2009–10 Commissioner of Taxation Annual Report*, p.vi.

10 Parliament of Australia, Department of Parliamentary Services, *Bills Digest*, 13 June 2008. Nos 131–134.

11 Federal Chamber of Automotive Industries (FCAI) available from <www.fcai.com.au> [accessed 23 February 2011].

Luxury Car Tax

1.5 The LCT[12] came into effect on 1 July 2000, when the Australian Government introduced the Goods and Services Tax (GST) into the Australian system of taxation. For LCT purposes a 'luxury car' is a car with a GST-inclusive value above a specific threshold that is designed to carry fewer than nine passengers and a load of less than two tonnes.

1.6 Prior to the introduction of the GST, a 22 per cent wholesale sales tax applied to cars generally, while a 45 per cent wholesale sales tax applied to luxury cars. With the abolition of the wholesale sales tax, the introduction of the LCT in addition to the GST on luxury cars maintained a substantially higher rate of taxation on this category of vehicle.

1.7 Table 1.1 shows the most popular cars exceeding the LCT threshold as determined by the number of sales in 2010.

Table 1.1

Most popular vehicles exceeding the LCT threshold

Rank	Model Group	Sales
1	Toyota Prado	15 423
2	Toyota Landcruiser Wagon	7 273
3	Holden Commodore	6 749
4	Mercedes-Benz C-Class	6 658
5	Mitsubishi Pajero	5 065
6	BMW 3 Series	4 943
7	BMW X5	3 105
8	Toyota Kluger	2 731
9	Audi A4	2 652
10	Mercedes-Benz M-Class	2 589

Source: Federal Chamber of Automotive Industries.

1.8 The LCT does not apply to prescribed emergency vehicles and vehicles purchased for use by people with a disability. Legislative changes implemented in 2008 increased the applicable rate of the tax and introduced a rebate scheme for eligible primary producers and tourism operators.

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12 *A New Tax System (Luxury Car Tax) Act 1999*.

1.9 Key features of the LCT are outlined in Figure 1.1.

Figure 1.1

Key features of the LCT

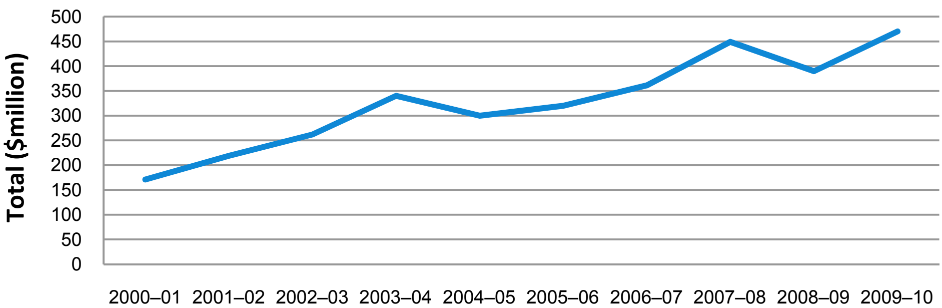
Key features of the LCT include that it:
• is paid to the Tax Office or the Australian Customs and Border Protection Service by car retailers, wholesalers and manufacturers of cars, and importers;
• applies to new and used cars sold at a price exceeding the relevant LCT threshold;
• is currently assessed at the rate of 33 per cent on the value in excess of the LCT threshold;
• is indexed annually using the motor vehicle purchase component of the Consumer Price Index;
• has a higher LCT threshold for vehicles meeting fuel efficiency standards (being $75 375 in 2010–11);
• incorporates a primary producer and tourist operator rebate scheme; and
• is reported on the Business Activity Statement (BAS) of entities registered for GST.

Source: ANAO analysis of Tax Office information.

1.10 From the implementation of the tax in July 2000 to June 2010, collections from the LCT contributed a total of $3.2 billion to Australia's taxation revenue (see Figure 1.2). This figure included $472 million for 2009–10,[13] with further increases expected in subsequent years, reflecting the improved outlook for Australia's economic recovery and an expected increase in motor vehicle sales generally.[14]

Figure 1.2

Luxury car tax collected since 2000



Source: ANAO analysis of Tax Office data and Budget papers.

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13 Tax Office, *2009–10 Commissioner of Taxation Annual Report*, p. 88.

14 The *2010–11 Federal Budget,* Budget Paper 1, Revenue Statement 5, p. 23.

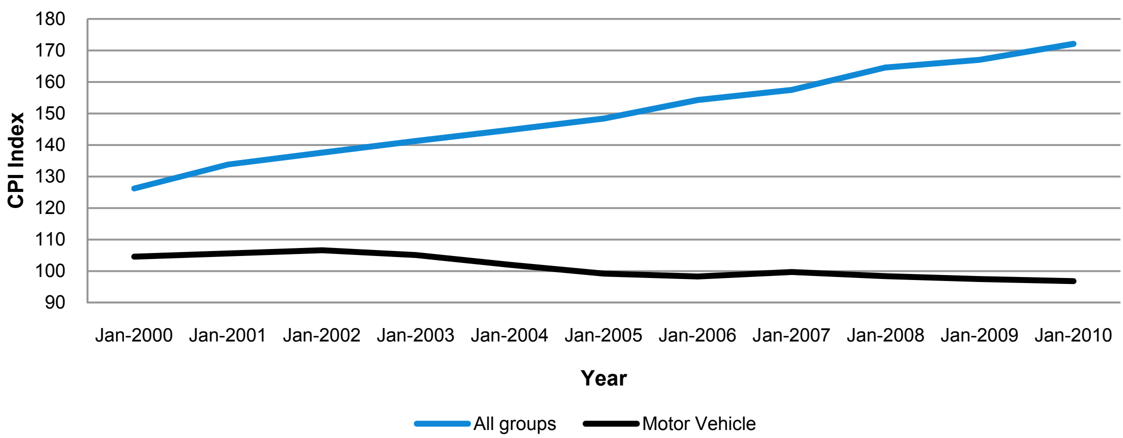
The LCT threshold

1.11 The LCT threshold is indexed annually using the motor vehicle purchase component of the Consumer Price Index (CPI), and has increased from an initial $55 134 in 2000, to $57 466 on 1 July 2010.[15] This reflects the slow growth in the price of motor vehicles in recent times, and the industry has reported that the proportion of vehicles subject to the luxury car tax has quadrupled over time from around 2.5 per cent of vehicles in 1979 to more than 11 per cent in 2010.[16]

1.12 Figure 1.3 charts the motor vehicle purchase component of the CPI compared to overall CPI.

Figure 1.3

Motor vehicle component of the CPI



Source: Australian Bureau of Statistics.

1.13 The changes to the legislation in 2008 also introduced a higher LCT threshold for vehicles meeting fuel efficiency standards, defined as seven litres of fuel consumed per 100 kilometres.[17] For 2010–11 the LCT threshold for cars meeting fuel efficiency standards is $ 75 375, increasing from $75 000 in 2008.

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15 The CPI is composed of observed price movements for new vehicles sold in Australia. If the change in the motor vehicle purchase component of the CPI is negative, the threshold is not reduced. The *2008–09 Federal Budget,* Budget Paper 1, Revenue Statement 5, p. 52.

16 FCAI, submission to the *Review of Australia's Future Tax system, March 2009.*

17 For further information see <www.greenvehicleguide.gov.au> [accessed 23 February 2011].

1.14 A Private Binding Ruling (PBR)[18] was issued by the Tax Office in July 2010 that further defined the 'fuel efficient' classification in relation to the LCT threshold. The PBR explained that the higher fuel efficient threshold would apply to a new fully electric vehicle to be introduced into the Australian market.

