

INTEGRITY: THE KEYSTONE TO GOOD TAX ADMINISTRATION

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The way in which revenues are collected and spent defines the symbiotic relationship between the state and its citizens, strengthening the former and making it more accountable to the latter.¹

The proposition presented in this article is that corruption has a corrosive impact on the wellbeing of a nation and is especially damaging to tax administrations. On the flip side, integrity can be the keystone to good tax administration and benefits the nation in a number of ways.

The approach taken in this article is to contrast perceptions of corruption in relation to South Africa and Australia, with a view to supporting growing concerns that corruption might be getting worse in South Africa.

Corruption operates at multiple levels. At the national level, the political will to fight corruption requires leadership and the engagement of the wider community. At the level of tax system design, there are principles that can help to reduce the opportunity for corrupt practices. While these will require the agreement of government, policy advisers, including tax administrations, can influence government on the shape of the tax system. Similarly, at the level of the tax administration, leadership is also required. However, it is open for tax administrations to implement strategies that can be employed to minimise the risk of corruption associated with the collection of tax. Moreover, in doing so, the tax administration can be an agent of change by building community trust in public sector institutions by seeking recompense from those who undertook fraudulent activities and by collecting much-needed revenue to fund public goods and services.

Creating a mature tax administration is not a simple task. It requires unwavering commitment, at senior levels, to walk the talk and to nurture a high integrity culture. Nevertheless, the processes taken by the Australian Taxation Office (ATO) as a consequence of the reprehensible activities of Petroulias, probably the most significant corruption case in ATO history, provide a useful path to follow.

The corrosive impact of corruption

Corruption is recognised as one of the main barriers to sustainable economic growth, political and institutional stability and social cohesion.²

The Transparency International (TI) Corruption Perception Index 2016 highlighted the connection between corruption and inequality, which feed off each other to create a vicious circle between corruption, unequal distribution of power in society, and unequal distribution

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of wealth.³ Under that index, Australia is ranked 13th out of 176 countries. This means that it is a relatively 'clean' country in terms of corruption. Nevertheless, there should be no complacency. And there is not: this is reflected in the recent changes to the bribery laws and calls for further progress in the fight against corruption.⁴ These calls are made notwithstanding a number of successful inquiries by state-level Independent Commissions Against Corruption.⁵ South Africa is ranked 64th on the TI Corruption Perception index.

While corruption indexes may have methodological flaws and are indicative only, many tell a similar story. For example, the Heritage Foundation 2017 Index of Economic Freedom ranks Australia 4th out of 180 countries, with the commentary:

In addition to abundant natural resources, the economy has benefited from an effective system of government, a well-functioning legal system, and an independent bureaucracy, all of which have facilitated robust entrepreneurial development.⁶

South Africa is ranked 81st under that index, with the commentary:

Performing far below its potential, South Africa's economy has been stifled by political instability and a weakening rule of law. Corruption hampers the functioning of government, however, and enforcement of anticorruption statutes is inadequate.⁷

Under the Worldwide Governance Indicators, in 2015 Australia was ranked 10th out of 215 economies, with scores of 92, 97, 94 and 95 (out of 100) for Government Effectiveness, Regulatory Quality, Rule of Law and Control of Corruption.⁸ By comparison, South Africa's scores for these factors in 2015 were 65, 64, 59 and 58.⁹

It is acknowledged that different levels of corruption may be tolerated by different cultures and that the negative impact of corruption may not be uniform across all countries:

The concept of corruption, defined as the act of breaking an accepted social or legal norm, must inevitably recognize that different societies respect different norms, and that some norms are not precisely defined. Therefore, an act that may be considered corrupt in one society may be seen as normal, expected, or tolerated in another. This is especially the case when the act reflects relations with, or assistance provided to, friends and family, or to other members of close communities.¹⁰

Nevertheless, while no society is immune from isolated acts of corruption, the impact of corruption on the ability of any state to carry out its functions increases as it becomes more systemic and acute:

[I]n some circumstances corruption is no longer a deviation from the norm, but is manifested in a pattern of behaviour so pervasive and ingrained that it becomes the norm. In these situations, the state's ability to carry out its basic functions — such as raising revenue, supplying public goods and services (including security), regulating markets, and acting as an agent of society's redistributive goals — can become sufficiently undermined that it is likely to have a significant impact on economic performance.¹¹

This is a risk that South Africa needs to bear in mind, because the indications are that the country has a corruption problem which is weakening the nation's potential. Corruption has been seen as a cancer eating away at South Africa's society.¹² This view is shared by many in South Africa, with a major concern being the involvement of the political elite in corruption.¹³ A similar warning emerges from World Audit's 2017 World Democracy rankings:

At 44th in the world [South Africa] is not out of reach of achieving full democracy, it ranks 5th amongst African nation states, but its democratic status is unquestionably under threat since the inheritors of power in the state, after independence, still dominate the nation's politics. These are inevitably without heavyweight political competition, riddled with corruption — always a mortal danger to democracy with any such distortion of an effective balance of power.¹⁴

The reality is that there are many factors that go towards a healthy economy and a healthy democracy. Most of these factors relate to the culture and customs of the wider society, so it is more extensive than just a public sector problem.¹⁵ The solution to these wicked problems often requires the active involvement of that wider community. This too has been recognised by many in South Africa:

In our own country, we have also watched how the abuse of power and misuse of public funds can compromise a young democracy ... We have to remember that our democracy does not end at the ballot box, but that the public has to be actively engaged and participate at all levels of governance in ... demanding transparency and accountability.¹⁶

There are both supply and demand factors associated with corruption, with no one panacea. Nevertheless, it is often argued that the strong political will of the political leaders is vital to countering corruption.¹⁷ The effective, committed and persistent implementation of South Africa's draft 2017 National Anti-Corruption Strategy would be a step in the right direction.¹⁸

Leadership needs to be evident at multiple levels of government and administration. As the International Monetary Fund concludes:

As in all areas, a key catalyst for institutional change is effective leadership. Accordingly, senior governmental officials can play a critical role in changing norms and expectations, not only through the design and execution of public policy but also through their own personal behavior.¹⁹

Possible futures

At the annual conference of the Asia–Oceania Tax Consultants' Association, held in Manila in 2005, the delegates expressed genuine concern about what they described as a malaise in the Philippine economy.²⁰ The nub of the concern was the lack of foreign investment — attributable to the absence of modern infrastructure and poor educational and health facilities. According to the speakers, all this was attributable to their tax administration not collecting sufficient revenue to fund essential public goods and services.

