

The Members of the Legislative Assembly
Parliament House
SYDNEY NSW 2000

In compliance with Section 38E of the *Public Finance and Audit Act 1983*, I present a report to the Legislative Assembly titled **Office of State Revenue: The Levying and Collection of Land Tax.**

A C HARRIS

Sydney
August 1998

Performance Audit Report

Office of State Revenue

**The Levying and Collection of
Land Tax**

State Library of New South Wales cataloguing-in publication data

New South Wales. Audit Office.

Performance audit report : Office of State Revenue : the levying and collection of land tax / [Audit Office of New South Wales]

ISBN 0731389018

1. Land value taxation - New South Wales - Auditing. 2. Real property tax - New South Wales - Auditing. 3. New South Wales Office of State Revenue - Auditing. I. Title: Office of State Revenue : the levying and collection of land tax. II. Title: Levying and collection of land tax.

336.22209944

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Executive Summary

Executive Summary

The Audit

This Report presents the findings of a performance audit to evaluate the economy, efficiency and effectiveness of the levying and collection of land tax by the Office of State Revenue (OSR). The Government's recent decision to vary land tax requirements relates to a policy objective, which is not a matter for comment by The Audit Office.

Findings

Specifically, the focus of the audit was on determining whether:

- OSR's land database can identify all landholdings in NSW liable for land tax:
 - ◆ the finding is that data quality prevents this.
- OSR can identify all landholders liable for NSW land tax:
 - ◆ the finding is that present arrangements limit OSR's ability to do this.
- Land tax processing and administrative procedures are undertaken economically and efficiently by OSR:
 - ◆ the finding is that scope for economy and efficiency improvements is evident, but OSR's ability to achieve improvements by itself is limited. Inter-agency systems development is first required.
- Land tax debts are effectively managed to maximise recoveries, and penalties are fairly and effectively imposed for late lodgement and late payment of land tax:
 - ◆ the finding is that OSR's performance is creditable.

In determining these factors the audit also examined whether OSR's information systems provided adequate information to allow assessment of the effectiveness of OSR's administration of the tax: the finding is that further enhancement is necessary.

Conclusion

Land tax has a significantly higher cost to collection ratio than other State taxes. In part this is because of its design. But there are opportunities to reduce collection costs within current policy constraints. OSR has been actively pursuing better practice initiatives for some time and a substantial range of improvements has been made. OSR is continuing these efforts. However, inadequate systems and continued difficulties with the quality of land information remains as an impediment to efforts to increase efficiency and effectiveness and reduce collection costs.

It is not realistic ever to expect that a tax system will operate perfectly. However, improvements canvassed in this Report (a number of which OSR had already been addressing before the audit commenced) would provide reduced collection costs (through greater efficiency) and improved collection results (through better education of taxpayers and better use of penalties and incentives). Notwithstanding these improvements, the long standing issues of land information standards and land ownership data compatibility between NSW agencies (largely outside OSR's control) remain to be satisfactorily resolved.

Land Tax

Land tax raised \$640 million for the State in 1996-97. This represented around 6.4 per cent of the total taxation revenues raised by OSR.

Land tax is a tax on the ownership of land, or interest in land, situated in NSW. The wide range of exemptions allowed under the land tax legislation means that the majority of NSW land in private hands is exempt from the tax.

Land tax has the highest collections cost ratio for the dollars collected of any State tax. This is chiefly due to the way that the Government has designed the tax, which is outside of OSR's responsibilities, but cost is exacerbated by procedural difficulties and system inefficiencies.

Data Quality Hampers Economy and Efficiency

Considerable progress has been made by OSR in implementing automated assessments. However, the quality of data hampers continued improvement in collection efficiency. The land database contains duplicated and corrupted data, and some data are missing. The magnitude of errors in OSR's land database was estimated in 1996 at between 6 and 24 per cent.

OSR spends considerable time and resources in cleansing operations on its database to identify and correct errors and to locate missing information. Because of ongoing difficulties with the quality of the data OSR receives from the custodians of land information (that is, Land Titles Office and the Valuer General's Department) some of the investment in cleansing activities for past data is wasted.

OSR is forced to continue to maintain its current database and undertake data matching activities to ensure that land owners declare all their landholdings. Maintaining a land information database is not the proper function of OSR. However, because the State's central database of land information does not meet the needs of various government agencies which seek to make use of it, a number of agencies (including OSR) maintain separate databases, often duplicating information held elsewhere. Because agency systems are developed independently, the sharing of information between agencies is hampered by differing data standards.

Duplication of databases is not an efficient or economic use of the State's resources. The lack of a comprehensive, usable land database adversely affects the economy, efficiency and effectiveness of OSR's administration of land tax. Because OSR is forced to purchase and maintain information on all land in the State, and not just the information that it actually uses, OSR's ability to control and reduce collection costs is limited.

The various land information custodians have long recognised the need for change, and various projects to address such matters have been initiated over an extended period, with some success. However, the problems have proven to be extremely resilient. In the latest attempt to resolve the problem in NSW of land information, OSR has been instrumental in establishing the Spatial Information Partnering Project. This offers good potential. However, it is unlikely to be sufficient by itself.

The Audit Office believes that efforts finally to resolve the issues of land information standards and data quality should be made a major priority. There is potential for such improvements to benefit a number of agencies who are users of, or require access to, land information. Present initiatives are a positive start but may not be sufficient to achieve the desired results without Government guidance and further priority may need to be given to this issue.

Collection Completeness

Because of difficulties with the quality of land information, systems limitations and resource constraints, OSR cannot be certain that it has identified all land owners liable for land tax and collected all land tax that is payable. OSR is forced to rely heavily on information provided by taxpayers.

One of the methods used by OSR to assist in identifying and addressing risks to revenue is the development of Revenue Profiles. The land tax Revenue Profile in May 1997 estimated the revenue gap (the difference between tax collections with complete compliance by all citizens and the amount actually collected) to be somewhere between \$31.8 million and \$64 million. This broad range illustrates the extent of uncertainty about how much tax is currently not collected. And even the upper estimate may yet prove to be conservative.

In the last twelve months OSR has aggressively pursued strategies to reduce the revenue gap and OSR's Land Tax Focus Group continues to develop strategies to reduce this gap even further. Strategies, such as developing Revenue Profiles, have assisted OSR to identify and quantify risks to revenue, and implement strategies to address those risks. Further initiatives to promote greater voluntary compliance by taxpayers are canvassed in this Report.

OSR believes it is getting close to identifying all land tax liabilities. However, enforcement initiatives are continuing to identify greater outstanding liabilities than OSR estimates. For example, the revenue gap for Special Trusts was estimated at between \$2 million and \$6 million; actual revenue identified was \$14.1 million (including penalties). Sales tracking activities had a revenue gap estimate of between \$4 million and \$9.5 million; \$20.1 million of actual revenue was identified (including penalties).

Once a liability is identified, OSR follows up collection and applies penalties for the delay in payment as appropriate. However, identifying all liabilities in the first instance remains the key challenge for OSR, and indications are that further opportunities remain. The extent of this obviously cannot be known, but the substantial results from enforcement initiatives may indicate that outstanding liabilities continue to be material.

Enforcement Activities

OSR enforcement activities identified \$19.0 million in additional land tax revenue in 1996-97. For the current financial year, OSR's enforcement work identified \$43.3 million of additional land tax revenue up to 5 May 1998.

The Audit Office considers that OSR's methods of targeting enforcement activities are sound. However, up to 15 per cent of the resources allocated to individual land tax enforcement projects are being used to cleanse erroneous data before follow-up action can begin. There is also some duplication of effort, because information is not easily interchanged between OSR's land tax and management information systems. Present system limitations prevent all of the information required for senior management reports being obtained from operational inputs.

Whilst sharing of intelligence information occurs within OSR, further use could be made of the intelligence information that OSR derives (or has the potential to derive) from enforcement activities better to focus client education and prevention strategies.

OSR utilises a range of education and awareness mechanisms to enhance voluntary compliance. A significant part of OSR's efforts in this area is directed at tax advisory professionals. Given the importance of this strategy, a thorough review of its efficacy is deserved and may provide further insights to improve its effectiveness. Land tax publications produced by OSR are also an important component of their strategy. These could be further developed to enhance their effectiveness. For example, OSR could promote more vigorously the penalty aspect of non-compliance with taxation legislation in its land tax material.

Debt Collection

The outstanding debt for land tax represents over one third of the total amount of known outstanding State taxes. Because land tax is an invoice-based tax (whereas other State taxes predominantly rely on self-assessment and self-identification), the proportion of known outstanding debt attributable to land tax may be inflated.

OSR has been active in collecting outstanding land tax which has resulted in a reduction in the amounts of land tax outstanding. However, The Audit Office considers that the current instalment arrangements hinder OSR's ability to gain further efficiencies in this area. Changing instalment arrangements should be considered firstly by OSR, to seek to optimise its efficiency. However, changes could also have revenue cash flow implications for the State, which would need to be considered outside of OSR.

Further improvements can be made to collect debts in a more timely manner and to reduce further the level of outstanding debt. Suggestions for improvement included in this Report would lead to debt being collected earlier, which has benefit for the State. OSR is working on these matters as part of its ongoing range of improvement initiatives, and has agreed that improvements in the order of \$7 million worth of tax being collected earlier in future years are achievable.

Recommendations

It is recommended that:

1. The resolution of long standing difficulties with land information be made a major priority and pursued to their resolution - whether via the Spatial Information Partnering Project or other means.
2. OSR improve voluntary compliance by enhancing client education and information activities. OSR should:
 - identify and analyse, as part of its enforcement activities, the reasons for land owners' non-compliance and use this information to better focus prevention strategies
 - review as a matter of priority, and thereafter periodically, the effectiveness of information and education strategies to ensure that they meet corporate objectives
 - review all land tax publications to correct existing gaps in information, and especially to ensure that adequate mention is made of penalties imposed for non-compliance with land tax legislation.
3. Improvements be made in the efficiency and timeliness of the collections process to allow identification of defaulters earlier, and commencement of follow-up action sooner. OSR should consider seeking changes to land tax payment arrangements to:
 - extend the current three periodic payments instalment scheme to all taxpayers
 - include a schedule of the taxpayer's total indebtedness with assessment notices
 - abolish instalment schedules and replace these with reminder notices to be sent shortly before the instalment was due.
4. OSR periodically review the success of its debt collection strategies in a comprehensive and structured manner, and consider tailoring actions where this may be more effective.

Response from the NSW Treasury

Dear Mr Jambrich

I acknowledge with thanks your letter of 25 June 1998, enclosing a copy of the abovementioned Performance Audit Report.

I am grateful for the opportunity to respond on behalf of NSW Treasury and have attached to this letter my formal comments in relation to the various recommendations.

Please let me know if any further information is required.

Yours faithfully
(signed)

George Maltabarow
Acting Secretary

In general, the thrust of the recommendations contained at page 7 of the Report is supported.

There is no doubt that the quality of land data supplied by various trustees to the Office of State Revenue has contributed in the past to difficulties in identifying land owners with land tax obligations and issuing assessments to them. This fact has also been acknowledged recently in the report of Parliamentary General Purpose Standing Committee No. 1 when it inquired into and reported on recent changes in land tax.

However, the more important consideration is whether or not adequate action has been or is being taken to address data quality issues.

In fact, OSR initiated interest in the Spatial Information Project (SIP) in 1997, when it wrote seeking central agency support for an inter-Departmental attack on land data quality issues. The current inter-Departmental project was established as a direct outcome of OSR's actions and is regarded as being of sufficient importance to be chaired by the Director-General, Premier's Department. It is expected to deliver database and revenue cash flow improvements within the next 18 months - 2 years, by developing standards for adoption by all relevant data collecting agencies that will directly facilitate the matching of land ownership details with land tax obligations.

Recommendations aimed at review and improvement of current client education and information strategies adopted by the Office of State Revenue are accepted. The suggestions advanced in the Report will be taken up as soon as possible and subject only to competing pressures on available resources.

The recommendation concerning changes to land tax payment arrangements will be considered by Treasury, having regard to the implications of the proposal to abolish the existing 'mid

It is noted, however, that the suggestion for reminder notices to be issued shortly prior to instalment due dates has already been adopted by the Office of State Revenue for the 1998 land tax year.