1.15 In the 2007–08 budget, the Government announced an increase in the LCT rate from 25 to 33 per cent, effective 1 July 2008. Transitional arrangements were implemented, subject to when the car was ordered and when it was delivered. Generally, cars delivered or imported before 1 July 2008 and between 1 July and 3 October 2008 (the period of transition to the increased rate of taxation) were taxed at 25 per cent. For all luxury cars delivered or imported after 3 October 2008, LCT is applied at 33 per cent.

Process for calculating the LCT

1.16 The calculation of the LCT involves a number of steps. LCT applies to cars with a GST-inclusive value that exceeds the LCT threshold. While LCT is payable in addition to GST, it is not payable on the full value of the vehicle. LCT is payable on the GST-exclusive portion of the value of the vehicle above the specific LCT threshold. Taxpayers must calculate the amount of GST which applies above the LCT threshold, and deduct that amount prior to calculating the LCT.

1.17 Similar calculations arise when a luxury car, on which LCT was previously paid, is sold again in a taxable dealing. On the subsequent sale, the previous amount of LCT must be taken into account and subtracted from the original sale price, before the new LCT amount is calculated. LCT on the sale of a luxury car is payable on any subsequent taxable supply of the car up to two years after the initial sale.

LCT collections and taxpayer profile

1.18 The LCT applies to luxury cars at the point of sale or importation. Any business that sells a luxury car, including car retailers, wholesalers and

[18] The Private Binding Ruling system aims to reduce uncertainty in the law by providing protection to taxpayers who act consistently with Tax Office binding advice. A Private Binding Ruling is the Tax Office's written opinion of how it will apply tax laws to an applicant's completed or proposed transactions.

manufacturers of cars must pay LCT. Importers of luxury cars, including private buyers, are also subject to LCT on their vehicles.

1.19 The LCT utilises the same administrative framework as the GST. LCT is accounted for in a GST registered entity's Business Activity Statement (BAS) and is for the same tax period that applies for GST. When the tax was introduced, the additional compliance impact of the measure was considered to be marginal, as taxpayers do not have additional payment and administrative obligations, over and above their GST returns.

1.20 Car manufacturers and dealers in luxury cars will have an Australian Business Number (ABN), will be registered for GST and will account for LCT liabilities at specific LCT labels in their BAS returns. Importers of luxury cars are able to quote[19] their ABN to the Australian Customs and Border Protection Service (Customs) and defer payment of LCT if they intend to use the car for a quotable purpose, such as holding the car as trading stock. LCT becomes due and payable when the luxury car is sold or it is no longer used for a quotable purpose.

1.21 At September 2010, 1692 taxpayers had registered an LCT account with the Tax Office since the implementation of the tax. However, total annual LCT revenue is typically paid by less than 1000 taxpayers, (approximately 59 per cent of those taxpayers with an LCT account). The tax is also relatively concentrated, with almost 84 per cent of the total LCT revenue collected being paid by the top 100 LCT taxpayers in 2009–10.

LCT rebate scheme

1.22 The primary producer and tourist operator rebate scheme introduced in 2008 enables registered primary producers and tourist operators (as defined by ANZSIC codes)[20] to claim refunds on a portion of the LCT they have paid on vehicles meeting the criteria for the rebate. This is the difference between the current LCT rate of 33 per cent and the previous LCT rate of 25 per cent. The maximum rebate is $3000 for one eligible car purchased or leased in a financial year for primary producers, and for all eligible cars for tourism operators. The rebate is considered to be ordinary income, cannot be claimed through

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[19] Quoting is a mechanism to defer LCT to a later assessable dealing or to give effect to exemption from the tax for a particular type of vehicle.

[20] ANZSIC codes: Australia and New Zealand Standard Industrial Classification codes.

taxpayers' BAS returns, and must be included in assessable income on producers' and operators' income tax returns.

Administration of the LCT

1.23 The LCT is collected and administered by the Tax Office and Customs. Specifically:

- the Tax Office collects LCT for the Australian domestic market and most imports, where payment of LCT has been deferred at point of entry; and
- Customs collects LCT on behalf of the Tax Office on some imports.

Administration by the Tax Office

1.24 As Australia's principal revenue collection agency, the Tax Office has primary responsibility for administering the LCT, including for compliance arrangements. At a policy level, the Department of the Treasury has responsibility for LCT legislation.

1.25 Tax Office staff with responsibility for LCT revenue collection and compliance matters are primarily located within the Indirect Tax (ITX) business line[21], although some aspects of the tax are administered in other areas of the Tax Office. The Tax Office staff are located in Canberra, Melbourne, Sydney, Adelaide and Brisbane.

Administration by Customs

1.26 Customs manages the security and integrity of Australia's borders. It works with other government and international agencies to detect and deter the unlawful movement of goods and people across the border.

1.27 With respect to the LCT, Customs helps with inquiries relating to the calculation of the LCT at importation and collects the LCT on imported vehicles at the border. However, car dealers and other businesses importing luxury vehicles typically quote their ABN and postpone payment until after the vehicle is sold.

[21] The Indirect Tax business line was established in July 2010, following an amalgamation of the Excise and GST business lines.

LCT and *Australia's Future Tax System* review

1.28 In May 2008, the Treasurer announced a review into Australia's future tax system, with a final report being delivered to the Government on 2 May 2010. Recommendation 80 of the review called for the LCT to be abolished:

> In the current Australian context, a tax on luxury cars is not a desirable means of raising revenue. It discriminates against a particular group of people because of their tastes. It is not an effective way of redistributing income from rich to poor. Its design is complex and becoming more complex over time.[22]

1.29 The response from the motor vehicle industry was that it supported the recommendation to remove the LCT, agreeing with the view that the LCT acts as a tariff and is a barrier to trade.[23] Motoring bodies also regard the tax as a deterrent for new energy efficient and 'greener' cars, as the development and design of luxury cars is often at the forefront of new technology.

1.30 In its response to the recommendation, the Government ruled out abolishing the LCT or changing the taxation rate or applicable thresholds of the tax, 'in the interests of business and community certainty'.[24]

Draft legislative amendments

1.31 On 18 January 2011, the Assistant Treasurer released an exposure draft of legislative amendments to harmonise the existing self-actuating system for the GST, Wine Equalisation Tax, LCT and fuel tax credits, with the income tax system of self assessment.[25] The changes will be implemented on

[22] The Treasury, *Australia's future tax system – Report to the Treasurer,* December 2009, p. 476.

[23] Hassall, D, *LCT fight not over – Mercedes Benz*, <www.GoAutoNews.com.au> [accessed 31 October 2008].

[24] Swan, W, (Treasurer), 2010 *Stronger, Fairer, Simpler: A Tax Plan for Our Future,* media release, *Parliament House,* Canberra, 2 May.

[25] Under an assessment system of taxation, a taxpayer's tax liabilities and entitlements are determined by an assessment made by the Tax Office, whereas in a self-actuating system, a taxpayer is automatically liable to pay or entitled to a refund of indirect tax based on the liabilities and entitlements attributable to a tax period. Other differences include the period of review during which the Commissioner may amend a taxpayer's assessment in the self-assessment system; in a self-actuating system a limitation period applies after which time the Commissioner and the taxpayer may no longer require payment of any liabilities or entitlements.

1 July 2011, and give effect to the recommendations made in the Board of Taxation's review of the GST.[26]

Audit approach

Audit objective and scope

1.32 The objective of the audit was to assess the effectiveness of the Tax Office's administration of the LCT, including aspects of the tax administered by Customs on behalf of the Tax Office. Particular emphasis was given to the Tax Office's:

- governance arrangements for the LCT; and
- approach to managing taxpayers' compliance with their LCT obligations.