The Philippines is not alone in the challenge of developing a modern and high-integrity civil service, including an effective tax administration. Yet the integrity of the public sector and of a country's institutions of law and governance are vital to a nation's wellbeing:

A public service that is based on merit, that does have high standards of integrity, that does in a quite fundamental way protect citizens from the arbitrary exercise of executive power, doesn't happen in most countries in the world today. And of course most of the time we don't realise we're doing this. It's only when you stand back from what you do and look globally that you recognise how profoundly important it is. We work and we've got to think to lead in the public interest.²¹

Dr Shergold went on to say in respect of Australia:

Money doesn't change hands for services. Taxes are collected fairly.²²

More pertinent perhaps for the African continent are the observations of Mwaniki Wa-Gichia, an ATO officer, made in 2010 to the then Commissioner of Taxation:

Organisational structures have been built in Australia that develop policy, collect revenue, deliver services and manage corporate services with integrity. Where there is absence of such organisational structure and professionalism then corruption, nepotism and failure to collect revenue from taxes fairly is present.

You have also stated that taxation is a price that we pay for a civilised society to provide social equity and promote economic competitiveness and that its administration reflects the nature of our society. It could reflect public fiat over the rule of law or disengagement from the law and its administration. I

explained in Brisbane how I had seen a practical reality of these views in my own country of birth, Kenya, as evidenced in the taxation system.

After a period of close to 24 years of organisational structures in the public services being eroded by poor governance (engendering corruption, nepotism, failure of collecting taxes fairly, gross avoidance of paying taxes), a government was voted in through a proper democratic process in 2002. This new government commenced on re-building the organisational structures and restoring professionalism in the public service. This was relatively successful and in the first term of government there were evidences of this success as manifested by the taxation system. Administration of taxes was fairer, more effective and efficient, with the public more engaged with the system and revenue was increasing significantly. Expenditure management of the government coffers was also significantly improved. After about four years of rebuilding organisational structures, development funds were disbursed nationally for nation building in an unprecedented manner.

This was just the beginning of the re-building of organisational structures and restoring of professionalism in the public service in Kenya. Although it was short-lived (due to the post-election disturbances of 2008), it demonstrated how taxation and its administration are a key element of a functioning democracy or maybe even a measure of the state of democracy.²³

It has been said in relation to South Africa:

The culture of 'rampant acquisition' is spreading so widely that the professional standards of integrity which are the hallmark of functioning institutions are under enormous pressure.²⁴

Tax corruption gives rise to a number of harmful consequences on social welfare and economic development. As the focus of this article is on the importance of a high-integrity tax administration to the social and economic wellbeing of a country, it is suffice to say that tax corruption has harmful consequences for a nation. These consequences have been well articulated by Binh Tran-Nam²⁵ and include:

- Tax corruption causes a loss in the tax revenue collected making it more difficult to fund much needed public goods and services.
- Tax corruptions causes distortion in the allocation of resources, reducing economic efficiency and inflows of foreign direct investment. It is likely to increase uncertainty and impose higher business transaction costs.
- Tax corruption reduces the policy equity of the tax system because those who predominantly enjoy its benefits tend to be higher-income individuals.
- Tax corruption has an adverse effect on the tax morale of taxpayers which weakens fiscal citizenship and voluntary tax compliance.²⁶
- Tax corruption reinforces the public's perception of general corruption which decreases the legitimacy of the government.

The impact of corruption on the tax system

There is increasing recognition of the centrality to development of strong tax systems.²⁷ A tax system that resources services and infrastructure for the development of social and economic institutions serves the community and builds the nation. Taxation, it can also be argued, is central to the social fabric of a country. It is part of the social contract by which citizens collectively agree to contribute to their society.

Corruption can diminish a state's ability to carry out its basic functions, including the proper collection of taxes. As Rahman²⁸ notes, the underlying causes that drive the supply of corruption from tax officials include complex and unclear tax laws and procedures; non-transparent hiring and reward mechanisms; a low level of skills; a lack of professional ethics and integrity; low pay and a lack of incentives; conflicts of interest; personal greed; and insufficient checks and balances within the administration.

The immediate impact of corrupt behaviour is the direct revenue loss as a result of each individual act of collusion between a person liable to pay tax or duty and a tax or customs official. But there will also be a more pervasive and problematic consequence of corruption for any country's tax system (which must ultimately rely, to a significant extent, upon voluntary compliance with tax obligations by the bulk of taxpayers). It is that, when corrupt behaviour is commonplace among tax and customs officials, the incidence of taxation can become quite arbitrary. If there is only a limited prospect that a taxpayer's non-compliance will be detected and appropriate sanctions imposed (because tax or customs administration is weak) and, in addition, officials regularly engage in collusive behaviour with taxpayers to help them to circumvent tax and duty liabilities, voluntary compliance with the tax laws will necessarily continue to decline, as will the revenue collections.

Remedies

In reviewing the causes and consequences of corruption, it is important to address the overall factors which may lead to corrupt practices, such as extensive intervention of the government in the economy; cultural norms and practices that influence the behaviour of administrators; political interference in tax administration; excessive and unchecked discretionary power in the hands of administrators; the lack of independent agencies to detect and prosecute corruption; weaknesses in the rule of law; and the failure of courts to apply appropriate sanctions.

Many of these issues are outside the powers of the tax administration alone to deal with. In order to deal effectively with corruption, there should ideally be calls for change by the community and a commitment from the government to address the problem. However, subject to government support, progress can be made in relation to the collection of taxes by good tax system design to ensure that there is a clear and well-understood policy and legal framework. In addition, revenue authorities can introduce a range of measures designed to minimise the risk of corruption. In particular, digital processes that automate basic tax functions, appropriate levels of supervision and guidance, accountability mechanisms, codes of conduct, and internal hard and soft controls are effective strategies for improving the integrity of the tax organisation.