The remaining point to be made concerns the debt collection strategies adopted by the Office of State Revenue. While acknowledging that strategies of this kind should constantly be evaluated to establish their efficiency and effectiveness, Treasury takes the view that the general approach adopted by the Office of State Revenue is appropriate. The Office of State Revenue has taken the almost unprecedented step amongst revenue authorities throughout the world of attempting to qualify elements of the revenue 'gap' in relation to its various revenue bases and, in this regard, could justifiably be regarded as demonstrating best practice.

It needs to be understood that revenue gaps represent the one year impact of the particular element of the tax that is being calculated. For example, in the case of the Office of State Revenue project concerning family trusts, compliance action realised revenue considerably in excess of the revenue gap estimate. This was because the liabilities identified generally went back many years and, because the trusts investigated had not made a full and true disclosure, no limit was imposed on the Chief Commissioner of State Revenue on the number of assessments per client that could be raised.

It is critical to understand that the revenue gap does not represent 'lost' revenue - rather, it is the revenue at risk as the result of evasion or ignorance of land tax requirements.

In fact, the Office of State Revenue collects most of the gap by virtue of its compliance programmes and the system for 'clearance' of land tax obligations at the time property is conveyed. Moreover, the imposition of interest and penalties ensures that the Government recovers the opportunity cost resulting from late payment, together with a premium to cover higher costs of collecting tax from defaulters.

In fact, the only revenue 'lost' consists of

- *land tax written off, amounting to less than \$1m per annum, or 0.16% on total revenue in 1996/67. (This percentage is likely to be even less in 1997/98.)*
- *land tax not discovered at the time land is sold, where a clearance certificate is issued. Even in these cases, the Office of State Revenue has the capacity to recover tax from the liable owner if a liability is discovered subsequently. Of course, recovery may be substantially more costly (or impossible) if the former owner is bankrupt or cannot be located, because there is no longer a valid 'charge' on the land.*

1. Background

1.1 Introduction

Collection of State Taxes

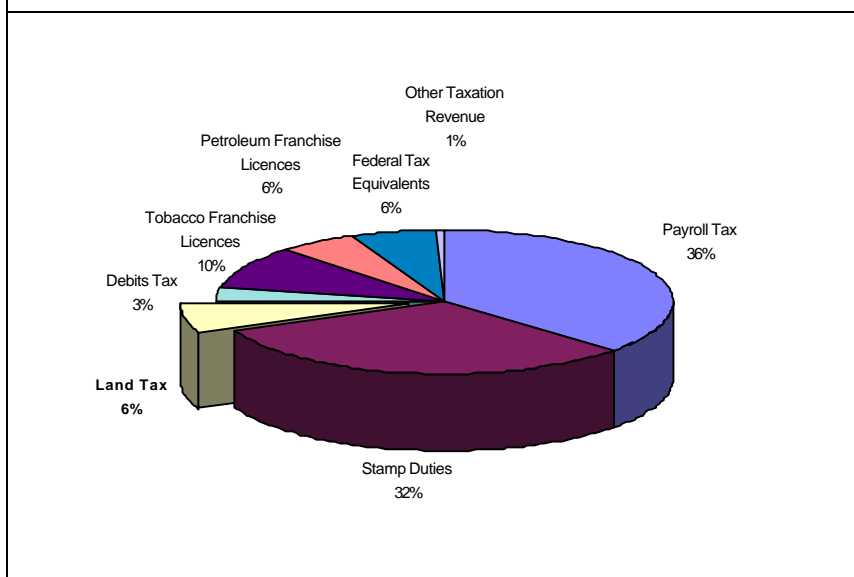
The Office of State Revenue (OSR) is a business unit of the NSW Treasury, with responsibility for the functions of levying and collecting State taxes and duties. The objectives of OSR are:

- to maximise revenue
- to maximise efficiency
- to maximise client satisfaction.

1996-97 revenue collections by OSR amounted to nearly \$10 billion, which represented 44 per cent of all revenue available to the State Government.

Land tax is small when measured against payroll tax and stamp duties. Even so, land tax raised \$640 million for the State in 1996-97, around 6.4 per cent of the total taxation revenues raised by OSR, and just under 3 per cent of all State revenues.

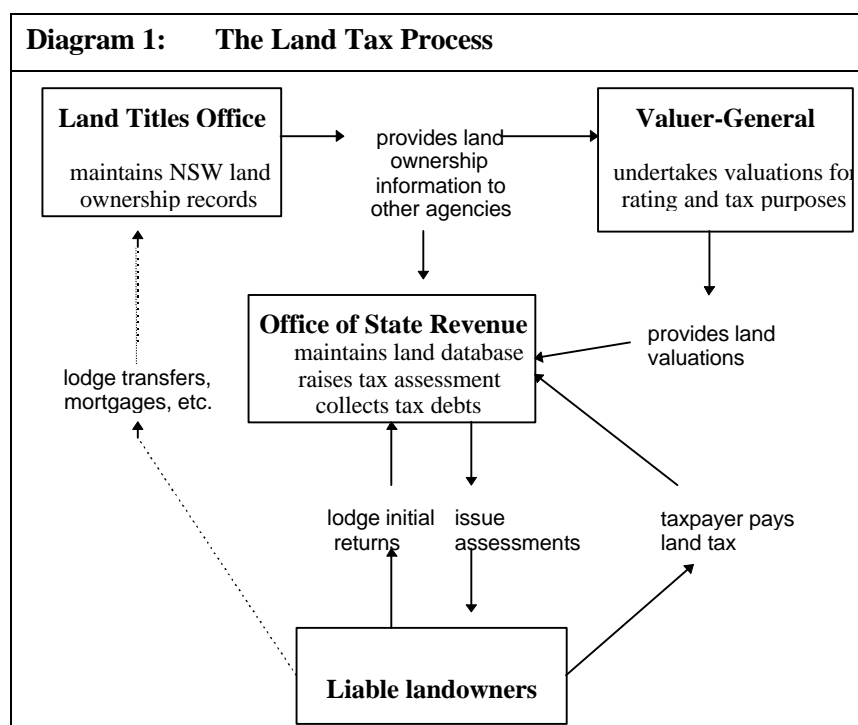
Figure 1: State Revenue Collections 1996-97



Source: OSR Annual Report, 1996-97.

Land Tax

Individual land owners, the Land Titles Office and the Valuer General's Department each provide information that OSR requires to undertake its collection function. The following diagram shows the relationships between the various stakeholders in levying and collecting land tax.

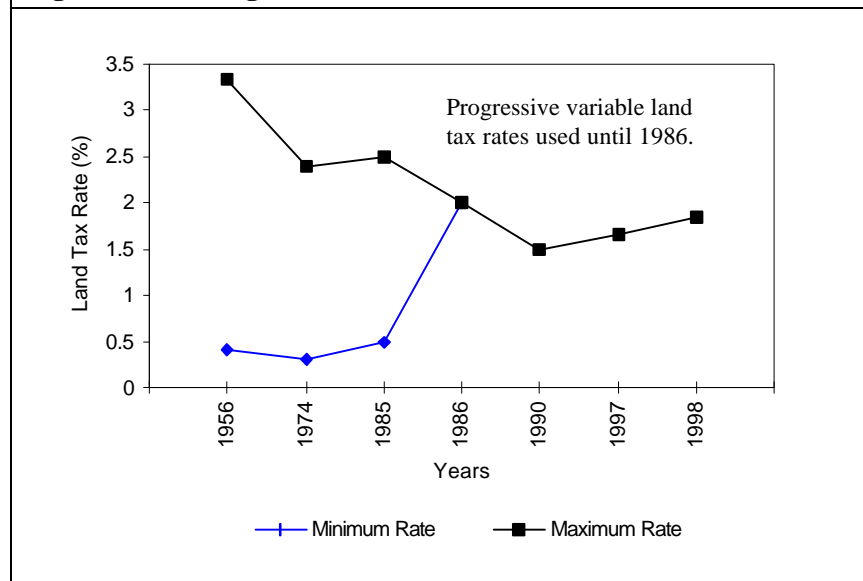


Relative Importance Of Land Tax Is Declining

The relative importance of land tax as a source of revenue has declined from a peak in 1976-77 when it represented 13.7 per cent of the total State taxation revenues. The decline in relative importance of land tax results from past Government policies. Changes included reducing tax rates (from 3.33 to 1.65 per cent) and increasing the tax threshold (from \$10,000 to \$160,000). Figures 2 and 3 illustrate some of the changes that have occurred since the introduction of State land tax in 1956.

Treasury forecasts that the downward trend in importance of land tax will continue despite the collections that result from the 1997 Budget changes which increased the land tax rate and extended the tax to principal places of residence valued over \$1 million. The Budget estimated revenue from land tax would increase to \$786 million in 1997-98, which would represent 6.1 per cent of total taxation receipts. The Treasury estimates now are for revenue of \$840 million in the financial year.

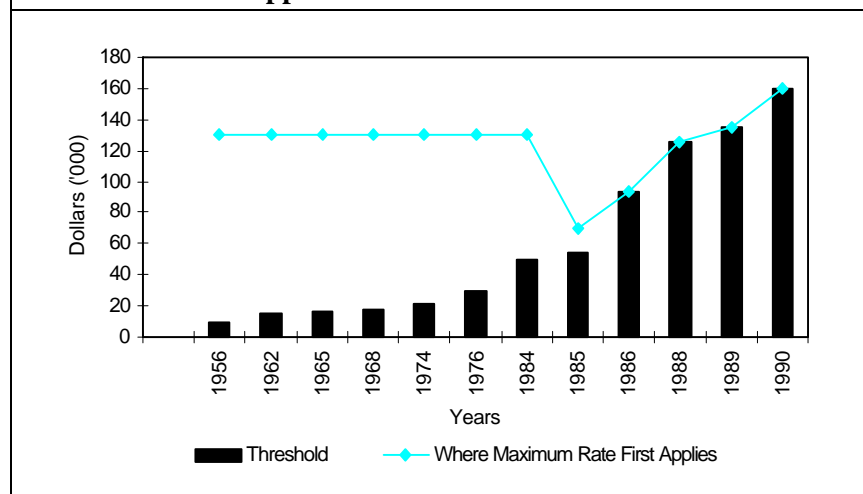
Figure 2: Changes To Land Tax Rates 1956-1998



Prepared by The Audit Office from: *Land Tax Review 1990*; *OSR Annual Reports 1993-97*.

Figure 2 shows the changes that have occurred in the rate of land tax since State land tax was introduced in 1956. When first introduced a sliding scale of rates were applied; from a minimum rate of 0.416 per cent applying for land valued at \$10,000 up to 3.33 per cent applying for land valued at \$130,000 or above. Progressive land tax rates were abolished in favour of one flat rate in 1986.

Figure 3: Threshold and Land Value Where Maximum Rate First Applies 1956-1998



Prepared by The Audit Office from: *Land Tax Review 1990*; *OSR Annual Reports 1993-97*.

Land tax legislation has always included a tax-free threshold and governments have increased the threshold from time to time to allow for appreciations in nominal land values. In addition, until 1986 the sliding scale of land tax rates meant that the maximum rate of tax did not apply from the threshold. Since 1986 a flat rate of tax has applied to all land above the threshold amount. In 1985, changes to the land tax rate structure reduced the level of land value where the maximum rate applied.

1997 Changes to Land Tax

The Treasurer announced several changes affecting land tax in the 1997 Budget. From 1 January 1998 the rate of land tax increased to 1.85 per cent. This rate applies for the 1998 and 1999 tax years, after which it will fall to 1.7 per cent for the year 2000 and subsequent years. The Government expected the change in the land tax rate to raise an additional \$67 million in 1997-98 and \$80 million in a full year.

In addition, principal places of residence with a land value of \$1 million or more are taxable from 1998. The \$1 million threshold figure will be indexed in line with the Sydney CPI for 1999 and subsequent years. OSR estimates that this change will affect slightly less than 3,000 properties and raise \$15 million in additional revenue for 1997-98 and \$30 million in a full year.

The Treasurer also announced measures to lessen the hardship of land tax to certain groups of taxpayers. Such taxpayers include retirees on a pension or those with a limited income insufficient to pay land tax on their principal place of residence. These taxpayers will be able to defer payment of land tax, but a market rate of interest will apply on the outstanding debt. The debt and interest will be recoverable from their estate or from the proceeds on sale of the property.

1.2 Liability for Land Tax

Land tax is a tax on the ownership of land, or interest in land, situated in NSW. Land tax is payable by owners of non exempt land owned at midnight on 31 December each year (the taxing date). For land tax purposes "land" may include vacant land, land that is built on and a unit (or lot) in a strata plan.