Audit methodology

1.33 The ANAO conducted fieldwork in the Tax Office's Moonee Ponds, Dandenong and Canberra offices between September 2010 and January 2011, as well as Customs offices in Melbourne and Canberra. This included a review of relevant LCT documentation and interviews with staff from the ITX business line.

1.34 The ANAO also consulted with a range of stakeholders including the Federal Chamber of Automotive Industry (FCAI), and several motor vehicle importers, dealers and manufacturers.

1.35 The audit was conducted in accordance with ANAO auditing standards at a cost of $171 000.

Acknowledgements

1.36 The ANAO appreciates the assistance provided by Tax Office and Customs officers and industry contributors in undertaking this audit.

Report structure

1.37 The structure of the report reflects the audit criteria outlined in paragraph 1.32. In particular, they examine whether the Tax Office had effective arrangements in place for:

- governance (Chapter 2); and
- managing compliance with legislative requirements (Chapter 3).

[26] Review of the Legal Framework for the Administration of the GST, The Board of Taxation, May 2009.

2. Governance Arrangements

This chapter examines the governance arrangements underpinning the Tax Office's administration of the Luxury Car Tax.

Introduction

2.1 The Tax Office has adopted a matrix approach in developing its corporate governance framework. This framework combines key elements of the organisation's management, planning and reporting processes.

2.2 High-level management is provided by a senior leadership group and through the senior executive reporting structure. Collectively, they have responsibility for managing a number of business and service lines designed to deliver the Tax Office's outcome and output commitments to government.[27] Planning, reporting and performance measures are linked through the development of a suite of corporate documents, which include the ATO plan[28], Annual Report, and various branch and line sub-plans.[29]

2.3 To assess the effectiveness of the Tax Office's administration of the LCT, the ANAO examined the following key aspects of the governance arrangements supporting the tax:

- administrative arrangements, planning and reporting; and
- assessment of compliance risks.

2.4 As Customs collects, under a Memorandum of Understanding (MoU)[30], approximately one per cent of annual LCT revenue at the point of importation of a luxury vehicle, the ANAO also examined administrative arrangements in Customs.

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27 Tax Office, *2009–10 Commissioner of Taxation Annual Report*, p.119.

28 ATO plan 2010-11, provides a high-level outline of all the work the Tax Office intends to undertake in the financial year, and includes performance measures against deliverables. The strategies outlined in the plan cascade down into the sub-plans and ultimately to tasks at the individual level for Tax Office staff.

29 Australian Tax Office management arrangements, file ref:05/8799, April 2010, available from <www.ato.gov.au> [accessed 23 February 2011].

30 Memorandum of Understanding between the (then) Australian Customs Service and the Australian Taxation Office,1 July 2008–30 June 2011. ATO ref: MoU 08.018.

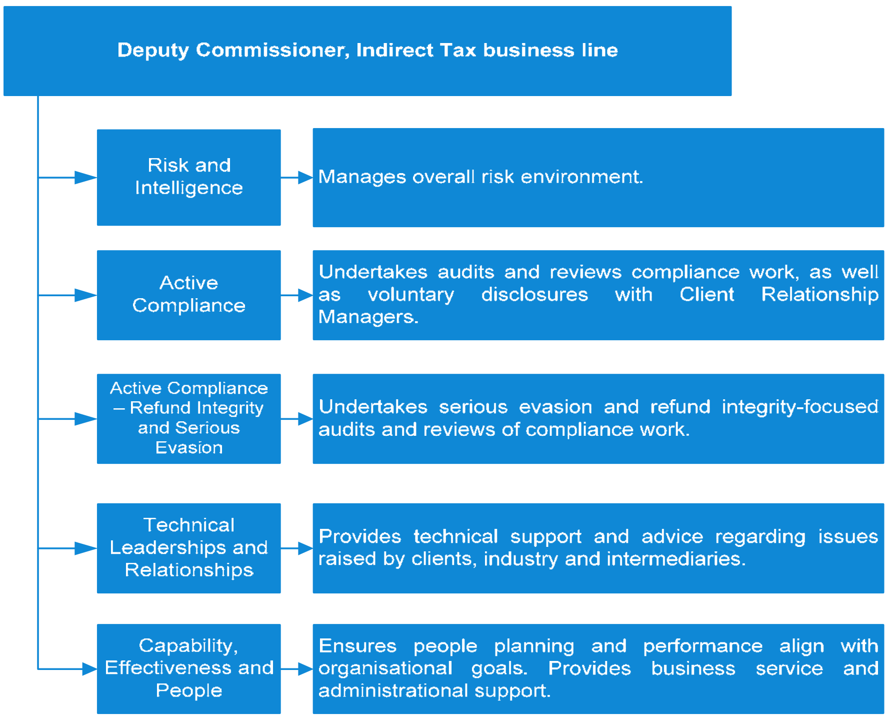
Administrative arrangements in the Tax Office

2.5 Administration of the LCT is currently managed through the Indirect Tax (ITX) business line, although some elements of the tax are administered in other areas of the Tax Office. For governance and operating purposes, the GST and Excise business lines were amalgamated in July 2010, creating the ITX business line. While there has been little immediate change as a result of this re-structure, the new business line aims to better align the Tax Office's administration of indirect taxes over the longer term.[31]

2.6 The management structure and planning processes in the ITX business line combine specialist services and market segments, as shown in Figure 2.1. Under these arrangements, administration of the LCT is divided across functional branches and teams, and is operating from Tax Office premises in many Australian centres.

Figure 2.1

Structure of the Indirect Tax business line.



Source: Tax Office November 2010.

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31 Tax Office, *Indirect Tax line plan 2010–11*, p. 7.

2.7 Administrative arrangements for the LCT have changed since the introduction of the tax. In 1999, a small team (referred to as the LCT team) was established to oversee the implementation and 'early years' of the tax, and provided a centre of expertise for monitoring and planning purposes until late 2005. This small team was then absorbed into specialised motor vehicle industry teams based in Victoria and South Australia. These teams maintained their focus on the motor vehicle industry, and contributed to taxation risk assessments and compliance monitoring across the industry, including for the LCT.

2.8 The current administrative arrangements for the LCT took effect in 2008, when the Tax Office moved to a functional rather than an industry or product-based structure, and the motor vehicle industry teams were effectively disbanded. Client Relationship Managers (CRMs) still provide assistance to the industry, and have a role in monitoring compliance by large clients. The CRM arrangement is well suited to the administration of LCT, given the relatively high degree of concentration of taxpayers (as discussed in Chapter 1).

2.9 The formation of the ITX business line is a further iteration of the management structure responsible for administering excise and indirect taxes. While this business line manages most aspects of the LCT, registration, refunds, payment and debt are the responsibility of other business lines within the Operations sub-plan. Lodgments are the responsibility of the Tax Practitioner and Lodgment strategy (TPALS) business line. The GST Product Committee has overall responsibility for the management of the LCT and other areas in the Tax Office also have some involvement in LCT administration, including the Information Communication and Technology business line, and the Revenue Analysis Branch (RAB).

2.10 The Tax Office has adequate structural arrangements to undertake all aspects of LCT administration, but could apply a more coordinated approach to the overall management of the end-to-end process. The LCT has low visibility for planning and operational purposes and there is minimal or no reference to the tax in the majority of planning documents prepared by the various functions and segments in the ITX business line.

2.11 Responsibility for co-ordination of the end-to-end process rests with the GST Product Committee. While the committee may give appropriate attention to the administration of the tax, the Tax Office acknowledged there is scope for more explicit reference to and documentation of the discussion of LCT matters occurring at these meetings.