Below is a shopping list of strategies that can be employed to minimise the risk of corruption associated with the collection of tax. Some of these measures are in the bailiwick of government, while others can be pursued independently by the tax administration.

Tax policy measures: simplification of the tax system

Simplification of the tax system (for example, reducing the number of tax rates and restricting exemptions) is not only good economic policy but it can also help to reduce opportunities for corruption. From the viewpoint of the tax and customs administrators, clear legislation can provide the framework for the development of systems and procedures that are easily understood by taxpayers and officials. For example, laws which do not contain discretions or exemptions limit the potential for political interference. Similarly, law that are clear, limit the need and heighten the transparency of administrative interpretations of those laws. This policy framework could be based on the following principles:

- **Minimum number of rates:** Rationalisation of tax and tariff rates and clear definitions of how and when different rates apply can reduce the need for interpretation of the law (and regulations) by administrators. This can significantly reduce the need for face-to-face contacts, where, for example, a negotiation may result in the exchange of money for a favourable ruling.

- **Low rates:** If the general perception in the taxpayer community is that the tax system is fair and broadly-based and rates of tax are reasonable, there is less incentive to become involved in fraudulent activities.
- **Minimum exemptions and discretions:** Tax legislation should be written so as to clearly spell out any exemptions in the law and thereby limit, to the greatest extent possible, the discretionary power of ministers or government officials to grant exemptions. Similarly, any discretions should be based on objective criteria and amenable to review processes.
- **Minimum non-tariff barriers to foreign trade:** The need for numerous approvals for foreign trade licences and multi-agency authorisations to import and export creates the opportunity and incentive to engage in corrupt practices.²⁹
- **An effective penalty system:** A culpability-based penalty system should provide the administrator with an ability to impose administrative penalties for offences. This may include monetary penalties or other administrative sanctions — for example, for failure to issue invoices for VAT purposes, for failure to file a return by the prescribed date and understatements of income or overstatement of deductions. Serious cases of fraud, including the bribing of revenue officials, should result in higher penalties or criminal prosecution.
- **An independent appeal mechanism:** In order to preserve the independence of the officials and the integrity of the tax system, it is important that taxpayers have the ability to challenge decisions, are assured of a fair and equitable hearing and know that decisions are widely publicised.
- **A regulated tax profession:** The regulation of the tax profession so as to mandate professional and ethical standards can mitigate both the supply and demand side of tax corruption. A well-regulated tax profession can guide their clients to comply with the tax law. In addition, the tax profession could bring to the attention of the tax administration situations where a tax officer is not applying the law correctly. Similarly, it can bring to the attention of scrutineers, the government or the community (for example, through the media), any systemic non-adherence to the tax law by the administration.
- **An effective anti-corruption agency:** Anti-corruption agencies have been used in many countries to varying degrees of success.³⁰ It is important that such an agency is independent, appropriately funded, sufficiently empowered and able to effect appropriate sanctions.

The framework for modern administration

A degree of autonomy

Many modern tax administrations have a degree of independence from the government, subject to appropriate levels of transparency, scrutiny and accountability. Best-practice approaches include the following:

- **Separating the setting of policy from its administration:** The policy-makers should engage in whatever research and dialogue is necessary during the design of tax policy and in the drafting of legislation, including discussions with the business community. Indeed, an integrated tax design process which involves the administrator and the private sector is recommended.³¹ However, once the policy has been established and provided for in the law, there should be a level of separation between the roles of policy-makers and administrators. It must be clear that the law, as interpreted by the administrators, will be applied in that way (subject to the courts) and that it is not possible to obtain more favourable treatment through the influence of the policy-makers. It should not be the responsibility of senior policy-makers or ministers to review and rule on individual cases. Many modern tax and customs administrations have clearly established rules supporting this separation of responsibilities. In some countries, this separation of

responsibilities is spelled out in the legislation that governs the administration of the tax system. This administrative autonomy must however be balanced by an appropriate level of transparency, scrutiny and accountability.

- **Administrative autonomy:** In recent years, one strategy that has been followed by a number of countries for improving the effectiveness of tax administration and to address, among other issues, corruption has been to increase the autonomy of the agency. While there are a number of alternatives to providing greater autonomy, most share the following common features: a degree of financial independence, in the sense that the administrations are able to allocate budget funds as they determine appropriate; administrative independence, meaning that the administrations are provided the authority to formulate their own administrative policies and objectives; and independence from some of the general civil service requirements, so that the administrations are responsible for their own recruitment, salary structure, career paths, training, and establishing performance standards and codes of conduct. These are balanced by requirements for transparency, accountability and scrutiny.

Clear, transparent procedures

Whatever the level of government support, there are strategies which the tax administration can take to minimise the risk of corruption. These include simple, transparent and, where possible, automated procedures; a professional administration; transparent performance standards; a code of conduct; and an effective internal audit and fraud control capability.

Simple and transparent procedures not only reduce compliance costs for taxpayers but also minimise the opportunities for corruption. These procedures could include the following:

- **Digitisation:** The introduction of computerised support for the processing of tax returns and customs declarations, perhaps more than any other change, provides the opportunity to implement standardised procedures in tax and customs administration that leave little to the discretion of the officials. At a minimum, a properly designed system can generally ensure that correct rates of duties and taxes are applied; time frames for payment are met; and those who do not comply with filing and payment time frames are identified, with follow-up action being taken. In addition, the system can provide useful management information including, for example, transactions that do not meet time standards for processing or individual officers who undertake actions that are out of the ordinary.
 - **Consistent guidance and interpretations:** Under self-assessment systems it behoves the tax administration to provide clear, concise and consistent guidance to taxpayers about their rights and obligations. Taxpayers can only be expected to self-assess their liabilities with confidence when the interpretation of the tax and duty laws is consistent and procedures are standardised.
 - **One-step process:** This would cover the lodgement of the return together with any tax payable (both preferably undertaken electronically).
- Information and documentation requirements:** Tax and customs administrations should define their information and documentation needs in a way that minimises the compliance burden on taxpayers. However, the existence of documentation requirements for tax purposes will help to provide a trail to verify the bona fides of the taxpayer's transactions, against which can be judged any interaction with tax officers. In addition, tax office staff should be required to keep documentation which outlines the rationale for their decisions.