Exemptions to Land Tax

Land tax legislation allows a range of exemptions. The majority of NSW land in private hands is exempt from land tax. These exemptions necessarily contribute to, and must be taken into account when assessing, the administration costs of collecting land tax. The main exemptions allowed are for land that is the principal place of residence¹, and for primary production land. Generally organisations such as churches, charities, sporting and racing clubs, hospitals are also exempt, as are government departments and local government. A threshold land value (currently \$160,000) also applies.

The Review of the State Tax System Report² estimated that the tax exemptions allowed under the land tax legislation can be valued at \$1.9 billion per annum (1986-87), compared to total land tax revenues raised in that year of \$346 million. Land tax accounted for over 70 per cent of all the State's "tax"³ in 1986-87. Graph 4 shows the effect of these land tax exemptions.

The 1992 Government White Paper on Land Tax discussed the costs involved in exempting large numbers of taxpayers from a tax. The White Paper stated that once any tax system provides significant exemptions the collection costs increase sharply.⁴ This is a significant issue in administering land tax in NSW.

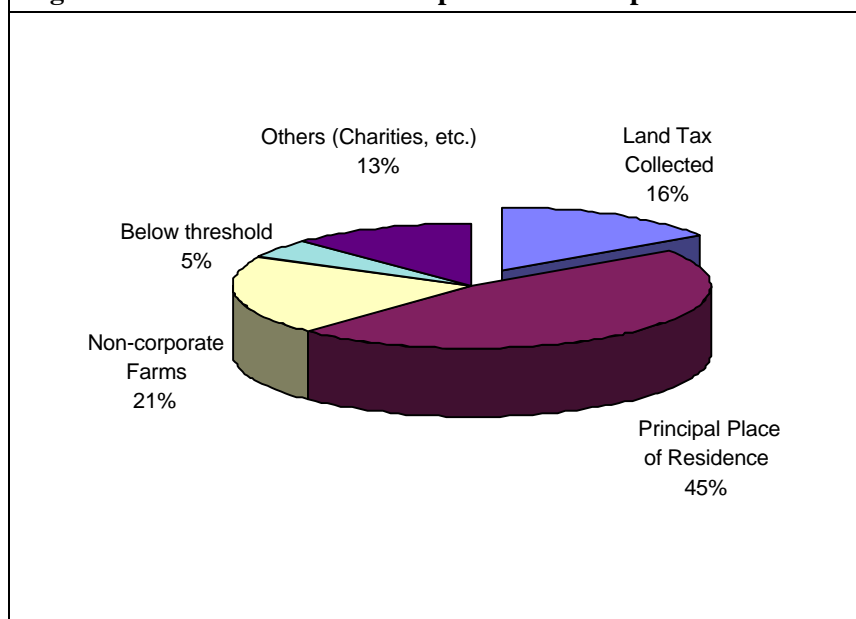
The data provided in the Review of the State Tax System represents the most recent comprehensive analysis of the cost of land tax exemptions. Since 1988, changes have occurred to the threshold amount, the land tax rate, exemptions and concessions; these changes will affect the proportions of the segments in Figure 4.

¹ As mentioned above, principal places of residence with land values of \$1 million or more are taxable from 1 January 1998.

² *Review of the State Tax System*, New South Wales Tax Task Force, August 1988.

³ *Ibid* p122. The 1988 report defines "tax expenditures" as the cost (ie, the loss of taxation revenues) of exempting certain activities or assets from a tax.

⁴ White Paper, p6.

Figure 4: Revenue Raised Compared To Exemptions 1986-87

Source: Prepared by The Audit Office from information contained in the *Review of the State Tax System, 1988*.

1.3 Valuation and Assessment

Land tax is levied at a set rate (currently 1.85 per cent) on the value of liable land less the land tax threshold (if applicable) and any allowable concessions. Land values include improvements *directly related to the physical land* such as clearing, leveling and drainage but excludes improvements which are not directly related such as buildings. Land values also reflect the zoning and the optimal use for the land. When deriving land values, consideration is given to factors that may reduce the value of land below that which would otherwise apply; such factors may include mixed development land and land with heritage or planning restrictions. The Valuer General's Department currently obtain land valuations for OSR by contracting out the valuation process to the State Valuation Office and to private valuers.

Land Tax Requires Annual Valuation Land tax legislation requires annual land valuations. In comparison, the *Valuation of Land Act 1916* requires the Valuer-General to provide local government with valuations for rating purposes at least every four years. The different time frames between the two types of valuations explain the quite significant variance that may arise between valuations for local rating purposes and those for land tax purposes. This can result in confusion, as land owners attempt to reconcile differing valuations for the same land.

Assessment Is Based On Aggregation Land tax is levied on aggregated land holdings. That is, OSR is required to aggregate the value of each land parcel in an owner's portfolio and to levy the tax on the total value of the owner's land portfolio.

Aggregation occurs because of the threshold aspect of the land tax legislation. A taxpayer may own several parcels of land each below the threshold; but the total portfolio value may be above the threshold. An owner with multiple land holdings may only claim the threshold amount once, not on each parcel of land held.

1.4 Administration of the Tax

Collection Costs and Efficiency

The cost of administering the land tax program was \$24.6 million in 1996-97. Land valuation costs, amounting to just under \$10.0 million, comprised the largest single item of expenditure. OSR recovered \$2.6 million of these expenses through user charges, mainly land tax search fees.

Collection costs by themselves do not show how well OSR administers the tax. However, collection costs when compared to the revenue raised, provide a measure of the efficiency of revenue collection. The resulting ratio shows the cost of collection as a percentage of revenue collected. Alternatively, this may be expressed as the collection costs per \$100 of raised revenue.

Land Tax Has The Highest Collection Costs Land tax has the highest collection cost ratio of any State tax (3.8 per cent). In comparison, the stamp duties collection ratio in 1996-97 was 0.7 per cent and payroll tax 0.23 per cent. Collection costs for the main State taxes over several years appear in Table 1.

	1986-87	1989-90	1993-94	1994-95	1995-96	1996-97
Payroll tax (%)	0.24	n.a	0.33	0.25	0.23	0.23
Stamp duties (%)	0.75	n.a	0.76	0.85	0.83	0.71
Land Tax (%)	2.59	2.02	4.43	4.87	4.08	3.83

Prepared by The Audit Office from: OSR *Annual Reports* 1993-97.

Benchmark For Tax Efficiency Is Two Per Cent

A Victorian Government inquiry into revenue raising in that State used collection cost ratios to produce a benchmark for revenue collection efficiency. The inquiry considered two per cent or less to be an efficiently collected tax; five per cent or greater would require strong effort to reduce costs or may indicate that the tax should be abolished.⁵ Land tax, with a collection cost ratio of 3.8 per cent in 1996-97, is at the high end of this benchmark and has significantly increased from the minimum collection cost ratio of 2.02 per cent achieved in 1989-90⁶.

Completeness of Land Tax Collections

In addition to concerns over the cost of collecting land tax, the completeness of land tax collections is an issue. Because of difficulties with the quality of land information, systems limitations and resource constraints, OSR cannot be certain that it has identified all land owners liable for land tax and collected all land tax that is payable. In recent years The Audit Office has expressed concerns over the collection costs of land tax and about the completeness of land tax collections.

Revenue Profiles Developed to Assist Compliance Activities

Notwithstanding these difficulties, OSR has been pursuing actively strategies to improve compliance and increase revenue collections. One of the strategies to assist OSR in identifying risks to revenue, quantifying those risks and developing strategies to address those risks, is the development of nineteen Revenue Profiles.

⁵ *Report of the Committee of Inquiry into Revenue Raising in Victoria*, Victorian Government, 1983 quoted in *Review of the State Tax System*, NSW Tax Task Force, August 1988, p88.

⁶ Land Tax Review, Government Treasury Advisory Committee, 1990, p29.

Revenue Profiles provide OSR with a deeper knowledge and understanding of its revenue base, how it affects taxpayers and also assists in identifying taxpayers. Knowledge and appreciation of these is assisting OSR in giving the right priority and emphasis to strategies for compliance improvement. In the case of land tax, the “Revenue Gap”⁷ analysis contained in the Revenue Profile assists OSR to identify areas of unreported and under reported tax liabilities, overstated concessions and under payments of tax conceded to be due by the taxpayer. The Revenue Gap estimates for land tax is shown in Table 2.

Risks Identified	Revenue Gap 1997-98	
	Minimum	Maximum
Administrative Gap		
- Non lodgement by registered clients	0	
- Late lodgement by registered clients	0	
- Late payment of established debts ⁸	\$10,000,000	\$25,000,000
- Non payment of established debts	\$1,000,000	\$1,500,000
- Hardship Board waivers and deferrals	\$350,000	\$1,000,000
Technical Revenue Gap		
- Potential land tax clients	\$10,000,000	\$14,000,000
- Section 47 processing	\$500,000	\$1,500,000
- Code 3 clients	\$1,000,000	\$2,000,000
- Rental Bond Board project	\$3,000,000	\$5,000,000
- Family trusts projects	\$2,000,000	\$6,000,000
- Sales tracking action	\$4,000,000	\$8,000,000
Total Revenue Gap	\$31,850,000	\$64,000,000

Source: OSR Revenue Profile Land Tax, May 1997.

⁷ “Revenue Gap” is the difference between the amount of tax revenue that would be collected with complete compliance with taxation legislation by all citizens and the amount actually collected by the taxing agency.

⁸ This is measured in cash terms for a particular year not in net present value terms which would be a much smaller figure.

OSR estimated in May 1997 that the revenue gap for land tax was between \$31.8 million and \$64 million. However, in the past twelve months OSR has aggressively pursued strategies to reduce this gap. OSR's Land Tax Focus Group is continuing to develop strategies to address the risks identified in the Revenue Profile and reduce the revenue gap even further.

The "Administrative Gap" in Table 2 primarily relates to the collection of debt that the taxpayer agrees is owing. Debt management is discussed in Chapter 4 of this report. The "Technical Revenue Gap" represents activities to identify land owners who have not registered for land tax although liable to pay land tax. In these instances the taxpayer may be evading tax. Compliance and enforcement issues are discussed in Chapter 3.

1.5 Cost of the Audit

The cost of the audit totalled \$78,580 and comprised the following:

Direct salaries cost	\$47,485
Overheads charged on staff time	\$20,351
Value of unpaid staff time (at standard rates only)	\$ 6,144
Printing	\$ 4,600
Total Cost	\$78,580

1.6 Acknowledgments

The Audit Office gratefully acknowledges the excellent cooperation and assistance provided by representatives of the Office of State Revenue, the Valuer General's Department and the Land Titles Office to The Audit Office, and in particular to Stephen Horne, Director Performance Audit and Stephan Delaney, project leader.

2. Maintaining Land Information

2.1 Introduction

OSR places reliance on automated systems to administer land tax but these systems are based on records for land parcel rather than taxpayers. The land ownership system in NSW relies on a unique record generally separate and distinct from records for other land parcels. An important difficulty for OSR is that there is no requirement for owners of land to advise the Land Titles Office that they own more than one parcel of land.

The difference in focus between the land ownership system and a taxing system requires OSR to expend resources to match individual records to derive taxpayer land portfolios. More importantly because there is currently no reliable database of land information that meets the needs of land tax, OSR is forced to be a keeper of a land database. This is not OSR's role. Further, OSR continues to maintain records for all land in the State although only a small proportion of that land is liable for land tax. Land information and land valuations cost OSR \$10.4 million in 1996-97.

In addition to being forced to maintain land information itself, OSR's land database, on which the automated assessment systems rely for land and owners' information, contains duplicated and corrupted data and some data are missing. Efforts to improve data quality are hindered because of ongoing difficulties with the quality of the data OSR receives from other agencies. In 1996 OSR estimated the magnitude of these errors at between 6 and 24 per cent of all records. It is not certain what the current figure is. However, it is apparent that the problem is still of a significant level.

2.2 The Land Information Database

The land ownership and land valuation records maintained by OSR make possible automatic issuing of land tax assessments. To enable the process to occur OSR holds ownership records for all land in NSW⁹. OSR obtains this information from the Office of Land Information Policy and Coordination (OLIPaC¹⁰) which processes information provided by the Land Titles Office into a format suitable for the needs of OSR. Tapes supplied by OLIPaC regularly update the information on OSR's database with details of sales and transfers of ownership. At any given time OSR's land database should reflect the most up-to-date land ownership information.