2.12 Similarly, the LCT has minimal profile for reporting purposes, with only one aspect of the tax, revenue performance, reported on a regular basis. LCT revenue performance is reported on a monthly basis to the GST Product Committee, the ITX Executive; and was included in the GST 2009–10 revenue product HOTSA.[32] The amount of LCT revenue collected each year is reported in the Commissioner of Taxation's Annual Report.

2.13 The LCT accounts for approximately 0.15 to 0.19 per cent of total taxation revenue collected each year, and the Tax Office allocates resources according to competing priorities. However, the ANAO considers that enhanced planning and reporting processes would support a more coordinated approach to administrating the LCT without making an unreasonable demand on existing resources, and has made one recommendation to this effect. It would also provide senior staff across the various functions and market segments with a clear 'line-of-sight' to the LCT, assisting them to fully explore synergies across the broader revenue streams, and monitor the risk rating on a more timely basis.

Recommendation No.1

2.14 To support a more co-ordinated approach to administering the LCT, the ANAO recommends that the Tax Office enhances its planning and internal reporting processes for the tax.

Tax Office response

2.15 *Agreed.* The Tax Office has already enhanced the documentation of LCT reporting at GST Product Committee meetings.

Compliance risk assessment arrangements for LCT

2.16 The Tax Office seeks to build confidence in its administration of taxation legislation through helping people to understand their rights and obligations, improving ease of compliance and access to benefits, and managing non-compliance with the law.[33] The risk of taxpayers' non-compliance with their taxation responsibilities is determined using an enterprise risk framework.

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[32] Tax Office, Compliance Sub-plan Health of the system assessment (HOTSA).

[33] ATO publication: *Making a difference – the intent behind our Strategic statement 2010-15* booklet, p. 2.

2.17 The Tax Office's Enterprise Risk Management Framework[34] examines risk through a number of lenses, enabling the office to assess the extent of the risks across the economy and to develop a range of remedial responses that are proportionate and appropriate to address the underlying areas of concern.[35]

2.18 In relation to LCT, the risks associated with taxpayers' non-compliance with their tax obligations was most recently assessed in November 2009, and resulted in a 'low' rating. The risk assessment considered LCT taxpayers' profiles, revenue performance analysis, and audit results. While the assessment acknowledged that some taxpayers are engaging in behaviour to minimise or avoid their LCT obligations, the residual risk was not considered material to either loss of revenue or reputational risk to the Tax Office. It was considered appropriate for this residual risk to be managed by the then Complex Audit area as part of the serious evasion risk. This risk assessment has shaped the Tax Office's current approach to LCT compliance.

2.19 The Tax Office has a number of mechanisms in place to manage and monitor the level of compliance by LCT taxpayers. It is in the process of transferring responsibility for managing LCT risks to the area within Indirect Tax Risk and Intelligence that has responsibility for managing the Wine Equalisation Tax (WET) and the various smaller Excise schemes. This area, which was previously part of the Excise business line and is now part of the newly created ITX business line, has experience in managing the risks associated with smaller taxes, and will support better co-ordination of the management of LCT risk.

2.20 The changed administrative arrangements for the management of LCT risk provide an opportunity to review the individual components of the LCT risk framework, to assess the overall management and monitoring of the compliance risk associated with the LCT, and identify where they could be strengthened and/or updated. These issues are discussed further in Chapter 3.

Administrative arrangements between the Tax Office and Customs

2.21 A Memorandum of Understanding (MoU) between Customs and the Tax Office sets out the arrangements that relate to the importation or

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34 The Tax Office's Enterprise Risk Management Framework is an integrated risk management strategy linking tactical, operational and enterprise risk. The current version meets ISO 31000:2009 standards.

35 Commissioner of Taxation, Risk: The framework, the vision, the values. Presentation to the CPA Public Sector Finance and Management Conference, 12 August 2010.

exportation of goods under the provisions of Customs or Tax Office administered legislation, specifically for Excise, GST, LCT and WET.

2.22 The MoU applies for three years to June 2011, and is currently under review. While the audit did not examine the broader application of the MoU, the review process is an opportunity for the Tax Office and Customs to assess whether the processes in place could be improved.

2.23 The current MoU includes arrangements for the transfer of outstanding LCT taxpayer debts established by Customs. While the intent of the MoU was that debt of more than $10 000 or greater than 120 days outstanding should be transferred from Customs to the Tax Office, Customs advised that arrangements to facilitate this transfer have not been implemented. As at 30 November 2010, Customs was managing just over $800 000 of LCT debt, with several accounts outstanding for more than four years. The Tax Office has advised that it has commenced a program of work to implement the arrangements for the transfer of debts from Customs.

2.24 The MoU also outlines the requirements for the exchange of management information and data between the organisations. Customs provides the Tax Office with regular performance data on each of the four taxes covered in the agreement. The Tax Office maintains the Australian Business Register and this is uploaded each day into the Integrated Cargo System (ICS) [36] for Customs' verification of importers' ABNs.

2.25 The various data files received from Customs are used in a number of ways across the Tax Office, including for pre-populating GST activity statements. While information provided on the use and application of the LCT data was less specific, the Tax Office has advised that the LCT data stored in its data warehouse will be used in upcoming risk assessment and case profiling activities.

2.26 Customs advised that the same data elements for LCT[37] have been captured and transferred from Customs to the Tax Office since the implementation of the tax in 2000, although there is capacity within the ICS to further refine validation and data capture processes, including for LCT

[36] A new system for managing Australia's imports and exports, implemented by the (then) Australian Customs, 12 October 2005.

[37] Detailed design specifications for the Integrated Cargo System (ICS) project, ATO, 23 May 2007. Customs extracts and transfers four data elements from ICS related to LCT: LCT paid amount; LCT paid quantity; LCT quote quantity; and LCT Quote VOTI (value of the taxable import) amount.

transactions. The Tax Office provides Customs with the specifications for the performance data, and has advised that the design specifications will be reviewed.

Administrative arrangements in Customs

2.27 Customs is responsible for assuring that liabilities arising at the Australian border, including for LCT, are correctly reported, assessed, paid or deferred. Where an importer complies with quoting arrangements, Customs has no further responsibility with regard to the LCT.[38]

2.28 The ICS provides electronic transaction capability to importers and exporters in an integrated, end-to-end process for the movement of goods. Through ICS, importers can pay their LCT liabilities to Customs but entities typically postpone payment of LCT until they have lodged their BAS. As a consequence, the revenue collected by Customs on behalf of the Tax Office is relatively small, as shown in Table 2.1.

Table 2.1

LCT collected by Customs: 2000–01 to 2009–10, $m

2000–01	2001–02	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08	2008–09	2009–10
n/a	1.11	1.08	1.25	1.21	2.66	2.42	3.3	3.5	2.80

Source: Customs' annual reports (various).

2.29 For importation purposes, including all vehicle imports, cargo data is entered directly into ICS by Customs brokers, freight handlers, or registered ICS clients. The ICS cross-checks cargo data from initial loading to delivery, and profiles within the system alert Customs officers to inconsistencies in the details of the cargo, including vehicle valuations and LCT liabilities.[39] A decision is then made as to the appropriate follow-up action. While few

[38] MoU between the (then) Australian Customs Services and the Australian Taxation Office, section 1.7.8.

[39] The LCT profile programmed into ICS checks for vehicles with a value equal to and above the applicable LCT threshold. This figure is calculated using the base Free-on-Board price of the vehicle, plus duty, transport and insurance. Importers have to elect to pay LCT or to quote their ABN and defer payment of the tax. If neither option is selected, the import processing is blocked in ICS. Similarly, vehicles within a specified value range are profiled on several variables, including make, model and year of manufacture. Any anomalies are blocked and flagged in ICS for manual verification. These profiles were refined and included in ICS in early 2009. Where a taxpayer elects to pay LCT to Customs, the ICS calculates the amount.