Professional tax and customs administrations

The development of professional tax and customs administrations is important, not only to improve the effectiveness of these administrations but also to address issues of corruption. Experience in developed countries has shown that the best way to ensure fairness and neutrality in the administration of the tax system is to develop professional administrations that have clearly defined responsibilities and that are transparent about and accountable for their performance.

The following features characterise professional tax and customs administrations:

- **Professional management:** It is important that tax and customs administrations include skilled, knowledgeable supervisors and managers. The turnover of senior officials in the administrations, where, for example, there is a change of government, without regard to their abilities, integrity and expertise can have a negative impact on the effectiveness and culture of the administration. This is particularly so where good staff are replaced by individuals with little or no knowledge of legislation, regulations, systems, and procedures. In these circumstances, staff may perceive that they have limited career opportunities in the organisation and, perhaps as a consequence, may be more open to corruption. For those who join a tax or customs organisation for the term of a new government, working in that organisation may be seen as a reward and an opportunity to enrich themselves through the provision of exemptions and other concessions to the business or accounting community.
- **Management controls:** These include a clear statement of goals and objectives; well-documented operating procedures; supervision of day-to-day activities; and a regular review of the outputs of employees. These management controls need to be supported by effective communication to staff, internal investigative capabilities and appropriate sanctions. Management should also consider the results of its internal audits, feedback from taxpayers, and the views of its employees in evaluating the health of the tax organisation.
- **Merit-based recruitment and promotions:** A feature of the recruitment and promotional practices of leading tax administrations is the emphasis placed on merit.³² It is important that people get appointed on merit and not on the basis of nepotism or undue influence. In developing professional administrations, it is important that personnel requirements are clearly defined, including the education and experience requirements of those being employed. Recruitment practices would then base job offers on candidates that best meet those selection criteria. In some countries, revenue administrations, because of restrictive civil service rules, have difficulties in engaging people with the skills required to carry out specialist tasks. However, the revenue authority, if supported by their minister, could seek an appropriate degree of flexibility in relation to human resource management matters (subject to appropriate scrutiny). An important part of establishing a professional administration is a clearly defined (but not guaranteed) potential career path and promotion policy that is based on merit. Each individual must feel that there is an opportunity, based on hard work, ability and integrity, to advance and that to engage in inappropriate behaviour may jeopardise this opportunity (and lead to dismissal). If this is not the case, staff may not be engaged with the goals of the organisation.
- **Compensation and working conditions:** Staff must be provided with sufficient compensation to minimise incentives to engage in corrupt practices. Salaries should be set at a level that provides a reasonable standard of living. This will reduce the incentive to accept bribes to augment wages where they are set so low as to place the officer at the poverty level. In recognition that it may not be possible to address low civil service pay in general, some countries have implemented special pay scales and incentives for staff in revenue agencies. However, improvements in salary levels alone will not be sufficient to guarantee a corruption-free environment. There still needs to be

complementary hard and soft management controls, including appropriate monitoring and sanctions to safeguard the integrity of the organisation and of its staff. Proper office space, equipment and training should also be provided to tax officers if they are to carry out their responsibilities in a professional manner. Poor conditions can also adversely impact on the psychology of the tax officials, reducing their level of pride and commitment to the work they carry out.

- **Staff rotation:** This is a common practice to reduce opportunities for collusion. However, care needs to be taken to ensure that there is a critical mass of capabilities to maintain skills and to ensure the effective day-to-day operations of the administration.
- **Training:** Staff training is crucial to the development of professional tax and customs administrations. In this regard, it is important that a careful analysis of the needs of both the organisation and its staff is completed to ensure that the training matches their needs. For example, the processes for the introduction of new legislation should give adequate attention to the training needs of staff, as well as the guidance necessary to assist taxpayers. In addition to improving the tax technical skills of staff, training can also serve to build 'esprit de corps' and an awareness of the need for responsibility and loyalty to the organisation, thereby reducing the incidence of corruption. Leading tax administrations also undertake office wide fraud awareness programs designed to inculcate high levels of integrity.
- **Complaint monitoring:** Tax administrations can establish a special unit for the receipt of complaints (both from taxpayers and from staff) concerning the performance of officials, and those complaints should be taken seriously and dealt with promptly. Often, the very existence of a unit of this kind may ensure that officials who might think about engaging in some form of unprofessional behaviour will be deterred from that action by the fear that they will be reported. It is good practice for the management of complaints to be monitored by an independent party. For example, in Australia the Ombudsman monitors and assists the ATO in its management of complaints.³³

Organisational structure

Organisational structure can play an important role in limiting opportunities for corruption. While many leading tax administrations are moving to segment-based structures (for example, large business office, small business office and so on), for many developing countries, the creation of a functional organisation can be an effective way to combat corruption. Even within segment-based structures, there is a division of labour to increase efficiency, thereby also providing visibility across the segment to the end-to-end treatment of particular taxpayers.

Whether the structure is segment-based, functional or a hybrid, the important consideration is a shift away from individual officers being assigned responsibility for all activities (including audits) related to a particular taxpayer, importer or exporter. Through the separation of responsibilities for different tasks in a tax or customs administration, checks and balances can be built into the system. For example, the processing of a customs declaration and physical inspections of goods, when carried out by different officers, can reduce the opportunity to influence decisions such as those related to the classification and valuation of goods. Similarly, in a tax administration, decisions about which taxpayers should be audited will be made in one unit (ideally using digitised case selection systems), the taxpayers' cases will be assigned to a second unit (and the case progressed on a team basis and under appropriate supervision) and, possibly, a third unit will provide quality assurance in relation to the outcomes.

A major development in the history of the ATO was the shift to national approaches rather than local or regional management of the taxpayer population.³⁴ This refinement to the ATO's planning processes provided greater flexibility for structure to follow strategy rather

than circumscribing the treatments that could be used under functional approaches to improve levels of compliance (and to minimise compliance costs).

In the ATO context, national responsibility is distributed across the country, but decision-makers have a national focus in carrying out their duties. While integrity was not a factor for the ATO's decision to move to national management, in other environments there may be potential for local or regional 'fiefdoms' to resist change, sometimes for improper purposes.