Similarly, OSR obtains land valuations from the Valuer General's Department. Valuations are undertaken annually at a base date of 1 July, and OSR receives the majority of valuations between July and November each year. The Valuer General's Department also undertakes and supplies valuations throughout the year for new subdivisions and other changes to existing properties. OSR loads data processed by OLIPaC from the information supplied by the Land Titles Office and the Valuer General's Department into its database weekly.

Land Information

Maintaining a land information database is not the proper function of OSR which is, by definition, a revenue collection agency. However, the State does not possess currently a central database of land information, maintained according to uniform and agreed data standards, and accessible by all agencies requiring land information. As a result many agencies (including OSR) maintain separate databases often duplicating the information contained in other databases. This is not efficient or economic use of the State's resources.

Further, as agency systems are developed independently and often in isolation from systems being developed or existing in other agencies the sharing of information between agencies is often hampered by differing data standards. The incompatibility between computer systems design remains the main outstanding problem to be addressed.

⁹ There are some exceptions to this, for example land still registered under the "Old System" (that is, not Torrens Title). However, such land forms a very small proportion of the total land holdings in NSW.

¹⁰ Now the Geoinformation Infrastructure and Management Program within the Department of Land and Water Conservation.

These are the problems that OSR has experienced for some time and they affect the economy, efficiency and effectiveness of OSR's administration of land tax. Because OSR is forced to purchase and maintain information on all land in the State and not just the information that it actually uses (that relating to land and owners liable for land tax) its ability to control and reduce collection costs is severely limited. For example, if OSR had the option of paying for values used in any given land tax year, the cost of collections would be comparable with taxes currently regarded as efficient.

A Land Ownership System - not a Taxpayer-Based System

OSR's land tax system is based on the land ownership rather than being a taxpayer-based system. Land ownership records are kept on an individual land parcels basis; each land parcel has a unique record, generally separate and distinct from records for other land parcels.

Individual Land Records Need To Be Matched

The land tax legislation requires aggregation of land holdings and so OSR is required to expend resources in matching individual records to derive a total landholding portfolio for each taxpayer because there is currently no other method of ascertaining the aggregated land holdings of taxpayers. As said before, there is no requirement for owners of land to advise the Land Titles Office that they own more than one parcel of land and for this fact to be recorded in land records.

Slight Differences In Names May Not Be Matched

The individual nature of land records hampers OSR's matching activities because there is no requirement that land titles be recorded in the full name of the owner or even in exactly the same form of name for the same owner.

However, documents that are lodged for registration at the Land Titles Office affecting a change in land ownership are legal documents. The Land Titles Office has a legal requirement to register the change in ownership as recorded on the documents. It is Land Titles Office policy to reject documents where it is evident that the name has not been disclosed in full. But where lodging parties produce evidence that the land owner is known legally in the manner appearing on the document being lodged, then the Land Titles Office legally is bound to record ownership details as stated on the document.

Inconsistencies in registering names of land owners cause difficulties for OSR because although land held in the names of “J Smith”, “J B Smith” and “John Smith” may all relate to the same person, OSR’s matching programs will not easily identify this fact unless another source of matching data exists, such as each name having the same address for service of notices (ASON). Because of this, the land tax system may erroneously allow principal place of residence exemptions on each property.

The Land Titles Office has neither the incentive nor the power to impose naming standards on persons seeking to register changes in land holdings and legislative change is required to give that power. The Spatial Information Partnering project (discussed further below) has as one of its fundamental objectives the development of data standards and this may lead eventually to the necessary proposals for legislative amendments.

**Not All Land
Records Are
Used**

Although the land database must be useful record the ownership records of all land in NSW, only a very small proportion of the land information held by OSR relates to active land tax clients. Currently the database holds records on 3.96 million individual parcels of land and over 8.4 million ownership records¹¹. However, as at 30 June 1997 there were around 85,000 active land tax clients (representing about one per cent of all land owner records). OSR issued a total of 125,101 assessments during 1996-97.

Aggregation causes a similar problem with regard to land valuations. The Valuer General’s Department supplies valuations for all the State’s land but the majority of land falls below the threshold for the tax or is in other ways exempt. Land information and land valuations cost OSR \$10.4 million in 1996-97, most of which relates to redundant information. This is inherently inefficient although unavoidable. However, until a reliable land information database for the State becomes available (that also meets the needs of land tax), OSR is forced to continue to maintain its current database and undertake data matching activities to ensure that land owners declare all their landholdings. There is a potential for savings here. However, costs would be incurred to develop systems to address the problem.

¹¹ The difference between the two figures relates to multiple ownership of a parcel of land. In such cases OSR records the joint ownership and separate ownership for each party. This is required to aggregate landholdings correctly.

Potential For Increased Revenue Exists

Because of the difficulties experienced by OSR (difficulties outside of OSR's control even if within the Government's control), OSR cannot be sure that its records of all land owners' portfolio are complete and accurate and that it collects all land tax. This is not effective. There is potential for increased revenue, however, costs to develop systems would be involved.

A reliable central database, which served the needs of all users of land information and provided efficient access to the specific data required by each user, would be a great step forward. The various land information custodians have long recognised the need for change, and various projects to address such matters have been initiated over an extended period, with some success. For example, the Land Titles Office has been developing a Central Register of Restrictions, which is a central database of government authority land use restrictions.

However, the problems have proven to be extremely resilient and the goal of a reliable central database is yet to be achieved. Current initiatives to address this issue should be expedited (refer section 2.4).

Inaccurate Data In The Land Database

The land database contains duplicated and corrupted data and some data are missing. Because the land tax system relies on information contained in the land database, corrupt and duplicated data directly affect the assessment process. For example, the land tax system requires an ASON before it can raise an assessment. OSR staff advised that the majority of records rejected by the system during the 1994 enforcement activities were missing ASONs. Other data errors noted during the audit included:

- missing data fields within property records, such as 504,580¹² property owners with empty information sets and 58,393¹³ group records with empty member sets (whilst a significant level of data deficiency, these defects are not of themselves a major source of difficulty for OSR)

¹² As at 30 April 1997.

¹³ As at 28 May 1997.

- trust records affected when OSR converted its computer system in the early 1990s. At that time the system coded some trusts to allow a threshold exemption to which they were not entitled (there were 4000 trusts but the problem did not affect all trusts). OSR corrected this error in existing records during 1997 as one of the projects undertaken during the Special Revenue Initiative (SRI)¹⁴. However, OSR needs to ensure that new trusts added to the database in the future are coded correctly.

**Data
Inaccuracies
Largely
Historical**

OSR's land database difficulties are largely historical and result from an initial load of corrupt and duplicated data in 1989-90. Additional corruption of data occurred due to:

- the non-sequential supply of some data
- the supply of duplicated or unformatted data
- the inability of land information custodians (that is, the Land Titles Office and the Valuer General's Department) and/or the OLIPaC to provide accurate property linkages
- the limitations of existing OSR programs used to load regular updates of information.

Despite efforts undertaken by OSR over several years to correct missing, duplicated or inaccurate data, some data corruption remains. The magnitude of errors in its land database is uncertain, but 1996 estimates (the most recent available) varied from 6 to 24 per cent.

OSR Activity to Improve Data Quality

**Problems
Continue With
Land
Information
Quality**

OSR spends considerable time and resources in cleansing operations on its database to identify and correct errors and missing information. Because of ongoing difficulties with the quality of the data OSR receives from custodians of land information, some of the investment in cleansing activities for past data is wasted. For example, OSR estimates that while 95 per cent of property disposal transactions (that is, sales) are accurate, acquisition transactions (purchases) are less reliable (whilst a figure was not provided to The Audit Office, anecdotal advice indicated that the extent of errors was material).

¹⁴ The SRI committed additional resources to several enforcement projects across all State tax streams. The SRI project promised to return for 1995-96 \$22 million in additional revenue across all tax streams. OSR reports that this target was exceeded. Land tax was one of the tax streams to benefit from SRI resourcing.

The main problems experienced by OSR are incorrect ASONs, and an inability to match names recorded on transfer instruments with owners' names recorded in the database. Other problems OSR continues to experience include:

- some names not having an identified surname or family name
- use of free text (that is, text that is not formatted to enter readily into OSR's land owners files) to record long or complex names
- duplication and non standardisation of names recorded where an owner or entity owns more than one parcel of registered land.

OSR loading programs identify some of these data problems as they load Land Titles Office and the Valuer General's Department data into the land tax system and print exception reports of all entries that require some form of manual intervention.

OSR staff review loading exception reports regularly. However, the correction of data is a laborious process often requiring OSR staff to re-enter the data manually in an acceptable format. Because there are thousands of records on each tape, OSR's ability to cleanse corrupted data is dependent on the availability of skilled staff and competing demands for relevant staff and system resources.

OSR Is Unable To Correct All Errors

OSR advised that it is not possible for it to totally cleanse all of the corrupt data, either because the programming required is too complex or costly, or because the information required is not available. Instead OSR staff concentrate on protecting identified revenue by ensuring that information on existing clients' records is current. However, this strategy does not address the ongoing problem of data quality.

Agencies Duplicate Data Correction Activities

The Valuer General's Department advised that it also manually corrects property records received from Land Titles Office. The Valuer General's Department advised that it could provide corrected property records to OSR, but at a cost. Although this would reduce duplication of effort between two State agencies undertaking the same activity to produce similar outcomes, a better solution would be to ensure that information provided by custodians was in a useable format in the first place.

The Land Titles Office stated that it has been very willing to cooperate with OSR and has offered assistance over the past 12 months to address these problems. The Land Titles Office believes that enhancements to its systems over the past 12 months, particularly the Integrated Titling System, should have resolved many issues. However, it is apparent that further cooperative efforts are needed to address ongoing concerns.

2.3 Effects of Data Quality on Tax Collections

As explained in the preceding sections, data problems in the land database directly affect the economy, efficiency and effectiveness of OSR's land tax function.

Revenue Lost or Delayed

OSR cannot be certain that it has identified all land holdings for every land tax client. Revenue is lost if land owners are avoiding registration or do not disclose all land holdings and OSR is unable to identify these holdings because of the inadequacy of land information.

The amount of revenue lost or delayed as a result of database errors is not quantified by OSR. However, the technical revenue gap (shown in Section 1.3) represents activities by OSR to identify land owners who have not registered for land tax. These enforcement activities often require some form of data cleansing before actual investigations can begin.¹⁵

OSR believes that it is not correct to categorise all of the technical revenue gap as "lost revenue", because of other measures being taken to prevent revenue loss. These measures include the land tax clearance system (where a certificate can be issued stating there is land tax owing on a parcel of land) and compliance projects which have resulted in defaulters being identified and revenue recovered. OSR stated that although revenue may not be recovered in the same tax year to which the liability relates, the imposition of interest and penalties for late or non-lodgement of returns ensures that the Government is compensated for the opportunity cost and the additional costs of compliance programs. As such, OSR considers that the potential for revenue to be 'lost' is minimal.

¹⁵ As such, some of the revenue lost or delayed through database errors is contained in the figures shown earlier in Table 2.

Work is being done by OSR to identify land owners not paying their full liability for land tax. OSR logs and deals with all data quality issues according to available time and resources. OSR recognises that the longer the delay before recovery action begins the greater the risk to the revenue. OSR agrees that prior years debt is more difficult and more costly to collect. As such revenue risks associated with each data quality issue are scoped, and priority is given to data quality fixes according to such risk, and the ease of rectification. Much of this effort to avoid lost or delayed revenue, whilst commendable, is inefficient and a waste of OSR resources. It would be unnecessary if land information quality was improved.

Increased Costs

Data problems also increase the cost of administering land tax. The following discusses examples of costs attributable to data problems.

Because of doubts on the accuracy of OSR land data, OSR staff check information obtained from the land database against current records held by Land Titles Office or the Valuer General's Department. These agencies charge for this service and, to some extent, OSR is buying information that it has already bought from these agencies. This is not an economical use of resources. Although there has been a significant reduction (from about \$75,000 per month in 1995) in the cost of supplementary information searching by OSR, the cost remains about \$25,000 per month.

The need to cleanse data before actioning hampers enforcement activities. Estimates provided by OSR officers suggest about 10-15 per cent of all land tax enforcement activities actually involve correcting errors and missing information in the land database.

2.4 Improving Data Quality

Spatial Information Partnering

OSR and other agencies have yet to address satisfactorily the problem of data quality. One recent suggestion to overcome OSR's data problems is the Spatial Information Partnering (SIP) project. OSR has been instrumental in establishing this project, which is another attempt to resolve the long standing problem in NSW of land information.