Customs officers are based at the actual dock or bonded precinct, all cargo movements are under Customs' supervision and control.

2.30 The ANAO examined Customs' operational and processing arrangements for administrating the LCT including tracking cars unloaded from a cargo ship in Melbourne, reconciling individual vehicles to relevant import documentation in ICS, and viewing data extracted from ICS and included in monthly performance reports sent to the Tax Office.

2.31 Customs assesses compliance risks associated with LCT revenue collection through quarterly monitoring reports prepared by the Compliance Data Monitoring Team. The data shows a consistency in LCT collections over time, and in line with broader economic trends that impact on the importation and purchase of luxury goods, including luxury cars. Combined with profiling individual importations through ICS, Customs applies a 'low' rating to both revenue and compliance risk in relation to the LCT it collects.

Cost of administering the LCT

The Tax Office

2.32 The Tax Office's Program Framework provides cost information by deliverable and activity. In addition, the Tax Office's Strategic Costing Framework (SCF) uses the Program Framework to develop administrative costings for Income Tax, GST, Superannuation and Excise, and by market segment.

2.33 In 2009-10 the Tax Office's expenditure for administering the GST, of which LCT is a component, was $598.3 million from a total operating expenditure of $3087.1 million.[40] No detailed costing for the administration of the LCT is available.

Customs

2.34 Under the MoU, Customs receives a portion of the Tax Office's GST funding. The MoU between the two agencies sets out the process for determining amounts payable for Customs' services associated with Tax Office administrative responsibilities. For 2010–11 the Tax Office will make quarterly

[40] Tax Office, *2009–10 Commissioner of Taxation Annual Report*.

payments to Customs, totalling $53.9 million,[41] in relation to the administration of the Excise, GST, LCT and WET.

Compliance costs to industry

2.35 When the LCT was introduced and replaced the wholesales sales tax on luxury cars, the additional compliance impact of the measure was considered to be marginal. Taxpayers do not have additional payment and administrative obligations over and above their GST returns.

2.36 Car dealers interviewed were generally unconcerned with the cost of complying with the tax. However, comments from industry representatives included that:

- they regretted the demise of the specialist Motor Vehicle Industry teams, and compared the relatively lower levels of support they receive for LCT as a 'poor cousin' to the GST. One large dealership indicated they were unaware of the client relationship manager service provided through the Tax Office.
- changing the LCT threshold in their system and price scheduling mechanisms each year is not an insignificant task. They expressed concern over the relatively short notice provided to them of the applicable threshold for the forthcoming year, as well as the work involved in implementing a threshold change that resulted in a minor change to both the price of the vehicle and the LCT amount.

Conclusion

2.37 The Tax Office and Customs have adequate governance arrangements in place to undertake all aspects of LCT administration. However, governance arrangements that took effect in 2008, when the Tax Office moved to a functional rather than an industry or product-based structure, reduced visibility of the tax for planning and reporting purposes, and this environment has continued with the formation of the ITX business line. Responsibility for end-to-end administration of the LCT rests with the GST Product Committee. While the committee may give appropriate attention to the administration of the tax, more explicit reference to and documentation of discussions relating to LCT matters at these meetings may be beneficial.

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41 Information provided by Customs, January 2011.

2.38 The Tax Office currently applies a 'low' rating to the risk of taxpayers' non-compliance with their LCT obligations. There is scope to strengthen current governance and compliance arrangements for LCT, to better support the low risk assessment. The Tax Office is aware of this and is in the process of transferring responsibility for managing LCT risk to the area within the ITX business line with experience in managing smaller specialist taxes.

2.39 While Customs collects a small percentage of total LCT revenue, it plays an important role in monitoring the importation of luxury vehicles and identifying importers with an LCT liability. The MoU between the organisations sets out the arrangements for administering indirect taxes, including for the LCT. The MoU is currently under review and will give both agencies the opportunity to identify the most efficient use of the data and information available to each of them.

3. Managing Compliance

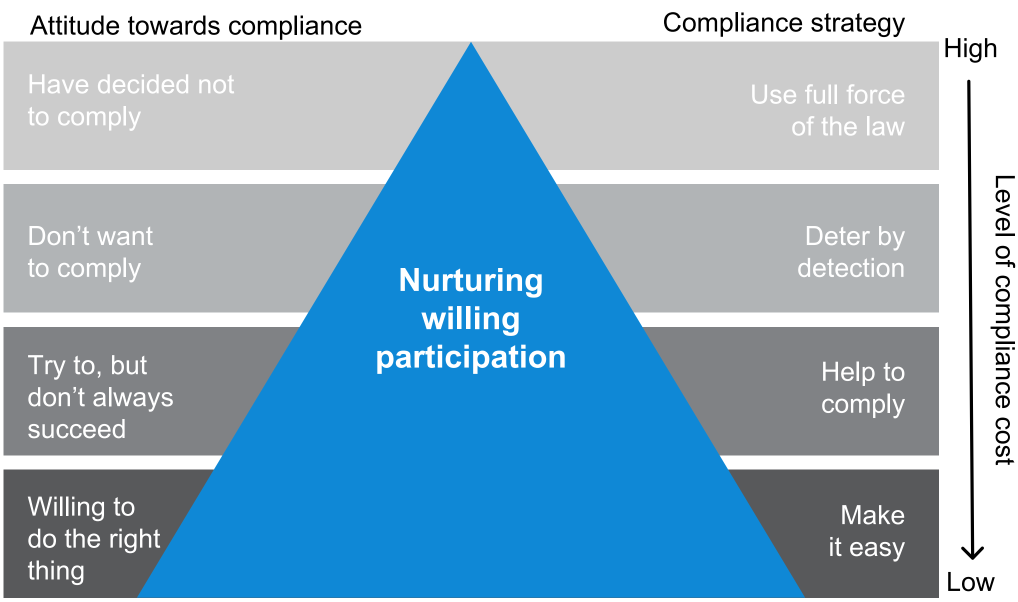
This chapter examines how the Tax Office gains assurance that taxpayers are complying with the legislative requirements of the Luxury Car Tax.

Introduction

3.1 In administering the taxation system, the Tax Office strives to provide an environment conducive to high levels of voluntary compliance with Australia's tax laws and community confidence in what they do. Subsequently, the Tax Office's approach to compliance is based on a model of taxpayer behaviour, which aims to better understand what motivates people to comply or not comply with their taxation obligations. The model assists the Tax Office to plan interventions that are proportionate and appropriate to address the underlying cause of non-compliance (see Figure 3.1).

Figure 3.1

The Tax Office's compliance model



Source: Tax Office Compliance Program 2010–11.

LCT Compliance risks

3.2 As discussed in Chapter 2, the Tax Office has assessed the overall level of compliance risk associated with the LCT as 'low', and has undertaken minimal compliance planning and compliance activities in relation to the tax across all market segments. Rather, the Tax Office relies on compliance by the large taxpayers in the industry who pay almost 84 per cent of total LCT revenue collections; and actual or emerging risks about taxpayers' compliance with their LCT obligations being identified through intelligence gathering or anomalies in payment or refund patterns. Where appropriate, these issues are referred for follow-up by Active Compliance staff, or for consideration by the relevant risk committee. Meanwhile, LCT revenue performance is reported monthly, and benchmarking is undertaken on a quarterly basis to monitor the high level or 'macro' risk associated with the tax.

3.3 Responsibility for managing LCT risks, as discussed in Chapter 2, is currently being transferred to the area within ITX Risk and Intelligence, which has responsibility for managing the WET and various smaller Excise schemes. In addition, the Serious Evasion team within ITX Risk and Intelligence continues to be responsible for managing the residual risk associated with evasion by some prestige motor vehicle dealers operating in the small to medium segments of the market.