In its national approach, with distributed national leadership, the ATO differs from the way a more traditional headquarters and regional/branch office structure operates in managing market segments, functions or tax types. Effective control of regional/branch approaches under the more traditional models relies on a strong headquarters to direct and monitor localised decision-making and performance.

Performance standards

Building on a base that includes clear legislation and transparent and streamlined procedures, tax and customs administrations should put in place performance standards that enable policy-makers, management and the public to measure how well an administration is performing. This has several advantages. First, it enables the policy-makers, including ministers, to hold heads of administrations responsible if agreed standards are not met. Secondly, it enables management to measure the performance of segments or offices to identify potential problems. Performance standards can also cascade to monitor the work of teams or individuals. Thirdly, it makes very clear to staff what the management's expectations are and that the performance of their area or team (and their own performance) will be measured against these expectations. Fourthly, the public is aware of what is expected and, therefore, should be more willing and encouraged to bring to the attention of management cases where the standards have not been met.

Performance standards should not consist solely of a revenue target and need to include the 'how' as well as the 'what'. In leading tax administrations, revenue targets are not allocated to individual staff, although their performance may be linked to the outcomes of their teams, office, market segment, tax type or national outcomes.

If the only performance standard established for the tax administration (and its staff) is the requirement to collect a certain amount of revenue, the agency (and its staff) may not be brought to account on 'how' the target might be achieved. Meeting revenue targets may do little to ensure that the law is applied in a consistent manner to all taxpayers and that the collection of expected revenue from new policy initiatives will be achieved in a sustainable way.

Similarly, where revenue estimates are not evidenced-based and prove to be fanciful, tax administrators may lose confidence in the legitimacy of their work, providing fertile ground for improper practices. In this situation, there is a need for a revenue estimating capability to better inform the government on realistic targets.

Performance standards in revenue administrations should include the following:

- **Revenue targets:** A professional revenue estimating unit should exist to guide the government in setting revenue targets. Tax and customs administrations should participate in discussions leading to the setting of revenue expectations. Tax statistics and expected GDP developments have critical roles to play in setting realistic forecasts of revenue collections. The administrators should also be invited to provide an

assessment of the practicability of policy proposals being considered by government; the feasibility of collecting projected revenues expected from those proposals; and the compliance cost implications for taxpayers. Once overall revenue estimates have been set, based on the available evidence, it is the responsibility of the administration to determine the strategies for facilitating the collection of revenue. Best-practice administrations would develop a range of strategies (both help and enforcement) built upon an in-depth analysis of risks.³⁵ The relevant programs, be they national or geographical, would be monitored and their performance measured against preset criteria.

- **Service, audit and enforcement standards:** There should be clearly articulated standards for the various functions that are performed in tax and customs administrations. Legitimacy and accountability is enhanced where a tax administration is transparent about its performance standards, particularly where taxpayers have the ability to seek reasons for any delays or shortcomings. By establishing service standards and making them known to staff and taxpayers, an administration can establish mechanisms to monitor its different functions and identify segments, offices, units and individual officers who regularly do not meet the required standards.

Performance standards are also important for monitoring audit and enforcement operations of a tax or customs administration. Tax administration managers need to know how long auditors are taking to complete their cases and the results achieved so as to be able to compare the work against organisational averages (and against the outcomes achieved using different strategies). Reports from a tax administration monitoring system may help to identify areas that should be investigated for potential corrupt practices, as well as guiding the types of strategies that are productive in raising revenue and improving compliance.

Code of conduct and taxpayers' charter

It is important that both the staff of tax and customs administrations and the people with whom they have to deal on a daily basis are aware of the conduct that is expected of both parties. Codes of conduct and taxpayers' charters play an important role in setting the desired behaviours. By clearly articulating expectations, administrations can hold employees accountable for their performance and take appropriate action when these standards are not met. For a code of conduct to be effective, it should include a description of the disciplinary actions that will be taken if unacceptable behaviour is discovered (and, to be effective, disciplinary actions must be taken where necessary on a consistent basis).

Moreover, it is vital that the code of conduct and the taxpayers' charter is embedded in the culture of the organisation.³⁶

A code of conduct would normally include the following:

- **Maintaining integrity:** The acceptance of gifts, favours, or benefits to influence decisions is strictly forbidden. Disciplinary action, including dismissal, is normally taken in cases where employees accept a gift of any significant value. Prosecution action is taken where a bribe is involved.
- **Confidentiality of information:** Information contained in tax returns and customs declarations as well as that obtained from audit activities is highly confidential and, as such, must be kept secure by tax and customs employees. Leading tax administrations make it clear to staff that unauthorised access to taxpayer information is likely to lead to dismissal. Confidentiality of information is supported by data access constraints and holistic monitoring systems which track access to the organisation's IT systems.
- **Conflict of interest:** Employees should be prohibited from engaging in activities that are in clear conflict with their official position. For example, a customs officer would not be

permitted to own a customs brokerage business or to engage in any business that involves extensive import and export activities. Similarly, a tax official would not be allowed to conduct or control a tax advisory business. In addition, revenue officers would not be allowed to have any dealings with entities in respect of which the officers or their families have a material interest. Many administrations also have a requirement that employees disclose their assets at time of employment and update this information on a regular basis so that managers might detect, at an early stage, that an employee has accrued assets that are inconsistent with the level of compensation received by that employee. It is becoming more common practice for tax administrations to require the close relatives of tax officials to make similar declarations of their assets. The tax officials are also required to report any circumstance where the activities of their close relatives may constitute a conflict of interest for them.

- **Appearance and conduct:** Standards for appearance and conduct normally include observing the hours of duty; dressing appropriately; dealing courteously with the taxpaying public as well as with their colleagues; prohibiting the use of intoxicants in the work place; and using government equipment, including vehicles, only for business purposes.

Whistleblower provisions

The availability of avenues for whistleblowing (including protection from disclosure after the event) provides a hedge against corrupt practices. Information about whistleblowing should be actively provided to employees. This can be done, for example, through fraud awareness training, the employee handbook and the organisation's whistleblowing policy. Multiple channels could be offered to employees to raise concerns under the whistleblowing policy, including hotlines, secure intranet sites or directly to fraud prevention and internal investigations units.

There should also be public reporting of whistleblower numbers, with external monitoring by independent parties such as an Ombudsman.