This latest project envisages all the State's land information being stored on a central land information "hub". Custodians would regularly update land information and user agencies, including OSR, would access this information as they required.

An advantage claimed for SIP is that it removes the necessity for OSR to maintain complete NSW land records itself. This would be a major efficiency gain for OSR. OSR would access SIP when it needs land information and extract only the information that it required.

The SIP project is in the early stages of development. Although a Business Case has been lodged with Government in relation to SIP, it is now subject to the annual budgetary processes. The Department of Land and Water Conservation is calling for expressions of interest from consultants interested in bidding to undertake a physical design study. The participating agencies, including OSR will fund this study.

OSR Would Buy Only The Information Needed

There would be considerable advantages and savings if OSR could access only the information it needed rather than storing all land records of the State. This would reduce data storage costs and processing times for programs interrogating the land database. A 1996 consultant's report identified that a decrease in the number of records in the land database would give a greater decrease in effort to use the data. The consultant suggested the magnitude of decreased effort possible to be between ten to one hundred times with a consequent saving in system and personnel resources.

**Data Quality
Problems Not
Yet Addressed
By SIP**

Nevertheless, the main difficulty with the land database remains the quality of the data. The Audit Office discussed the SIP project with OSR, the Land Titles Office and the Valuer General's Department (and each agency pledged support for the project). However, The Audit Office was unable to establish that SIP will significantly overcome existing problems with custodian data records. Unless custodians change their methodology for recording information, the SIP project will not assist OSR greatly.

OSR acknowledges that SIP will not resolve all data quality issues. However, it will tackle the vexed question of data standards, the absence of which has been the major continuing element of OSR's struggle to identify the vast majority of land taxpayers.

Comments supplied by OSR also acknowledged that legislative changes may be necessary to require particular information to be provided or information to be provided in a certain format. Similarly, OSR identified a need for a linkage between the business systems of each contributor to the hub, and the establishment of such a hub would have to be accompanied by common standards for system specifications, computer hardware, software design and data entry.

The Audit Office believes that efforts to finally resolve the longstanding issues of land information standards and data quality should be made a major priority. There is potential for such improvements to benefit a number of agencies other than OSR and the Valuer-General, who are users of, or require access to, land information.

OSR Review of its Own Systems

OSR is taking action independently of the SIP project to address current difficulties. The major thrust of internal improvement is the RECOUPS¹⁶ project that aims to review and redevelop all OSR systems and procedures over the next few years.

¹⁶ RECOUPS is an acronym for OSR's Revenue and Compliance Processes and Systems project.

OSR will review the land tax system as part of the RECOUPS project. In relation to land tax RECOUPS aims to:

- identify what land information is still corrupt
- identify what land information is missing
- rectify corrupt and duplicated data problems to the extent that it is possible
- determine how OSR can improve load programs that manipulate and store data obtained externally.

OSR is placing emphasis on redeveloping systems with the highest risk to the Year 2000 problem. OSR assessed land tax as having a low exposure to the Year 2000 threat and scheduled development action by September 1999. Contingency plans are in place to allow continued running of the existing land tax system past 1 January 2000 should RECOUPS development be delayed.

Recommendation

It is recommended that the resolution of long standing difficulties with land information be made a major priority and pursued to their resolution - whether via the SIP Project or other means.

3. Identifying Liable Landowners

3.1 Introduction

Although improvements to the land database may eventually enable OSR to reduce the emphasis on voluntary registration, at present this is not possible. OSR continues to rely on a mixture of:

- voluntary registration encouraged by its information resources and education programs
- intelligence and enforcement action, aimed at identifying potentially liable land owners not registered with OSR.

It is important for OSR to know the reasons why taxpayers do not comply; whether this is deliberate or occurs through ignorance or lack of information. The former may warrant increased enforcement activity whereas the latter may require improvements to OSR information and education strategies.

OSR

uses resources in the most effective and efficient manner.

3.2 Voluntary Taxpayer Registration

Registration Procedures

The land tax legislation requires liable land owners at 31 December of each year to register for land tax. OSR requires land owners to file initial returns by 28 February.

Land owners registering for the first time are required to notify OSR of their total land holdings and the date that each parcel of land came into their possession. Land owners must also provide information on whether the land ownership is a trust or company and any deductions or exemption they wish to claim. This information allows OSR to determine correctly the basis for assessing the tax.

Annual Returns Are Not Required

After a taxpayer registers for land tax OSR does not require further tax returns unless land holdings changed through the year. In such instances OSR requires taxpayers to submit variation returns within 30 days after receiving an assessment. To enable taxpayers to meet this deadline OSR issues variation return forms with assessments.

Penalties Can Apply For Late Or False Registration

OSR imposes penalties if a liable land owner fails to lodge a required return by the due date. The purchase date shown on the land tax return, or obtained from the Land Titles Office, allows OSR to determine whether any penalties for late lodgement should apply. Penalties also apply for false, misleading or incomplete disclosure by an owner.

The *Taxation Administration Act* 1996 specifies the type and level of penalties available against defaulters. Chapter 5 of this report discusses penalties.

Information and Education Activities

OSR has processes to check the completeness of information supplied by land taxpayers on their landholdings. Nevertheless, the land tax system largely relies on information provided by taxpayers.

To assist the process of voluntary compliance OSR undertakes activities to make owners aware of their responsibilities as land taxpayers. Activities include press and electronic media advertising, information seminars, attendance at business “expos”, through the availability of brochures and pamphlets, and by way of the internet.

Education And Information Activities Are Not Reviewed

OSR education strategies place emphasis on keeping tax advisory professionals (that is, lawyers, accountants, taxpayers’ associations) informed on the land tax legislation. OSR advised that its strategy is based on the assumption that the majority of land taxpayers will use the services of such professionals. However, the strategy dates from the time of the former Department of Finance (the forerunner of OSR) and has not been formally evaluated for efficiency or effectiveness.

The land tax amnesty of 1994, and more recent enforcement activity, identified significant numbers of land owners who had not registered for land tax. For example, land owners identified during the 1994 amnesty and enforcement activities as being liable for the tax but unregistered increased the number of clients on the land database by approximately 20 per cent. Such results call into question the effectiveness of OSR’s information and education strategy and seems to indicate that:

- significant numbers of land owners may not use professionals
- professionals may not be passing on that information, or
- owners are not sufficiently “encouraged” by those professionals to comply with the law.

Therefore, a review soon (and thereafter periodically) of the effectiveness of ensure that they meet corporate objectives is warranted.

OSR advised that although a complete review of the effectiveness of land tax client education has not been conducted, the activities of the Client Education Unit were reviewed by Internal Audit and found to be sound. The Internal Audit report did suggest that clear objectives were needed for the client education programs and that performance be measured against those objectives. OSR states that this will occur.

Land Tax Forms and Documentation

Year-Specific Documentation Used

Land tax return forms and the land tax information booklet produced by OSR are specific to the tax year (in a similar manner to Income Tax Returns). The rationale behind producing year-specific documents results from there being no requirement for an owner to advise OSR of land holdings before 1 January of the taxing year. A year-specific form can also contain the most up to date information for the taxpayer.

Benefits Of Generic Documentation

Nevertheless, there may be merit in OSR introducing generic forms rather than the current practice of year-specific land tax documentation. The type of information required by OSR does not often vary from year to year (the only changes that would normally occur to land tax forms would relate to changes in legislation).

Land Tax Initial Return Form Needs Improvement

OSR could improve the initial return forms by:

- highlighting key dates in bold text to emphasise the requirement to register by a specific date
- mentioning that penalties that apply for non compliance with the law
- emphasising that the taxpayer must sign the form. Although there is a declaration box for a signature, instances were identified where the land owner did not sign documents. This may affect enforcement if the taxpayer has not declared that the information given is true, accurate and complete.

**Information
Gaps Exist In
OSR
Publications**

OSR publications on State taxes are generally useful and easy to understand. However, there are information gaps in each major land tax publication which limit their usefulness to land owners. All land tax publications should be reviewed to correct existing gaps in information. Improvements to current publications could include:

- information that liable land owners incur late lodgement penalty tax if they fail to register. All publications containing information on land tax should contain this aspect but not all do
- information on the valuation process, particularly on the differences that can arise between values for rating purposes and those for land tax purposes. Enhanced information in land tax information booklets and initial returns on this matter may reduce the level of objections
- discussion on the importance of a clear s47 certificate¹⁷. A purchaser of land is liable for any outstanding land taxes unless OSR has issued a clear certificate before purchase
- all sections discussing penalties should mention the Taxation Administration Act and the availability from OSR of a brochure explaining that Act.

OSR states that these issues will be included in the review of the effectiveness of OSR's client education program mentioned above.

3.3 Enforcement Activities

OSR does not rely solely on education and information activities to encourage land owners to comply voluntarily with tax legislation. OSR regularly undertakes enforcement activities designed to identify and penalise land owners who are evading land tax.

The risks associated with non-compliance with land tax legislation are significant. In its land tax Revenue Profile, OSR estimated non-compliance risks at between \$20.5 million and \$36.5 million for 1997-98. Difficulties faced by OSR in matching land records were discussed in the previous chapter.

¹⁷ Unpaid land tax is a first charge on land and may be recovered from a subsequent purchaser of the land. Under Section 47 of the *Land Tax Management Act 1956*, intending purchasers (or other parties with an interest in a particular parcel of land, such as mortgagees, lessees and vendors) can apply to OSR for a certificate disclosing any outstanding land tax on that land.

1994 Amnesty and “Potentials” Projects

Enforcement activities using the abilities of OSR’s (then) new systems and the land database began in 1994. Before OSR commenced action against defaulters it had identified through these processes, it declared a Land Tax Amnesty in 1994 to enable defaulters to come forward voluntarily and so avoid penalties. Subsequent follow-up action (the first “ project - named from its objective of identifying *potential* land tax clients) was taken against those who did not avail themselves of the Amnesty.

Additional Liable Owners Were Identified

The combined Amnesty and potentials projects were successful in identifying 15,921 additional liable land owners; this represented an increase of 20 per cent in the number of land taxpayers then registered. OSR identified \$46.3 million in back taxes for 1994 and prior years and additional revenues of approximately \$15 million per year since 1994.

Problems With Data Quality Were Highlighted

The 1994 projects again highlighted problems with the quality of data in the land database. An estimated one million records were found by the system to be corrupt or incomplete. OSR copied these records to a separate file with the intention of undertaking analysis later. However, such action was not possible due to the magnitude of the problem and resource limitations, and other strategies were pursued to identify and follow up land owners who may have a liability. Some 2,117 owners were subject to post-amnesty audits.

Since 1994 much of the corrupt and incomplete data would have been corrected by subsequent updates of information from custodians. OSR considers that it was more cost effective to adopt this approach than to attempt to correct the data (and the only practical approach). OSR further advised that the 1997 Potentials project again reviewed these records and has identified defaults occurring prior to 1994. But:

- owners in 1994 may have subsequently sold their liable property, or
- owner liable in 1994 may have had their property fall below the threshold.

In both these situations recovery of any revenue identified may be difficult given the delay in pursuing the land owner.

1997 “Potentials” Program

To address The Audit Office’s expressed concerns in previous years about the completeness of land tax collections and the adequacy of enforcement actions being taken against defaulters, OSR gave an undertaking to repeat the Potentials program at a later date. The 1997 Potentials program fulfilled that undertaking.

Existing Computer Programs Were Enhanced

The 1997 project made use of the programs developed in 1994 but with enhancements to:

- further refine the database prior to extracting data for investigation
- improve processing and turnaround times which were significant in 1994.

The 1997 Potentials was undertaken in two phases. The first phase identified land owners liable for the tax on a single holding basis. The second stage identified aggregated holding above the threshold. Results at 6 May 1998 identified \$25.3 million in additional revenue.

Other Recent Enforcement Activities

Most of the recent enforcement projects (except for the 1997 Potentials project) undertaken by OSR were part of the SRI. This initiative aimed to raise \$22 million in additional revenue in 1996-97 and OSR reports \$35.5 million (land tax, \$6.1 million) of additional revenue was identified and \$24.1 million (land tax, \$3.6 million) collected by 30 June 1997. The Government approved an extension of SRI for 1997-98 to continue projects not completed at 30 June 1997.

Some of the land tax enforcement projects undertaken by OSR as part of the SRI include:

- comparison of trusts in the land database against Australian Securities Commission information
- review of family trusts recorded in the database as receiving the threshold (discretionary trusts are not entitled to the threshold)
- review of land taxpayers who did not receive an assessment for any preceding tax year but who may have actually been liable
- comparison of land information to Rental Bond Board information.