3.4 Information to identify those risks stems from a range of internal and external sources, including: knowledge forwarded by client relationship managers and field audit staff; information from other areas in the Tax Office; referrals from other agencies such as Customs and the Australian Transaction Reports and Analysis Centre (Austrac); and information from state and territory jurisdictions.

3.5 During the course of the audit, the Serious Evasion team finalised an intelligence plan[42] outlining a number of activities that would enable the Tax Office to better understand and determine the extent and nature of the residual risk of taxpayers' non-compliance with the LCT. The plan details a number of measures to examine the extent of serious evasion behaviour exhibited by some prestige[43] or luxury motor vehicle dealers, and where

[42] ATO Intelligence Plan, Serious Evasion (Prestige Motor Vehicle Dealers), November 2010.

[43] For the purposes of this Intelligence Plan, prestige motor vehicle dealers are dealing in motor vehicles with a minimum value of $100 000 and less than two years old.

individual taxpayers may be operating outside of the system with regard to their tax affairs, including their LCT obligations.

3.6 The plan also provides a review of some LCT administrative and data collection processes. These include:

- taxpayers' LCT registrations;
- the application of state and territory motor vehicle data;
- working arrangements with Customs to better understand the procedures and processes required when a vehicle is imported; and
- the trigger points for serious evasion behaviour to commence.

3.7 The Serious Evasion team is scheduled to present their findings to the ITX Risk Management sub-committee by June 2011. The team also advised that any recommendations made in respect to the compliance risk associated with the LCT would take into consideration an earlier draft risk assessment prepared in July 2008[44] in response to work undertaken by the (then) South Australia Motor Vehicle industry team. This draft assessment indicated that the risk of taxpayers not complying with LCT obligations in the 'high end' of the luxury vehicle market was more widespread than the results of revenue performance analysis would suggest, and represented a greater risk to revenue as well as to reputational risk for the Tax Office.

3.8 GST Cash Economy audits undertaken at that time (early 2008) focused on the motor vehicle industry in South Australia. The audits found a number of instances where buyers in the market for luxury cars avoided paying LCT and/or over-claimed GST input tax credits on their purchase by engaging in evasive behaviours, such as quoting an ABN when purchasing a luxury car with no intention of holding the vehicle as trading stock.[45] At the time, South Australia represented less than eight per cent of the overall market in luxury vehicles and, based upon these figures, the draft risk assessment suggested that the budget risk nationally could be greater than previously estimated.

[44] Risk Assessment, Luxury Car Tax Arrangements, GST Risk and Strategy Across Market segment.

[45] Car dealers can quote their ABN when purchasing a luxury car, that is to be held as trading stock, and defer LCT liabilities to the point of the actual sale of the vehicle. Dealers who engage in behaviour to avoid taxation liabilities may quote their ABN while intending to make personal use of the vehicle.

3.9 In response to the risk assessment, a draft treatment plan and strategy was developed but not approved or implemented. An intelligence scan[46] linked to the 2008 risk assessment also noted that there was no national project or strategy to oversee the luxury car market.

3.10 The compliance risks associated with the LCT, and the approach to compliance planning for the tax, will be better defined when the Serious Evasion team present their report later this year.

Managing and monitoring compliance risks

3.11 The ANAO examined the five key areas of the Tax Office's approach to managing and monitoring the broader compliance risk associated with the LCT:

- providing interpretative assistance and advice;
- analysing LCT revenue performance;
- managing LCT registrations;
- use of client relationship managers;
- applying pre-refund integrity checks, and
- conducting specific LCT active compliance activities.

LCT interpretative assistance and advice

3.12 Taxpayers' voluntary compliance with taxation legislation is based on timely and accurate advice being received regarding obligations to the Tax Office, and recognises the importance of consistency and transparency in applying the law.

3.13 Since the implementation of the LCT in 2000, the overall nature and low volume of requests for interpretative assistance, including for private binding rulings, infers that taxpayers have a good understanding of the tax and its application, including during the period of LCT legislative amendments introduced in 2008. The majority of the requests relate to new

46 Intelligence scan LCT and associated risks, July 2007 and updated Feb 2009.

vehicle design features, or where modifications to a car may affect its classification for LCT purposes.[47]

3.14 A similar picture emerges from examining the volume and content of taxpayers' contact with the Tax Office through call centres and the LCT-specific email box. Anecdotal evidence from call centre staff and reports from a new reference management system[48] indicate a low volume of calls about LCT, with very few calls being sufficiently complex to escalate to a higher level of authority and expertise.

3.15 Overall, industry associations and taxpayers contacted as part of the audit were satisfied with the volume and timeliness of guidance material and information available about the LCT, from both the Tax Office and Customs. They were also confident about the application of the tax, and commented that it was well understood across the industry.

3.16 The main exception involved tourism operators and the rebate introduced with the July 2008 legislative amendments. Rebates claimed by tourism operators and primary producers require separate and direct claims to the Tax Office, as they cannot be processed through the taxpayer's BAS. These rebates are assessed and processed centrally in Adelaide. At 30 September 2010, 584 LCT claims had been submitted to the Tax Office since the rebate was introduced: 470 were issued to primary producers, 11 to tourism operators (representing 15 vehicles) and 99 claims were declined.

3.17 Eligible tourist operators contacted in the course of this audit commented that they did not know about the rebate and had relied on their tax agent or 'word of mouth' for information. The Tax Office has not considered the factors that may be contributing to the seemingly low uptake by tourist operators, and it may be useful for the Tax Office to consider a program of information sessions for tourism operators and their representatives.

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47 A Private Binding Ruling (PBR) issued in July 2010 dealt with a four-wheel drive vehicle that had been modified with a drop-side body to accommodate commercial goods carrying, prior to sale, delivery and registration.

48 SMART: Scripting management and reference tool. Implemented in Dec 2009, this system provides the volume of 'hits' by call centre staff on topic reference material. Further refinements of this tool will link it to Call Centre data and provide more refined management information on call centre volumes and topics.

LCT revenue performance analysis

3.18 As previously mentioned, LCT accounts for approximately 0.15 per cent of the Tax Office's total annual revenue collection. The low risk associated with taxpayer's non-compliance with their LCT obligations is primarily based on assurance provided through high-level analysis of LCT revenue performance.

3.19 This analysis is based on an estimate of LCT revenue calculated from the Federal Chamber of Automotive Industries (FCAI) new vehicle sales data, VFACTS.[49] Benchmarking VFACTS data against actual LCT collections enables an assessment of LCT revenue trends over time.

3.20 For the most recent LCT compliance risk assessment conducted in November 2009, the Tax Office also assessed the macro revenue risk associated with the tax by calculating a theoretical amount of LCT payable based on states' and territories' motor vehicle sales and registration data for the previous year. The estimates for 2007–08 were compared with accrued LCT liabilities, and indicated a two to three per cent variance between estimated and actual revenue collections for the year, which is well within the Tax Office's margin of acceptable risk.

3.21 The Tax Office advised that combined estimates calculated from VFACTS and states' and territories' sales and registrations data can provide both trend and point-in-time estimates, and enable a more reliable assessment of LCT revenue performance. However, the more detailed assessment undertaken for 2007–08 was not applied in subsequent years. Consequently, monitoring of LCT revenue performance for the past two years had been based solely on revenue estimates calculated using the VFACTS data.

3.22 The Tax Office has recently extended its analysis for 2009–10 by providing estimates based on states' and territories' sales data and will undertake this more detailed analysis for 2010 and beyond. The results of the 2009–10 analysis reflect a 3.0 to 3.5 per cent variance between estimated and actual revenue collections for the year.