Effective internal audit

While it is the overall responsibility of management to monitor performance and ensure that operational policies are being followed and performance standards are being met, this must be supplemented by an effective internal audit function. Usually, the internal audit team reports to the head of the administration and is responsible for carrying out regular reviews of the operations in the organisation. It is often the internal auditors in tax and customs administrations who are the first to detect instances of corruption when reviewing compliance with procedures.³⁷ Serious cases of corruption, involving violations of the law, are usually turned over to law enforcement officials for criminal prosecution. Internal audit activities normally include the following:

- **Compliance with operational procedures:** Based on clearly defined procedures which would normally be laid out in manuals or procedural guides, an auditor reviews the key risk areas in the actual day-to-day operations of the tax or customs offices. This would include, for example, reviews of taxpayer account reconciliation processes or results achieved from particular audit initiatives in a tax administration. In a customs administration, the internal auditors might look at declaration processing or procedures for the selection of shipments for physical inspection.
- **Expenditure/use of government funds/assets:** There are opportunities in the administration of large government departments to misappropriate funds. It is one of the roles of internal audit to review activities related, for example, to the purchasing of supplies, awarding of contracts and hiring of personnel.

Ongoing vigilance

Building a system to promote integrity in tax and customs administrations requires the implementation of measures to combat corruption and ongoing vigilance to ensure that such measures continue to operate as intended. In those countries that are considered to have effective and honest tax and customs administrations, considerable resources have been devoted to ensuring that appropriate checks are in place to detect and deal promptly with corrupt behaviour.

External scrutiny

The administration of the laws governing taxation (including customs duties) is critical to the funding of public goods and services. The way taxation is collected also influences the behaviour of taxpayers and of the wider society which it serves. Accordingly, with substantial responsibility should come high levels of accountability. For example, a corporate value of the ATO was to be open and accountable.³⁸

In most leading jurisdictions, there is substantial scrutiny of the taxation agencies. For example, in Australia the ATO, while independent in the administration of the tax laws within its bailiwick, provides a comprehensive annual report to Parliament on its activities. The ATO is also subject to scrutiny by parliamentary committees, the Australian National Audit Office, the Inspector General of Taxation and the Commonwealth Ombudsman.

The Australian experience

The corruption indices referred to earlier in this article highlight potential 'alternative futures' for South Africa unless a concerted effort is made to mitigate the harmful consequences of corruption.

The contrasting fortunes of Australia and Argentina over the last century demonstrates the importance of good governance, the rule of law and institutions of high integrity:

At the beginning of the 20th Century, two new nations were commonly identified as offering the greatest promise for the prosperity and wellbeing of their peoples. They were Australia and Argentina. At that time, the GDP per capita of those living in each country was roughly equal. The prospects for each nation appeared equally promising. However, in the course of the ensuing century, the people of Argentina, despite the great natural resources of their country, fell behind. They did so largely because of the imperfections of their governance. The Australian people, generally speaking, have continued to prosper under their 1901 Constitution.

Among the reasons commonly advanced for these contrasting outcomes have been the inefficiencies and imperfections of the Argentinean law and practice on taxation. For much of the last century, the wealth in Argentina reflected the nightmare that haunted Lionel Murphy in his dissent in *Westraders*:

'[I]ncome tax becomes optional for the rich while remaining compulsory for most income earners.'³⁹

The example of Argentina's past misfortunes remains before us as a warning. In Australia, we must continue to uphold by law a regime of national taxation that obliges administrators to conform to their legal obligations; to act fairly; to avoid procedures or outcomes that are so disproportionate as to be irrational. At the same time, we must uphold the purposes of our revenue statutes and reject any notion that the paying of lawful taxes is optional.⁴⁰

The ATO experience

The ATO is regarded globally as a leading tax agency administering a modern tax system.⁴¹ The ATO also boasts a proud history where 'honesty and integrity had long been ingrained in the ATO, supported by a fraud and ethics consciousness program introduced in the late 1990s'.⁴²

The ATO always had a variety of internal guidelines designed to minimise the possibility of individual officers taking inappropriate action.⁴³ Nevertheless, these safeguards proved not to be foolproof against an opportunistic attack on the agency's integrity. Nikytas (Nick) Petroulias, a relatively newly appointed assistant tax commissioner, was charged in 2000 with corrupt conduct which he undertook at the end of the 1990s. He was committed to trial in 2002. After around 30 court proceedings, he was convicted in 2008 and jailed for three years.

While the fact that he was caught and diligently prosecuted demonstrates that the existing safeguards eventually worked, the fact that he had made it through the recruitment vetting process and was appointed and then promoted to a senior position, all in a relatively short time frame, while carrying out criminal activities, reveals shortcomings in the processes at the time.

This case highlights the ongoing need for vigilance in safeguarding the integrity of the organisation. The case exposed the failure to carry out appropriate vetting and integrity checks associated with the appointment to a senior position of a person from the private sector and identified further administrative improvements that needed to be made to the operation of the private ruling system.

While not an excuse, the administrative and political environment of the late 1990s and early 2000s helps to explain how the ATO let down its guard. It needs to be remembered that at the time:

[The ATO was] administering the most extensive tax reform program in the history of this country [associated with the introduction of the Goods and Services Tax] ... The ATO is also in the process of 'reinventing' itself as it prepares to introduce major organisational change to deal with the new tax system ... An important added complexity is the increased political sensitivity of tax administration as the major political parties draw one of their major battle lines on tax reform and administration.⁴⁴

More recently, in 2017, a deputy commissioner with three decades of experience in the ATO was charged with abusing his position as a public official, allegedly by having used his position to obtain information that he passed on to his son, who was subsequently charged with conspiracy to defraud the public purse.

As this matter is still to be resolved, it is not possible to determine the level of impropriety of the tax officer, if any. However, the allegations alone have an adverse impact on public perceptions of the ATO. Moreover, this sad episode highlights the importance of values and leadership to an organisation's culture, as well as potential risks associated with conflicts of interest.