Along with these dedicated projects, OSR field audits will also investigate compliance with land tax requirements when reviewing compliance with the major taxes such as payroll tax and stamp duties.

Enforcement Methodologies

Enforcement Methodologies Are Sound

The Audit Office reviewed the methodology currently used by OSR to develop enforcement projects and found them to be soundly based.

To improve outcomes from enforcement work by better focusing on areas of greatest potential revenue, OSR established an Intelligence Unit (staffed by experienced officers) to undertake analysis of information from external sources, results from previous enforcement actions and interrogation of information systems such as the land database. The Intelligence Unit prepares project proposals for all taxes collected by OSR not just land tax.

Procedures adopted by Intelligence Unit are to:

- develop detailed project proposals and methodologies
- extract likely cases for investigation
- field test a small representative sample of the cases (undertaken by the Field Audit section)
- assess the likely results from the full project based on the results obtained from the sample.

Those projects showing the most promise continue with Field Audit undertaking actual follow-up action on the cases.

OSR's methods of targeting enforcement activities are soundly based with a case selection and allocation systems that enables progress to be reported against available work and facilitating efficient, effective work practices in the case selection area.

Improvements Can Be Made

As said before, the level of enforcement resources required to cleanse erroneous data before follow-up action can begin is of concern. OSR officers suggest this may take up to 15 per cent of the resources allocated to individual projects.

Because of the limitations of OSR's land tax and management information systems, there is duplication of effort and information is not easily interchanged between systems. For example, although the land tax system has comments screens and officers enter action codes into the system (signifying what the last action was on each case and when this occurred), actions taken and results obtained are also entered into spreadsheets, collated and then aggregated to provide outcome information for senior management reports. It would be more efficient if OSR systems could provide such information directly from operational inputs.

Use of Intelligence Information

Intelligence Information Is Available

Different sections of OSR produce, or have the potential to produce, useful information that can assist OSR in achieving its objectives of maximising revenue and efficiency. The Intelligence Unit was mentioned above; another potential source of tactical information is the Collections Branch (see Chapter 5).

However, OSR could make even further use of such information. For example, OSR could develop formal procedures to focus intelligence information into education and information strategies. The current focus of enforcement activity is solely on identifying and penalising individual defaulters. OSR does not obtain the reasons for land owners' non-compliance.

Information Could Be Used More Effectively

Although informal information transfer does occur between different operational areas, OSR could improve the process. The managers of the Compliance Improvement Branch and Client Education Unit meet regularly to exchange information. Although the audit requested evidence of initiatives flowing specifically from such activity none was provided. Similarly, OSR officers claimed that some instances have occurred in the past where specific groups were identified and strategies developed to target education and information activities. However, evidence of this action had not been documented.

Increased use of information coming from Compliance and Intelligence Unit projects and analysis of taxpayers' behaviours could enable OSR better to focus prevention strategies into areas of greatest return. OSR's current enforcement activities could easily collect information on the reasons for non-compliance.

4. Processing and Administrative Procedures

4.1 Introduction

OSR decided in the late 1980s to move from the returns-based system for land tax then in use to one based on the automatic issuing of assessments using information already held by OSR. By relying on automated systems and land information obtained from sources other than the taxpayer, land tax had the potential to be a very efficiently administered tax. Significant advances have been made by OSR since the mid-1980s, such as removing assessment backlogs, enhancing cash flows to government and developing databases. These have improved efficiency considerably. However, data and systems issues outside of OSR's control continue to impede OSR's ability to achieve the level of efficiency which should be possible.

There are significant costs involved in reviewing objections against land tax assessments, which have increased significantly in 1998 over the previous year. Although OSR is taking action to reduce objections against its assessment processes, the majority of objections relate to land valuations. The recommendation made earlier that OSR should take steps to educate land owners on the valuation process may reduce the level of valuation objections.

4.2 The Assessment Process

System Generated Assessments

OSR has made considerable progress in implementing automated assessments. About 96 per cent of land tax assessments are produced by the system using the land information contained in OSR's land information database. In a "static" run (a term used by OSR to signify assessments issued automatically) the land tax system:

- reviews each client's land holdings
- ascertains the value of the land
- applies simple concessions and the threshold (if applicable)
- assesses the total amount of tax payable.

The system prepares an assessment for printing using the ASON recorded for the client.

Assessor Produced Assessments

Complex Assessments Cannot Be Automatically Produced

The 4 per cent of assessment not automatically produced by the land tax system are “non-static” assessments and require some form of manual intervention by assessors. The land tax system cannot process these assessments because they contain complex concessions claimed by the taxpayer or, alternatively, property records may be missing data such as an ASON. Non-static assessments also include major clients with large, complicated or constantly changing land holdings such as property investors, retail chains and utilities.

Assessors generally review non-static clients, update the database where necessary with information on sales and purchases to enable the system to generate an assessment. However, delays may occur in this process if OSR has to obtain additional information, such as valuations from the Valuer General’s Department for newly sub-divided land.

Economy and Efficiency of Collection Procedures

Efficiency Improvements Have Been Achieved

Despite experiencing difficulties with the quality of land tax data, the land tax system produces the majority of land tax assessments automatically. The proportion of assessments generated automatically has gradually increased from the 60 per cent produced automatically in 1988.

There has been a similar improvement in the accuracy of assessments. The number of assessments requiring amendment has also declined with the increased reliance on automatic assessments; from 22 per cent to around 10 per cent in 1998.

Figure 5: Increased Rates Of Automatic Assessment Indicate Improvements In Efficiency (Per Cent)

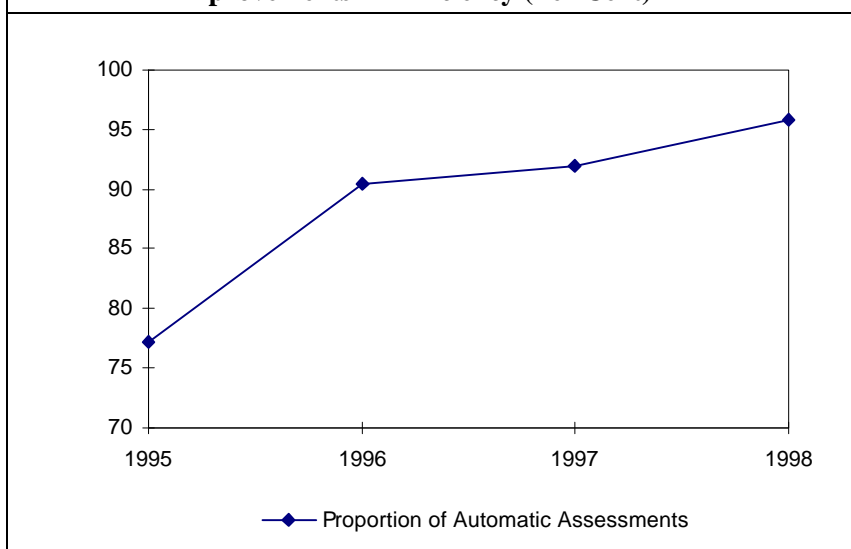
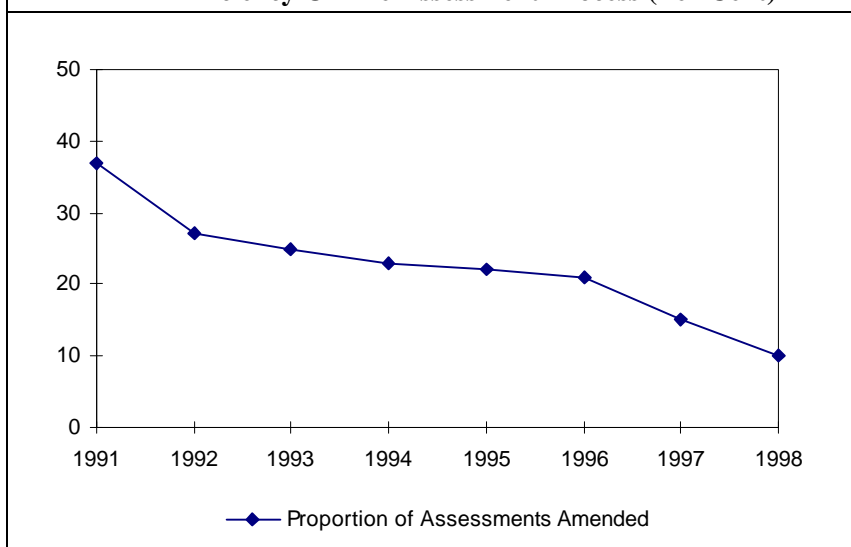


Figure 6: Falling Amendment Rates Indicate Improvements In Efficiency Of The Assessment Process (Per Cent)



Specialisation In The Assessment Function

Because of the differing requirements and complexities of land tax clients three OSR divisions share responsibility for raising assessments, namely:

- Client Services that raises simple assessments
- Revenue Advisory Service that has responsibility for the more complex assessments and also for major clients
- Compliance that raises small numbers (compared to the other Divisions) of assessments as a result of its enforcement activities.

There has been discussion within OSR in the past on the relative merits of the current arrangements compared to combining all assessment activities within the one section. Although the function could be undertaken within the one section, OSR would still require separate teams for simple and complex assessments. Segregation of the assessment function allows OSR to take advantage of specialisation and improves the service offered to taxpayers.

OSR has since advised that it is seriously considering adopting a program approach to the annual land tax cycle and functions that would allocate appropriate skilled resources from across OSR to deal with the particular functional peaks related to land tax as they arose during the year.

**Further
Efficiency Is
Hampered**

Within the constraints of its existing land tax system (that dates from the early 1990s) OSR has made considerable progress in implementing automated assessments and increasing the economy and efficiency of land tax collections.

However, the limitations of the system and the quality of data in the land database hamper continued improvement in collection efficiency. The problems discussed in Chapter 2 in regards to land information will need to be addressed if further efficiencies are to be gained. This will require the investment of additional resources by OSR and other agencies.

4.3 Objections and Appeals

Land Tax Objection Procedures

Taxpayers dissatisfied with tax assessments have a right of objection and may afterwards appeal to the courts a decision by OSR rejecting an objection. There are certain formalities that taxpayers must comply with when making an objection; these include that objections be in writing and be lodged with OSR within 60 days of the taxpayer receiving the assessment.

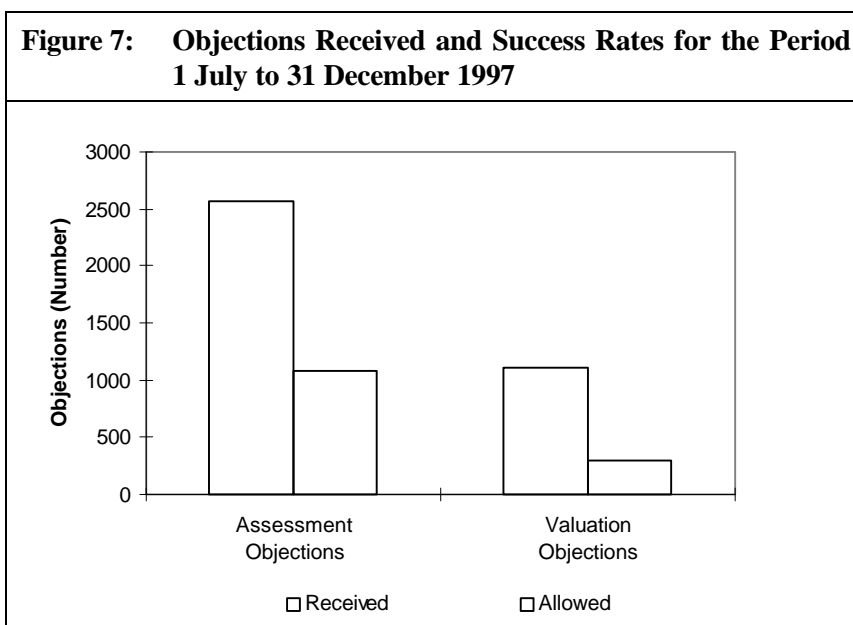
OSR places the onus on the taxpayer to provide evidence in support of their case. The taxpayer must provide this evidence within a certain timeframe or else the objection is disallowed.

Most Objections Are For Land Tax

The largest number of objections OSR receives relate to land tax. Objections to land tax assessments may be divided into two categories:

- those objecting to the methodology used by OSR to assess the taxpayer’s liability (for example, by disallowing an exemption or concession for a particular parcel of land)
- those relating to the valuation placed on the land by the land valuer.