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[49] Federal Chamber of Automotive Industries (FCAI), vehicle sales report (VFACTS). Using the VFACTS report, the Tax Office estimates the number and cost of cars sold in different marque, model and price ranges, and the associated LCT amount. VFACTS benchmarking provides results on trends and is used to check the reasonableness of the LCT tax gap analysis, which is calculated from states' and territories' sales data.

3.23 The Tax Office is now in the fourth year of sourcing states' and territories' motor vehicle data through the Cash Economy Risk and Strategy team (the primary user of the data), and has indicated to the relevant jurisdictions that similar requests will continue through to 2013.[50] Developments in the quality and integrity of the data have resulted in improved applicability for data matching processes, with more limited improvement for aggregated LCT gap analysis. Many of the data limitations still apply, such as confidence in the accuracy of the declared sale price of a motor vehicle.

3.24 Subject to relevant internal corporate approvals, the Serious Evasion team will be able to access the matched vehicle registrations data. While the primary use of the data is to identify individuals and businesses that may be deliberately under-reporting or not reporting income, results from the data matching program could also identify instances where taxpayers may not be meeting their taxation obligations, including for LCT.

3.25 The Tax Office's additional work in estimating the LCT tax gap for 2009–10 and beyond will enhance the LCT risk rating process. Previous assessments have not provided adequate assurance that the measured tax-gap and associated risk rating for the LCT is appropriate. The 2009–10 work builds on the 2007–08 tax-gap analysis, and provides a higher level of assurance than revenue estimates based solely on VFACTS data.

Managing LCT registrations

3.26 Over the life of the LCT to September 2010, a total of 1692 clients[51] had an LCT account with the Tax Office, of which approximately 58 per cent, or 1000 taxpayers, pay LCT in any one year. In 2008–09, 904 clients paid LCT, and 922 clients did so in 2009–10.

3.27 The Tax Office applies four indicators to LCT registrations: active, inactive, cancelled and not reporting. However, it does not actively manage taxpayers' changing status, or undertake any analysis of why a taxpayer may register for LCT and then not make a payment.

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[50] The Australian Taxation Office *Data Matching – Privacy Protocol, Motor Vehicle Data*, August 2010.

[51] Tax Office statistics. Taxpayers engaging in a taxable supply of a luxury vehicle must register their liability for LCT.

3.28 Legislation pertaining to the LCT[52] does not set out any requirements for registering for the tax other than the taxpayer having a current ABN and GST registration. In administering the LCT, the Tax Office does not apply any additional measures to verify the registration. A business entity with no prior or current dealings in motor vehicle sales can register for LCT.

3.29 Similarly, Customs does not validate a taxpayers' LCT account when an importer quotes their ABN and defers their LCT liability, although they have the capacity in ICS to do this. Taxpayers may pay or 'quote' LCT obligations to Customs, irrespective of whether or not they are registered for LCT.

3.30 Potential risks associated with LCT registrations have been identified in several Tax Office intelligence scans, including the December 2010 serious evasion Intelligence Plan. Potential risks and key intelligence needs include: abuse of the quoting mechanism to avoid LCT obligations; entities registered for LCT but not reporting any transactions; and entities that should register for LCT but do not. The Tax Office acknowledged a 'weakness' in the system for the registering and managing of LCT accounts, as it has not adequately addressed these key identified risks. The Tax Office advised these matters are being investigated in the process of implementing the December 2010 intelligence plan.

3.31 Analysis of taxpayer behaviour regarding their LCT registration is included in the Serious Evasion Team activities referred to in paragraph 3.5. Subject to the findings from this exercise, there is scope for the Tax Office to more actively manage the administration of taxpayers' LCT registrations. The priority given to identifying and then deleting obsolete registrations from the LCT database to improve its use for compliance purposes needs to be weighed against other potential LCT compliance activities.

Use of Client Relationship Managers

3.32 As discussed in Chapter 1, the Tax Office has client relationship managers (CRMs) with responsibility for supporting voluntary compliance by large market taxpayers, and acting as a conduit for those taxpayers to other parts of the Tax Office. As at 23 December 2010, the equivalent of 150 full-time employees belonged to a national team of field compliance staff, who have both compliance and CRM responsibilities across all business groups in the

[52] *A New Tax System (Luxury Car Tax) Act 1999*, sub-section 2-10.

large business market segment of the ITX business line. While the allocation of duties is flexible, approximately 120 staff conduct audit and risk reviews and 30 are designated as CRMs.

3.33 The allocation of CRMs and active compliance activity is subject to a number of factors, including the comparative size of the industry and the level of compliance and revenue risk associated with particular business entities. As at 31 December 2010, there were 379 motor vehicle entities in the large market segment, of which 138 entities were LCT taxpayers. Some of these motor vehicle entities are high-profile luxury car brand manufacturers or importers. Most entities are individual dealerships with their own ABN and taxation obligations, and neither the size of their business operations or the compliance risk associated with LCT liabilities warrants the allocation of a CRM.

3.34 Consistent with the broad approach to LCT compliance, CRM staff respond to any LCT enquiries from motor vehicle entities, but do not actively monitor their LCT payments or refunds. Rather, both CRM and active compliance staff rely on analysis undertaken by risk and intelligence administrative units to alert them to any actual or emerging risks across the industry, including with individual taxpayers. Although there is little evidence that CRMs have had a significant role in mitigating the compliance risks associated with LCT payments by large taxpayers, the Tax Office considers that the majority of large taxpayers are compliant with their taxation obligations.

Pre-refund integrity checks

3.35 Compliance risks associated with the LCT are managed to a limited extent by the Pre-Refund Integrity team within the ITX business line's Risk and Intelligence stream.

3.36 Pre-refund integrity checking seeks to identify significant changes in payments for any specific tax and the refund claimed by organisations, and results in the selection of entities with changed commercial circumstances. This process is common to many indirect taxes, and is relatively low cost. The unusual transactions detected by pre-refund integrity checks are then analysed to determine if the variation can be explained. Pre-refund integrity checking includes using a software application to identify significant variations in a tax or the refund claimed.[53]

3.37 Taxpayers may claim a refund of their LCT payments when changes occur that alter the amount of LCT they previously paid or were liable to pay. These include a decrease in the payment received for the supply of a vehicle or where LCT was previously paid on a vehicle for private use, but it was subsequently used as trading stock.

3.38 Pre-refund integrity checking for the LCT is 'low' on a hierarchy of general compliance tests applied in the pre-refund environment. A taxpayer's LCT liabilities may be reviewed if there is an anomaly in other fields of the BAS, for example with the taxpayer's GST amounts. Where no other issue with the BAS is identified, LCT refund checking is limited to a review of the two LCT fields in the BAS. Also, checking will only occur where a taxpayer has a net LCT credit, that is, when the LCT refund claim exceeds the LCT payable.

3.39 Table 3.1 shows the number of taxpayers claiming an LCT refund through their BAS, and the number of refunds stopped for analysis. Between 2005 and 2010 five pre-refund checks resulted in a total of $48 880 of LCT adjustments, which represents a very small percentage of the approximately $2 billion in net LCT paid over the same period.

Table 3.1

LCT refunds lodged and adjustments

Financial year	2005–06	2006–07	2007–08	2008–09	2009–10	Totals
Number of BAS lodged with a net refund	180	154	172	318	408	1232
Number of BAS lodged with net LCT refund	76	72	101	129	98	476
Number of Refunds Stopped	26	9	11	24	21	91
Adjustments	1	1	0	2	1	5

Source: The Tax Office, January 2011.