The Petroulias matter

Possibly the most significant corruption case in Australian tax history culminated in the conviction of Nick Petroulias on two charges for offences under ss 73 and 70 of the *Crimes Act 1914* (Cth). The jury could not agree upon a verdict with respect to the first count under s 29D of that Act. In passing judgement on Petroulias, Johnson J made the following comments:

(b) the Offender entered employment with the ATO for the purpose of conducting a business with respect to the marketing of EBAs [Employee Benefit Arrangements] outside the ATO, and using his contacts and influence within the ATO to advance his private business interests;

(c) throughout the period when the Offender worked as a consultant or employee of the ATO between 1997 and 1999, he did not reveal to anyone the true nature of his associations and his private business interests in areas directly relevant to the exercise of his duties;

(d) the Offender did, at the same time, influence favourable outcomes with respect to applications for advance opinions or private rulings in 1997 and 1998 and orchestrate, through Mr Morgan and others, the use of opinions and rulings (and associated documents) for marketing purposes for his own private financial interests;

(e) with respect to the issue of the opinions and rulings, the Offender exercised influence, to varying extents, over Mr Chow, Mr Charles, Mr Targett and Mr Aivaliotes with respect to the issue of favourable opinions and rulings;

(f) in the same period, the Offender used his influence to guide applications made by other interests towards unfavourable outcomes, which were difficult to reconcile with the favourable outcomes for interests associated with the Offender;

(g) the Offender agreed to receive a benefit, namely money, and did receive money (about \$41 000.00) as proceeds from these private business interests;

(h) the Offender provided client lists to Mr Morgan in breach of the secrecy provisions in the tax legislation — the client lists were compiled from information obtained by use of the ATO's compulsory powers and were provided to Mr Morgan for marketing purposes to gain a commercial advantage over their business competitors.⁴⁵

The judge went on to say:

Rather, as I have said, this evidence bears upon the detrimental impact on public confidence in the ATO and the private ruling system administered in the public interest by the ATO, and the practical need for use of substantial ATO resources to, in the words of the Crown submission, sort out the mess created by the Offender's improper conduct. The credibility of the rulings and opinions issued by the ATO was integral to the tax system, and the actions of the Offender brought the ruling system into serious disrepute.

The proper and impartial administration of the tax laws is critical to the operation of our federal system of government. The law vests substantial powers in those exercising these important functions. Those powers are accompanied by important responsibilities, including the duty to serve the public and to maintain confidentiality according to law. By his crimes, the Offender has betrayed the trust and responsibility vested in him. He has damaged the public fabric of our community by undermining confidence in the fair and impartial administration of the tax system.⁴⁶

Private ruling system

Petroulias's activities enlivened various reviews of the ATO and, in particular, in relation to the public and private rulings systems. These included a review of the private ruling system commissioned by the then Commissioner, Michael Carmody and carried out by Tom Sherman⁴⁷ — a former Head of the National Crimes Authority. Sherman identified the following as major issues for consideration:⁴⁸

- the tension between business lines and corporate requirements;
- the fragmentation of information technology systems in both case management and precedential systems;
- the establishment of appropriate accountability mechanisms for private rulings, including a distinctive identifier and a central registry;
- improving the system of delegations and authorities to perform private rulings work;

- whether there was any need for Advance Opinions (as distinct from binding private rulings);
- issues related to timeliness and costs;
- issues relating to fraud control;
- integrity checks;
- developing and maintaining current technical manuals; and
- whether private rulings should be drafted in a way that they could be made public without disclosing the identity of the taxpayer.

On 15 November 2000, Commissioner Carmody⁴⁹ responded to the Sherman report and agreed to its recommendations, which included the following:

- that private binding rulings be signed off by the relevant case office and countersigned by an authorising officer, both of whom have to be subject to an integrity check;
- use of IT precedent systems;
- use of a national Case Reporting System to record all private binding rulings and assist in quality and consistency through inbuilt mechanisms to identify significant issues and, through templates and prompts, to ensure that rulings are properly structured and relevant issues are considered;
- an income tax advice manual to guide officers engaged in technical work;
- escalation procedures designed to identify significant matters and to bring appropriate technical expertise to bear on these matters;
- quality assurance processes that involve a selection of representative cases on a regular basis for review by an assessment panel, commonly involving an external representative (from the private sector or academia); and
- the publication of private binding rulings on a public database without disclosing the identity of the taxpayer.

The latter recommendation, that is the publication of all private rulings on a public database with taxpayer identifiers deleted, was considered by Sherman as the most important measure.⁵⁰

ATO governance

As a result of the ‘mess’ associated with Petroulias’s activities, the ATO made a thorough and comprehensive review of its integrity framework. Existing processes were tightened, and new checks and balances were introduced.

As early as 10 March 2000, the Senate Economics References Committee report on the ATO concluded:

The Committee is of the view that no organisation can be fully protected from individuals with criminal intent, and it would be unrealistic to suggest that future examples of criminal activity within the office will not arise. However, the Committee notes that the ATO has developed and implemented a comprehensive range of fraud prevention and control procedures and has subjected these procedures to external review.⁵¹

Over time the ATO could claim to have a very comprehensive and well-developed governance framework which embedded the Australian National Audit Office’s public sector governance principles of leadership, accountability, efficiency, transparency, stewardship and integrity.

Some of the key features, processes and products associated with the ATO’s governance framework included the following.

Leadership

- A Strategic Statement to provide a clear sense of direction and a setting for ATO activities. The objective at the ATO became to embed within the organisation a virtuous circle of care, integrity and commitment by staff to the important work of the ATO to continuous improvement and top-down and bottom-up innovation, to new thinking and new ideas and to success.⁵²

Accountability

- An outcome and outputs framework that detailed the ATO commitments to the government. It is also used for planning, budgeting and reporting performance within the ATO and externally to government.
- The ATO Plan translated the outcome and outputs framework commitments into specific priorities and deliverables:
 - Business and service line plans and branch plans, as well as individual performance and development agreements, underpin the ATO Plan.
 - The ATO plans are informed by a robust risk management process and health of the tax system analysis.
- The agency agreements set the leadership requirements and development expectations of leaders and staff:
 - A range of communication mechanisms were also used to educate staff throughout the organisation about the importance, and key elements, of good governance and high integrity — these included the weekly Commish article in the ATO's online magazine *News Extra*, SES/EL2 dialogue days, seminars and online learning programs and the Employee Handbook.
- The Taxpayers' Charter set out the relationship the ATO wanted to have with taxpayers and promoted an environment of mutual respect. Its ethos was embedded into the ATO's culture:

Furthermore, at least so far, the charter approach to tax administration has continued in Australia and found support from both ATO staff and Australian taxpayers. In addition the Australian Taxpayers' Charter has moved on from a simple list of principles and become more embodied in the culture of the ATO. The survey evidence from Australian taxpayers is not only positive but also fits in with the way compliance policy is developing in the organisation.⁵³

Efficiency

- The ATO's Compliance Model required a proportionate response to identified risks. Planning processes became more sophisticated as the ATO undertook regular 'health of the system analyses' based on market segments and using multiple lenses.
- The ATO website made the ATO more accessible to taxpayers and their agents and started the trend towards self-service applications which, in recent times, have become a feature of leading tax administrations.
- The changes made to the way the ATO operates as a result of the Change Program were pervasive and in their totality provided a platform for innovation and for building comparative advantage for the ATO.⁵⁴
- There was also increased emphasis on the performance management of staff.⁵⁵

Transparency

- The ATO released its first Compliance Program to the public in relation to the 2002–03 fiscal year and has continued to do this annually.

- The ATO publishes its performance standards on its website and in its report to Parliament.
- The Australian Information Commissioner has described the ATO as being well placed to meet the new requirements of the *Freedom of Information Act 1982* (Cth) because of its approach to informing taxpayers.⁵⁶
- In seeking to make the system easier, cheaper and more personalised for taxpayers, the ATO pioneered two closely related concepts:
 - User-Based Design; and
 - The 3Cs of ‘consultation’, ‘collaboration’ and ‘co-design’. The 3Cs became formal elements of the ATO’s 2006–2010 Strategic Statement and were prominent in the values and themes that underpinned the ATO’s 2010–2015 Strategic Statement. The ATO convened an extensive number of consultative forums, which gave a broad range of stakeholders a voice in how the revenue system is administered. The forums included professional advisory committees, liaison groups, expert panels and industry partnerships. There was also active complaints management as an improvement loop for ATO operations. In addition, the ATO commissioned independent taxpayer perception surveys, which it made public. Such surveys are commonly designed to elicit taxpayers’ views about the overall fairness and integrity of the tax administration.

External scrutineers of the ATO included parliamentary committees, the Australian National Audit Office, the Inspector General of Taxation, the Commonwealth Ombudsman and the Office of the Privacy Commissioner. The Joint Committee of Public Accounts and Audit observed in its 2011 Report 426 that ‘On relationships with the ATO, the scrutiny bodies were unanimous — relationships are good and getting better ... Overall, the committee was satisfied with the ATO’s handling of the recommendations in reviews and reports made by the external review agencies, especially the large number of recommendations agreed and implemented’.⁵⁷

Stewardship

- Corporate committees constitute a key element of the ATO’s governance and assurance arrangements.
- Practice statements outlined internal policies which support efficient, effective and ethical stewardship of powers and resources.
- The ATO has an active Audit Committee, and a Fraud Control unit whose plans are signed off annually by the Commissioner.
- Financial management procedures existed to ensure proper use of money, public property and other resources:
 - Chief Executive Instructions guided officials delegated or appointed to undertake financial tasks under the *Financial Management and Accountability Act 1997* (Cth).
 - Financial assurance processes included implementation of financial controls, and the preparation of certificates of compliance in relation to these controls.
 - Business and service line managers assured the Commissioner of the ATO conformance with internal and external conformance obligations through certificates of assurance.

Integrity

- The Integrity Framework⁵⁸ outlined the arrangements that helped to build and maintain an integrity-based culture:

- The framework explained the behaviours, values, and ethics that were essential elements of the ATO's approach, as well as key integrity processes and responsibilities.
- The integrity framework was accompanied by an award-winning fraud awareness program, *Make the Right Choice*.⁵⁹
- Integrity assurance arrangements included the appointment of an external integrity advisor.
- Various channels and protections existed for whistleblowers, and all claims were investigated.
- There were real and severe penalties (including dismissal and prosecution) for malfeasance, a zero-tolerance approach for unauthorised access to taxpayer information and strong likelihood of detection by internal audit or fraud control staff.

The importance of values and organisational culture

As at 2012, the ATO's integrity framework included a wide range of integrity indicators and a program of certificates of assurance, complemented by internal audit and fraud prevention functions. As part of this framework the ATO:

- set ethical standards for employees, including adherence to the ATO and Australian Public Service values;
- told the community how they could raise concerns or make complaints;
- had an independent integrity adviser to provide advice directly to the Commissioner;
- had systems to prevent and control fraud; and
- used its corporate governance committees to consider and monitor integrity.⁶⁰

Strong internal controls; automated processes; avenues for employees, taxpayers or agents to raise concerns; and an internal audit and fraud control investigation capability coupled with appropriate sanctions are all essential elements of any strategy designed to address corruption in a revenue authority. However, an effective integrity framework works best when it is supported by a high-integrity organisational culture. A focus on nurturing the right culture is at the centre of building a world-class tax administration:

The ATO culture was of a community of people bound together by the shared knowledge that they were doing important work for the Australian community and a sense of shared professionalism.⁶¹

Conclusion

Just as a masonry arch or vault cannot be self-supporting until the keystone is placed, high integrity in government and administration, together with adherence to the rule of law, are necessary to carry the weight of community expectations.

While solutions that address the problem of corruption will often require the active involvement of the wider community, the tax administration can be an important harbinger of change. It can introduce measures that minimise the risk of corruption in its organisation and develop and nurture a culture of high integrity within its organisation. A high-integrity tax administration helps to build trust in the public service and collects the revenue necessary to support the government's expenditure agenda. This is not an easy challenge. A tax administration is better able to mature where it has high integrity. So many developing administrations face a catch-22 dilemma — they struggle to mature into world class administrations because corruption negatively impacts on their approaches and on the legitimacy of the tax agency in the eyes of the community.

Nevertheless, it is a challenge that needs a response. This article outlines some approaches that help guide the actions that can be taken to promote a corruption-free administration, where there is effective leadership and the will to do so. What is fundamental is that the staff of the tax administration are aware of and engaged with the importance of integrity at the personal, organisational and national levels.

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