Figure 7 shows the number received and the percentage allowed for both types of objections during the six months ending 31 December 1997.



Objections Against OSR’s Assessment Process

Objections to OSR’s assessment generally result from the taxpayer claiming that an exemption applied to the land or that OSR had not correctly considered concessions applying to their land when raising the assessment. For these objections an OSR assessor will review the basis for the original assessment and the evidence provided by the taxpayer. The assessor will then determine whether a reassessment is warranted. For the period 1 July to 31 December 1997, 42 per cent of assessment objections were successful¹⁸.

¹⁸ However, the majority of successful objections during this period (804 of 1050) were against penalties and interest applied to assessments raised following compliance activities and not against the accuracy of the assessment itself.

**OSR Initiatives
To Reduce
Assessment
Objections**

OSR is taking action to reduce objections to its assessment process. During 1997 OSR centralised the objection's function in the Central Objections Unit (COU). The objectives of COU are to improve client services and develop more consistency in applying the taxation legislation. One of the strategies developed for the latter objective is that the COU has begun analysing objections and appeals information to identify patterns for incorrect assessments. This information will be used to target training for OSR staff and to identify areas that may require policy decisions or changes to the legislation.

Objections Against Land Valuations

**Most Objections
Relate To Land
Values**

The majority of the 1998 objections are against land valuations. OSR refers objections against land valuations to the Valuer General's Department for review. There is considerable cost involved in the valuation review process because a valuer will review each case to ascertain whether the original assumptions and weighting placed on components of the valuation were reasonable.

The Valuer General's Department advised that 793 person days had been expended in processing valuation objections between 1 July 1997 and 28 February 1998. The Valuer-General advised that the cost of objections could not be quantified at the present time. However, the Valuer General's Department indicated that the charge for land valuations was based on a certain level of objections. As the current number of objections exceeds the agreed level it is possible that valuation costs may increase when the contract with OSR is reviewed although OSR has indicated it would oppose this. Approximately 24.7 per cent of valuation objections were successful in 1997.

**Valuation
Objections Are
Increasing**

Since January 1998 OSR has experienced a significant increase in the level of land tax objections over previous years. For 1996-97, 1,516 valuation objections occurred between 1 January and 27 May 1997 and a further 1,113 valuation objections were received in the period 1 July to 31 December 1997. For 1998 the figures supplied by the Valuer General's Department are 2149 objections completed up to the end of February; a further 539 objections were still to be processed at that date. The Valuer General's Department received a further 1591 objections in March.

However, this does not imply that there has been a decrease in the quality of land valuations supplied by the Valuer General's Department. There are a number of reasons for the increased level of objection in 1998 including:

- a large increase in the valuations for most metropolitan land holdings
- an increase in the rate of land tax from 1.65 per cent to 1.85 per cent
- the extension of land tax to principal places of residence with a land value greater than \$1 million
- the Land Tax Amnesty and OSR compliance activities which have resulted in assessments for prior years land tax being issued to land owners.

Land owners with land valued just above the threshold value are particularly susceptible to the effects of changes in land values or the rate of tax and so are more likely to object to land valuations. For these taxpayers a small increase in either land values or the rate of taxation generates a disproportionately higher rate of increase in their tax liability. For example, a property just at the threshold could increase in value by 15 per cent over the previous year but the land tax liability would increase by 444 per cent for the same period. For those properties where considerable land tax is collected, the percentage increase in taxation will be lower, but will always be greater than the percentage increase in property values.

Table 3: The Effect Of The Increased Land Tax Rate And Higher Land Values In 1998				
	1998 Land Tax Liability \$ (increase - per cent) . . .			
1997 Tax Year Land Value \$ '000	if no increase in land value	if a 5% increase in land value	if a 10% increase in land value	if a 15% increase in land value
160	\$100 (0%)	\$248 (+148%)	\$396 (+296%)	\$544 (+444%)
165	\$193 (+5%)	\$345 (+89%)	\$498 (+173%)	\$650 (+256%)
170	\$285 (+8%)	\$442 (+67%)	\$600 (+126%)	\$757 (+186%)
175	\$378 (+9%)	\$539 (+55%)	\$701 (+102%)	\$863 (+148%)
180	\$470 (+9%)	\$637 (+48%)	\$803 (+87%)	\$970 (+125%)
190	\$655 (+10%)	\$831 (+40%)	\$1007 (+69%)	\$1182 (+99%)
200	\$840 (+11%)	\$1025 (+35%)	\$1210 (+59%)	\$1395 (+84%)
250	\$1765 (+11%)	\$1996 (+26%)	\$2228 (+41%)	\$2459 (+55%)
300	\$2690 (+12%)	\$2968 (+23%)	\$3245 (+35%)	\$3523 (+46%)
400	\$4540 (+12%)	\$4910 (+21%)	\$5280 (+30%)	\$5650 (+39%)
500	\$6390 (+12%)	\$6853 (+20%)	\$7315 (+28%)	\$7778 (+36%)

Table 3 shows the percentage increase in land tax liability that occurred in 1998 for a given 1997 land value. For example, a property valued at \$160,000 in the 1997 tax year would be liable for land tax of \$100. If the value of that property increased by 5 per cent for the 1998 tax year (to \$168,000) it would incur land tax of \$248, or a 148 per cent increase over 1997. If the value of the same property increased by 15 per cent for 1998 (from \$160,000 to \$184,000) the land tax liability would increase by 444 per cent, to \$544.

**Educating
Taxpayers May
Reduce
Valuation
Objections**

Chapter 1 mentioned the confusion that may occur between the valuations used for rating purposes and those used by OSR for land tax purposes. OSR should take steps to educate land owners on the valuation process. The Audit Office reviewed land tax information produced by OSR and found no mention about the valuation process or that valuations are on an annual basis. This aspect, if advertised, may reduce the level of valuation objections.

5. Managing Debt and Imposing Penalties

5.1 Introduction

Outstanding tax debt is an issue requiring effective management and appropriate recovery action. Debt management aims to collect overdue taxes as quickly and effectively as possible, by ensuring that payment is made as close as possible to the due date, in the most cost-effective manner. Compliance by taxpayers is further encouraged by imposing penalties for late payment and beginning legal action should default continue.

Current instalment arrangements for paying land tax delay recovery action by OSR. This is because instalment arrangements allow different options for paying land tax debt and so create uncertainty as to when the taxpayer will actually make payment. OSR cannot begin recovery action until a default occurs.

Prior to 1998 OSR did not issue reminder notices for land tax. Until the land tax component of its RECOUPS project is operational it will not show outstanding amounts from previous years on land tax assessment notices. System limitations and cost considerations have precluded this activity in the past. However, this innovation has the potential to improve collections.

In the past analyses of taxpayer' payment behaviour and of the effectiveness of different collections strategies by OSR has been affected by system limitations. However, with the introduction of its new Debt Management System OSR is now able to examine taxpayer behaviour to better target collection efforts and assist proactive compliance activities such as client education programs.

One Third Of Known Outstanding State Taxes Is Land Tax

The outstanding debt for land tax represents over one third of the total amount of known outstanding taxes owed to OSR. However, the nature of the various tax bases administered by OSR distorts the proportion of known outstanding debts attributable to the different taxes.

Most State taxes are collected predominantly through self-assessment and self-identification by taxpayers. If a taxpayer does not self-identify and OSR does not detect this failure, the State tax outstanding remains unknown and impossible to quantify. The total outstanding debt for a tax so affected would be understated by an unquantifiable amount.

By contrast land tax revenue is generated entirely by assessment notices issued by OSR. Because of this any amount unpaid is identified and quantified; the amount is immediately and overtly factored into the known outstanding tax debt. The effects of the different tax administration procedures may tend to skew the known outstanding debt figure by inflating the land tax component.

Notwithstanding this fact, the Collections Branch has been active in collecting outstanding land tax and this has resulted in a reduction in the amounts of land tax outstanding. The reduction in overdue land tax is shown in Tables 4 and 5.

	1994	1995	1996	1997
Total Known Outstanding Debt (\$m.)	108.27	96.87	100.89	79.64
Land Tax Debt (\$m.)	48.63	44.54	50.39	35.77
Land Tax Proportion of Known Outstanding Debt (%)	44.93	45.98	49.94	44.91

Source: OSR Annual Reports 1993-94 / 1996-97.

Note: The 1996-97 figure for total outstanding debt is affected by the High Court decision of 5 August 1997 that Tobacco Franchise Licences were unconstitutional. As a result all business franchise licences outstanding and not collected at that date are no longer considered enforceable. Debt amounts shown in OSR Annual Reports have been adjusted to remove the outstanding debt attributable to business franchise licences so that a valid comparison with prior years can be made.

	1994	1995	1996	1997
Total Land Tax Collection (\$m.)	519.27	509.72	574.77	640.81
Land Tax Debt Outstanding (\$m.)	48.63	44.54	50.39	35.77
Outstanding Land Tax as a Proportion of Revenue Collected (%)	9.16	8.74	8.77	5.58

Source: OSR Annual reports 1993-94 / 1996-97.

OSR considers most of the debt is recoverable with the provision for doubtful debts being \$1 million in 1996-97. The actual amount OSR wrote off as irrecoverable for that year was \$622,000 in primary taxes and \$364,000 in penalties.

Nevertheless, OSR can make improvements to collect debts in a more timely manner and to reduce further the level of outstanding debt.

5.2 Current Collection Practices

Payment Options

Interest Free Instalment Arrangements Available

OSR allows taxpayers standard timeframes in which to pay their land tax. Currently most taxpayers have two payment options. The first option is to pay the whole amount by the “midpoint” date, roughly 105 days after the date of assessment. Alternatively, the taxpayer may take advantage of an interest-free instalment arrangement whereby three equal instalments are due at roughly 30, 90 and 150 days from the date of assessment. OSR estimates that about half of land taxpayers avail themselves of the instalment option.

In the case of major taxpayers, payment dates are tailored so that payment of the whole amount is due before 30 June, whether paid by instalment or by the midpoint date.

Instalment Arrangements Delay Recovery Action

The current instalment arrangements allowed to taxpayers affect the efficiency of OSR land tax collections by delaying the commencement of recovery action. OSR is uncertain when it will receive payment from taxpayers and recovery action will not begin until the taxpayer misses payment at certain crucial points.

Uncertainty arises because, if the taxpayer does not pay at the first instalment date, OSR assumes that the taxpayer is paying the full amount at mid-point. If the taxpayer misses payment at the midpoint then default has occurred and OSR can begin recovery action. However, the delay means that follow-up action cannot begin until about late April or early May allowing less than two months to collect the outstanding debt before the end of the financial year.

Notifying Taxpayers of Outstanding Debts

Reminder Notices Not Sent

OSR did not send reminder notices for land tax prior to 1998. This was because of cost considerations and also because under current procedures OSR sends an instalment schedule with each assessment notice. The onus is on the taxpayer to make the required payment when it becomes due. However, OSR advised that many previous defaulters claimed they were unaware of their liability and would have paid if OSR had sent a reminder notice.

During 1997 OSR tested whether reminder notices would improve the payment behaviour of taxpayers. OSR sent reminder notices to a sample of taxpayers just before payment fell due and obtained some encouraging results. A 20 per cent improvement in the timing of payments was achieved. As well, the overall proportion of defaulters declined from over 20 per cent, for a comparison group of taxpayers who were not sent reminders, to 7 per cent for the sample.

OSR has taken note of the results obtained and advised that it is issuing 1998 land taxpayers with reminder notices approximately 14 days prior to the due dates for instalments, and midpoint dates in respect of those taxpayers who do not pay the first and second instalments by the due dates.

**Total
Indebtedness Is
Not Shown On
Notices**

The current land tax assessment notices only show the assessment made for the current year. Assessment notices do not show any outstanding amounts from previous years and so do not show the taxpayer's total indebtedness to OSR. However, taxpayers may be genuinely unaware of an outstanding debt. There would be advantages in advising taxpayers of their total indebtedness (including any unpaid amounts from previous years) on each assessment notice in a similar manner to the current practices of utilities and local councils.

Currently OSR is unable to provide easily details of clients total indebtedness because of poor information systems. OSR says that details of a taxpayer's total indebtedness will be available in the new Debt Management System (DMS) currently being implemented. OSR is examining the possibility of issuing consolidated accounts out of DMS as an interim method as the need for assessment notices to show total liability has been identified as a requirement during the development of RECOUPS. As previously mentioned, the redevelopment of the land tax system under RECOUPS is scheduled currently for September 1999.