3.40 The Tax Office advised that accurate data on the number and value of LCT adjustments as a result of pre-refund checking and reviews on other fields

53 The risk rating engine compares the BAS data to a range of criteria to identify potential non-compliance at the time of lodgement. Where a BAS does not meet the prescribed criteria, it is referred for further review. Payment may be delayed until the BAS has been reviewed.

of the BAS is not readily available, but estimated that those adjustments raised net LCT liabilities of $482 780 in 2008–09 and $83 367 in 2009–10.

3.41 While a low percentage of adjustments suggests few compliance problems, net refunds alone are not meaningful from a compliance perspective. Existing LCT refund checking focused on net LCT credits is therefore likely to overlook other instances of non-compliance, such as those that may be indicated by a substantial reduction in LCT paid compared to previous periods.

3.42 There is scope for the Tax Office to re-assess pre-refund integrity checking related to the LCT with a view to broadening it beyond net refunds, to include abnormal movements in the gross LCT amounts, and to monitor LCT adjustments arising from reviews triggered by other fields of the BAS. This would provide the Tax Office with more accurate information on annual amounts and overall trends in LCT refunds.

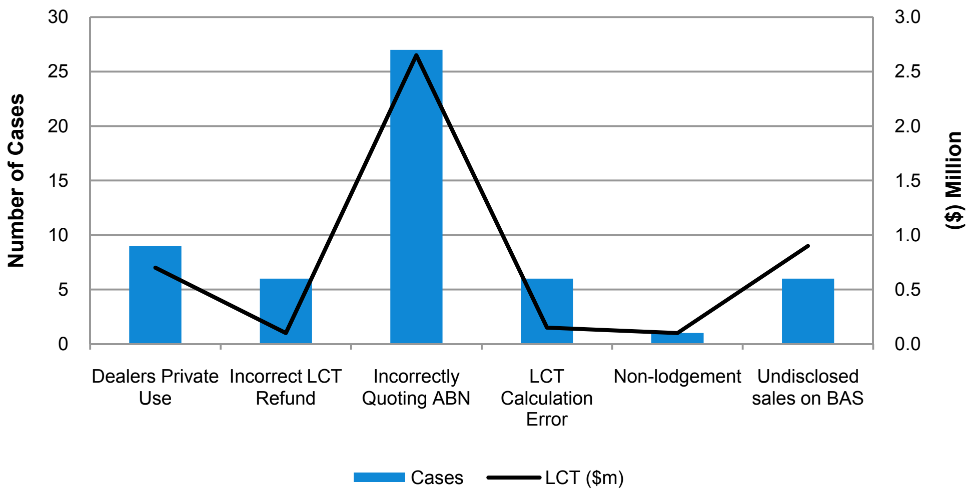
Active compliance

3.43 As discussed in paragraph 3.2, minimal compliance planning is undertaken for LCT, and the resulting compliance activity is relatively ad hoc in comparison to other taxes where specific compliance risks are identified and targeted.

3.44 Limited data is available on the overall volume and type of compliance activity undertaken for the LCT across all market segments. However, the November 2009 risk assessment reported that 56 compliance audits undertaken across 17 industries resulted in $4.6 million in LCT liabilities (see Figure 3.2).

Figure 3.2

LCT Active Compliance Adjustments—July 2006 to January 2009



Source: Internal Tax Office document, *Risk Assessment*, November 2009, p.7.

3.45 The report also refers to compliance activities undertaken for the full year 2008–09 in relation to 75 taxpayers. During this period 17 adjustments and net LCT liabilities of $860 683 were raised.

3.46 Figures published for 2009–10 report that $7.2 million in adjustments was raised through active compliance activities.[54] However, this amount included one large transaction in excess of $5 million where a refund was calculated in error and re-assessed by the taxpayer to a net LCT payable amount.

3.47 While LCT active compliance activities conducted in recent years have resulted in substantial liabilities being raised in a number of instances, there is scope for the Tax Office to more systematically design and monitor the active compliance program for the LCT.

Conclusion

3.48 The ANAO found that the Tax Office has mechanisms in place to monitor the level of taxpayers' compliance with their LCT obligations, but

[54] Tax Office, *2009–10 Commissioner of Taxation Annual Report*, p. 88.

shortcomings in individual components of overall compliance arrangements limit the assurance that taxpayers are meeting their LCT obligations.

3.49 The Tax Office had not undertaken detailed analysis of LCT revenue performance for the last two financial years, reducing the level of confidence that the LCT 'tax-gap' remains within Tax Office acceptable margins. The Tax Office has recently expanded the analysis for 2009 and intends to do this for the current and future years.

3.50 There are minimal controls applied to the registration or status of taxpayers' LCT accounts on their activity statements, and the Tax Office has acknowledged a 'weakness' in the system for processing LCT accounts. The work currently being undertaken by the Serious Evasion team includes analysis of LCT registrations. Any additional measures to reduce the opportunity for abuse of the quoting mechanism that allows taxpayers to defer their LCT payments should be identified through this work.

3.51 The Tax Office uses a risk rating engine to analyse taxpayers' BAS. LCT refund integrity would be strengthened if the parameters in the risk rating engine were expanded where an LCT liability is included in a taxpayer's BAS.

3.52 A more structured approach to the planning and targeting of LCT compliance activities would also provide the Tax Office with a better understanding of actual and potential non-compliant behaviour by taxpayers with an LCT liability. Similarly, there is scope to maintain more accurate data on the annual value of adjustments to taxpayers' LCT payments as a result of compliance activities.

Ian McPhee | Canberra ACT

Auditor-General | 31 May 2011

Appendices

Appendix 1: Tax Office Response to the Audit

Australian Government
Australian Taxation Office

Australian National Audit Office
Performance Audit - Administration of the Luxury Car Tax

ATO formal response:

It should be noted that while Luxury Car Tax (LCT) makes up less than 1% of total ATO revenue collections, LCT remains an important revenue product. The ATO's overall assessment of compliance risks relating to LCT is considered to be generally low, but the ATO continues to monitor and investigate instances of egregious behaviour, particularly in relation to prestige motor vehicles.

The ANAO notes that both the ATO and Customs and Border Protection have adequate governance arrangements in place to undertake all aspects of LCT administration. The ATO is pleased with the audit findings that industry associations and taxpayers understand the tax and that they are confident about its application.

The ANAO has noted that responsibility for ensuring a coordinated end-to-end process for LCT administration rests with the GST Product Committee (chaired by the Deputy Commissioner, Indirect Tax). The GST Product Committee is comprised of senior executives from across the ATO and Customs and Border Protection, including those responsible for processing activity statements and issuing refunds. On a monthly basis, the GST Product Committee reviews LCT revenue outcomes against budget and economic conditions as part of a standing agenda item.

The ATO agrees with the ANAO recommendation to enhance planning and internal reporting processes for LCT and has already enhanced the documentation of LCT reporting at GST Product Committee meeting.

Index

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ANAO Audit Report No.1 2010–11
Implementation of the Family Relationship Centres Initiative
Attorney-General's Department
Department of Families, Housing, Community Services and Indigenous Affairs

ANAO Audit Report No.2 2010–11
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Australian Taxation Office

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Department of Human Services

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Department of Sustainability, Environment, Water, Population and Communities

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Department of Broadband, Communications and the Digital Economy

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Australian Federal Police

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Attorney-General's Department

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General Practice Education and Training Limited

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Department of Foreign Affairs and Trade

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Department of Human Services

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Attorney-General's Department
Department of Infrastructure and Transport

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Department of Defence

ANAO Audit Report No.41 2010–11
Maintenance of the Defence Estate
Department of Defence

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Department of Regional Australia, Regional Development and Local Government

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