**Improvements In
Instalment
Arrangements
Could Improve
Efficiency**

OSR could improve the efficiency of the collections process by changing current instalment arrangements and including taxpayers' total outstanding debts with assessment notices. OSR would be able to identify defaulters earlier (at the first instalment date) and follow-up action could begin sooner. An improvement in collections similar to that indicated by the reminder notice test mentioned above could reduce outstanding land tax debt by \$7 million.

OSR could pursue efficiency gains by seeking to change land tax arrangements to:

- abolish the existing “mid point” payment option and extend the current three periodic payments instalment scheme to all taxpayers (taxpayers wishing to pay their land tax debt in full would do so by the first instalment date)
- include a schedule of the taxpayer’s total indebtedness with assessment notices
- abolish instalment schedules and replace these with reminder notices to be sent shortly before the instalment was due.

OSR advised that its Land Tax Continuous Improvement Project team review of land tax debt recovery did recommend changes to the instalment arrangements, including abolition of the midpoint and an increase in the number of instalments from three to four. These proposals were discussed informally by OSR with the Office of Financial Management (another business unit of Treasury) which indicated a reluctance to make changes which would adversely impact on the amount of land tax revenue collected by 30 June.

OSR advised that it is prepared to make changes to the payment cycle to improve the overdue debt position, but only if this does not affect adversely the Government’s budgetary objectives. OSR states that it will review the options for changing the instalment arrangements in a way that does not impact on the amount of revenue collected by 30 June.

OSR has identified significant revenue and operational considerations that could result from such changes, such as:

- the taxing date may need to be changed from 1 January to allow for four instalments in a tax year
- the Valuer General’s Department may have to provide valuations earlier to accommodate a change in the taxing date; this may be difficult to achieve
- there may need to be an adjustment period between the current and the new arrangements to ensure that revenue collections are not adversely affected. Such an adjustment period could involve land tax being levied twice in a twelve-month period and risk taxpayer and community hostility.

While not denying that a complete review and overhaul of the existing instalment arrangements may identify further improvements in collecting land tax, changes such as issuing reminder notices and providing schedules of total taxpayer indebtedness can be made within existing assessment procedures and so avoid adversely affecting tax collections. OSR has demonstrated already that change is possible within existing procedures by issuing reminder notices for land tax this year.

Notwithstanding these comments, it is acknowledged that any decision on significantly changing existing instalment arrangements raises policy and revenue cash flow issues which are outside the charter of OSR.

Collection Methodologies

Debt Recovery Timing

OSR collection policy dictates that a final notice be sent to payment defaulters. OSR sends a Notice of Intended Legal Action if the final notice does not gain payment. OSR has the ability to issue final notices as required. However, to spread workloads over manageable timeframes and to gain efficiencies from the batch processing of many taxpayers with a common due date for payment, OSR has one production run of final notices per week. Delays may occur in starting recovery action because:

- final notices may be sent to defaulters up to one week after a default occurs
- the current final notice allows 14 days to pay before OSR will issue a notice of intended legal action.

OSR is investigating reducing the time allowed from 14 days to seven. The current instalment procedures allow taxpayers ample time to contact OSR and request a payment extension if they experience difficulties in paying their land tax debts. A reduction in the time allowed before legal action begins is warranted.

Reliance On Caveats Is Not Sufficient

When an outstanding debt is of sufficient size and it believes that there may be some risk of recovering the outstanding amounts, OSR will lodge a caveat on the land in question with the Land Titles Office. A caveat is a legal instrument that prevents the Land Titles Office from registering any further dealings on the particular parcel of land until OSR withdraws the caveat. The effect is to prevent the land being sold and the outstanding land tax lost.

Although a caveat will protect the revenue (as the land cannot be sold until it is removed) it is not in itself a collection activity. It was noted that OSR may not be actioning all cases once caveats are lodged with the Land Titles Office. Because land tax legislation currently does not allow OSR to seize and sell land for unpaid land taxes, it is important that OSR pursue other collection strategies besides applying caveats.

Collection Strategies Analysis

The OSR executive have continued to review the extent to which collection strategies are effective, and to modify strategies accordingly.

Such analysis is a vital component of land tax management, and could be made even more effective by improved information and tools. System limitations have hampered OSR's ability to undertake analysis into payment behaviour and assess comprehensively the effectiveness of its collection strategies. Comprehensive analysis could assist in identifying high risk taxpayer types or groups that have the most likelihood of being late payers and enable OSR better to focus its collection strategies on the most effective method for a particular taxpayer profile.

Analysis Of Defaulter Behaviour

OSR could increase the extent to which it undertakes formal and systematic research into land taxpayers' payment behaviour to identify and target high risk taxpayers to improve collection rates. OSR advised that individual tax officers would know their difficult clients and take appropriate debt management action. However, this is not evidenced, and OSR does not aggregate such information to develop profiles of difficult clients.

In the past, analysis of taxpayer behaviour was not undertaken because of the limitations of the existing debt management system which was not able to provide the information detailed analysis would require. Any analysis would have had to be done manually at a significant cost in resources. Recent improvements to OSR's systems have assisted here and existing action could now be taken further to analyse available information in a more structured and comprehensive manner.

Debt Management System

DMS To Address Current Deficiencies The new DMS is designed to address many of the concerns raised above and OSR believes that the system should lead to a considerable improvement in recovery action generally. DMS monitors each taxpayer's payment history and this information now is used to determine the most appropriate collection strategy. DMS is able to examine the relative success of all actions to recover debt. For example, taxpayers with a history of late payment may have accelerated progression through the collection process to legal debt recovery. In addition, OSR will undertake a project to research the payment behaviour of taxpayers, using information generated by DMS, and review debt recovery strategies having regard to the results.

OSR introduced DMS as the first stage of its RECOUPS initiative in November-December 1997. However, the system was still in its implementation and familiarisation stages when the audit was undertaken and several of its features were not implemented at that time.

5.3 Penalties and Interest

Taxation Administration Act

Late payment penalties and interest are specified in the land tax legislation and more recently by the *Taxation Administration Act* 1996.

Penalties Vary With The Circumstances Causing The Default The Taxation Administration Act prescribes the interest and penalty taxes that can be applied when a tax default occurs. However, provision exists in that Act to apply different levels of penalties depending on the specific circumstances that caused the default. Table 6 shows the different circumstances identified in the legislation and the rate of penalty that applies to each.

Table 6: Penalty Rates Applying Under The Taxation Administration Act				
Penalty Category	Penalty Rate Applying			
	Prime Rate	Voluntary Disclosure		Concealment /Hindrance
		Before Investigation	During Investigation	
Reasonable Care	0	0	0	0
Failure to Take Reasonable Care	25	5	20	30
Intentional Disregard of the Law	75	15	60	90

Source: OSR *Business Rules*.

Interest Charged For Late Payment

Interest is charged on late payments and accrues on a daily basis on all overdue primary tax and penalty tax from the day after the due date to the day OSR receives payment. However, OSR does not charge interest on the interest it imposes because of late payment.

There are two components to the interest charged for late payment; a market rate component and a premium component. The market rate component aims to compensate the State for the loss of use of monies caused by a taxpayer's late payment. The premium component is a penalty for not complying with tax provisions. Current interest rate charged for late payments is 16.8 per cent comprising a market component of 8.8 per cent and a premium component of 8 per cent.

Remission Of Penalties

The premium component of interest may be remitted depending on the circumstances causing the late payment but OSR does not usually remit the market rate. However, where a land owner did not know that land was subject to land tax because there had been no notification by the Valuer-General of the land value, OSR waives both the market and premium rate of interest.

Land tax penalties remitted in 1996-97 amounted to \$2.79 million. The rates of remission of penalties when compared to total land tax revenues collected are small; declining from 1.1 per cent of total land tax revenue in 1993 to 0.44 per cent in 1997. OSR has developed Business Rules and procedures from the Taxation Administration Act to ensure consistency in the way in which applications for remissions of penalties are treated.

Publication of Penalties and Recovery Action

More Vigorous Publication Of Penalties And Recovery Action Needed

State taxation legislation includes penalties for taxpayers avoiding taxes or other non-compliance activities. OSR could more vigorously promote the penalty aspect of non-compliance in its land tax material.

Gaps noted include:

- little mention of penalties in land tax literature issued by OSR - the penalty aspect of the tax laws is largely dealt with in the information available on the Taxation Administration Act. This is not referred to in some land tax publications
- although land tax assessments mention that taxpayers will incur interest if the debt is not paid on time they do not mention other penalties and action that OSR can take to recover outstanding debts
- no mention that OSR may take other action to recover the debt including legal action
- no mention that OSR may lodge a caveat on the land preventing sale until the outstanding land tax is paid.

A review of all land tax publications would be valuable to ensure that the penalty aspect is emphasised adequately.

OSR advised that all land tax publications and forms will be reviewed to ensure that penalties for non-compliance are given appropriate publicity.

6. Appendices

Appendix 1

Audit Methodology

Audit Objective and Scope

The objective of the audit was to evaluate the economy, efficiency and effectiveness of the levying and collection of land tax by OSR.

Specifically, the focus of the audit was on determining whether:

- OSR's land database can identify all landholdings in NSW.
- OSR can identify all landholders liable for NSW land tax.
- Land tax processing and administrative procedures are undertaken economically and efficiently by OSR.
- Land tax debts are effectively managed to maximise recoveries, and penalties are fairly and effectively imposed for late lodgement and late payment of land tax.

In determining these factors the audit also examined whether OSR's information systems provided adequate information to allow assessment of the effectiveness of OSR's administration of the tax.

Audit Approach

The audit examined the functions involved in the levying and collection of land tax by:

- discussions held with key staff in the various OSR Divisions
- collecting and analysing supporting documentation
- interviewing officers from other relevant agencies such as Land Titles Office and the Valuer General's Department.

Audit Criteria

Audit criteria are reasonable standards against which an auditor may assess the activities subject to audit. Criteria reflect a normative (that is, desirable) control model for the subject matter under review and represent good practice - a reasonable and informed person's expectation of "what should be".

The Audit Office developed the following audit criteria for this audit. OSR was supplied with a copy of the draft criteria for comment at the beginning of the audit. The suggestions provided by OSR were incorporated in the final document.

1. Taxpayer Registration

OSR will have strategies to encourage landholders to register voluntarily if they become liable for land tax.

From its previous experience OSR will be able to identify groups of landholders most likely to avoid registration for land tax and will apply enhanced efforts in improving registration within such groups.

OSR initial return forms and associated registration procedures will make simple the process of registration for landholders.

OSR procedures will efficiently check and register land tax initial returns

2. Land Information

OSR will have a land record system that will be able to identify the owners of all landholdings in the State.

3. Investigation and Enforcement

OSR will undertake research and analysis of land records and other sources to identify landholders evading land tax.

OSR will take enforcement action against landholders evading land tax and will impose back taxes and penalties to those landholders.

OSR will monitor the effectiveness of the Compliance Division in its use of resources and in maximising returns from enforcement action.

4. Land Valuation and Assessment

OSR will administer land tax in a commensurate manner and cost to other State jurisdictions.

Land tax assessments will provide the taxpayer with sufficient information to determine whether the assessment is correct and will adequately detail procedures for objections to assessments.

5. *Land Tax Debt Management*

OSR will have strategies and procedures to encourage landholders to pay their land tax liabilities on time.

Analysis undertaken by OSR will identify taxpayers that pose a high risk of being late payers or defaulting on their land tax debt.

OSR will take efficient and effective measures to recover all land tax outstanding

OSR will impose late payment penalties in accordance with legislation.

Performance Audit Reports

Agency or Issue Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
Department of Housing	<i>Public Housing Construction: Selected Management Matters</i>	5 December 1991
Police Service, Department of Corrective Services, Ambulance Service, Fire Brigades and Others	<i>Training and Development for the State's Disciplined Services: Stream 1 - Training Facilities</i>	24 September 1992
Public Servant Housing	<i>Rental and Management Aspects of Public Servant Housing</i>	28 September 1992
Police Service	<i>Air Travel Arrangements</i>	8 December 1992
Fraud Control	<i>Fraud Control Strategies</i>	15 June 1993
HomeFund Program	<i>The Special Audit of the HomeFund Program</i>	17 September 1993
State Rail Authority	<i>Countrylink: A Review of Costs, Fare Levels, Concession Fares and CSO Arrangements</i>	10 December 1993
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