Introduction
This audit assessed how well the Office of State Revenue (OSR) collects state revenue (taxes and duties). In this report, taxes and duties are referred to collectively as taxes except where it is relevant to refer to one or the other.

The audit also looked at how OSR manages the cost of delivering its services. This involved looking at what OSR is doing to operate more efficiently.

Overview
OSR, a business unit in the Department of Finance with about 280 staff, is responsible for collecting most state taxes. In 2015-16, it raised $7.3 billion in tax. Most of this came from collections of payroll tax, transfer duty and land tax. Appendix 1 describes the 8 main types of tax OSR collects, as well as the actual tax raised from each of these in 2015-16.

State taxes and duties help pay for critical public sector services such as education, health and justice.

Governments estimate the taxes they believe can be raised. In WA, this is mainly done as part of the Budget setting process. The actual tax collected may be more or less than government estimates. This happens because of changes in economic conditions, differences in tax law interpretations, how a tax office carries out its operations, and taxpayer knowledge and willingness to pay.

Tax offices cannot influence the tax ‘lost’ from changes in economic conditions but they can limit the losses from other factors. Knowing how much tax is lost, and why, helps government to improve its estimates and tax offices to best allocate their resources.

Taxpayers that do not report or pay their full tax obligations do so unintentionally, carelessly or deliberately. This results in less tax paid than would otherwise be the case – a difference known as the tax gap. Estimating the dollar value of the tax gap can be one baseline for evaluating tax office performance.

Public sector agencies like OSR are expected to continually improve their efficiency. To satisfy this expectation, agencies publicly report, and have audited, key performance indicators of efficiency.

Audit conclusion
OSR generally performs well against government’s tax estimates. Its tax collections met or exceeded most of the estimates in the Government Midyear Financial Projections Statements from 2011-12 to 2015-16.

However, there is more tax that could be collected but OSR is yet to measure the size of this tax gap. This means that OSR cannot show what impact, if any, its activities have on reducing the tax lost through the tax gap.

OSR knows what it costs to run the agency. However, more needs to be done to measure how efficiently it carries out its activities and how actively it manages these costs.

OSR is working to improve its service delivery by redesigning and simplifying its operations. While results from this work look promising it is too early to say if OSR will improve its efficiency.
Key findings

Collection of state taxes

- OSR has steadily collected more tax over time. The amount of tax raised in the last 4 years increased by $1.3 billion. Reasons for this increase include additional work OSR did to reduce backlogs in its assessments; changes to legislation, tax rates and thresholds; and changes in economic conditions.

- OSR is doing well in collecting taxes when compared with government tax estimates, which take into account changes in legislation and economic conditions. In 2011-12, the total tax raised was almost $6 billion compared with a midyear tax estimate of $5.8 billion. In 2015-16, the $7.3 billion raised was about $59 million more than the estimate.

- Although OSR has raised more tax in total than estimated, there were major differences in the estimates for 2 types of tax. Landholder duty\(^1\) showed major differences in 4 of the past 5 years between the actual amounts raised and the respective midyear estimates. Transfer duty showed major differences in 3 of the past 5 years. The differences for landholder duty ranged from -22.3% to 358.9% and for transfer duty from -9.2% to 11.3%.

OSR does not know if incorrect estimates, a tax gap, or both, caused the differences. Until OSR identifies the reasons for the differences, it is not in a position to address potential tax gaps in its collection processes.

- OSR is aware of the risk that tax obligations can be underreported and that this can result in a tax gap. However, with the exception of vehicle licence duty, it does not estimate what the tax gap costs the state. Tax gap estimates provide a baseline for monitoring the loss of revenue and the impact of tax office actions to reduce the loss.

- In 2013, OSR estimated the vehicle licence duty tax gap and has been working on ways to collect some of it. In 2015 and 2016, it calculated new estimates but did not use results from its ongoing work to inform the estimates. An estimate based on actual experience would provide a stronger basis for measuring OSR performance in this area.

- There is a gap in OSR’s public reporting of timely tax collection. OSR publicly reports on the percentage of tax assessments paid on time. In 2015-16, the figure was 90%. However, it does not say how much tax in dollars this represented or how soon it collected tax not paid on time. An internal measure OSR uses is tax debt less than 1% of tax collected. OSR performs well against this measure but by not reporting it publicly, it does not demonstrate that it gives adequate priority to collecting overdue taxes.

Management of collection costs

- OSR does not use unit cost information to monitor if it carries out its activities at a higher or lower cost over time. This information would show which parts of its operations could become more efficient. The most important examples of what OSR does to measure its efficiency are:

  o Over the 5 years since 2011-12, OSR’s efficiency key performance indicator – Cost to raise $100 – has risen by 12.9%. An upward trend over time can indicate declining efficiency. While increases can be due to external factors outside OSR’s control, such as public sector pay increases, they can also be offset by new systems, processes and continuous improvements. Whether the upward trend indicates declining efficiency can only be determined by regular monitoring of the costs of specific activities or services, which OSR did not do.

\(^1\) Landholder duty is payable when someone buys a major interest in a company or unit trust that owns land worth at least $2 million.
OSR used 200 measures to track its core activities by volume. The results show volumes have increased over time. However, as OSR has received extra funding to do more over time, volume increases are not proof of increased efficiency. Unit cost information helps show if volume increases are due to greater efficiency or funding changes.

- OSR has programs underway to improve its operational efficiency. These include programs to make it easier for taxpayers to pay their tax electronically. Results to date are promising but it is too early to assess the impact.

**Recommendations**

1. **By June 2017, OSR should provide regular reports to internal stakeholders on:**
   a. unit cost indicators for key activities or services
   b. the impact of key activities and services on tax collection.

2. **By December 2017, OSR should:**
   a. Determine whether it provides all the information its stakeholders need to readily evaluate its overall collection of taxes. This may involve using its website to display comparisons with tax estimates, tax gap estimates and tax not paid on time.
   b. Identify the causes of the major differences between landholder duty and transfer duty collections and estimates and start to close these differences. This may include discussions with the Department of Treasury, government and other tax offices.
   c. Start refining its tax gap estimate for vehicle licence duty. This is likely to involve using experience gained from the work it is doing to identify and investigate causes of the tax gap.
   d. Determine whether it has all the information it needs to keep track of efficiency and provide the basis for well-informed external oversight. This may involve using its website to display the results.
Response from the Office of State Revenue

The Office of State Revenue accepts the recommendations in the report and considers them achievable within the timeframes specified. State Revenue appreciates recognition of its effort to improve operational efficiency and service delivery by re-designing and simplifying its tax operations, including through programs that are making it easier for taxpayers to make electronic payments.

In broad terms, the recommendations and timeframes are consistent with the timetable of work already underway as part of State Revenue’s 2016-17 Business Plan and the Department of Finance’s 2015-2018 Strategic Directions. There are several factors likely to affect how State Revenue implements its findings once the analysis required by the recommendations has been completed.

The report places reliance on the use of tax gap estimates to indicate lost Government revenue and as a baseline measure of how State Revenue’s programs affect taxpayer behaviour. Commonwealth and international research generally accepts that tax gap estimates, particularly for direct taxes, are not reliable indicators of a revenue administrator’s performance due to the level of uncertainty associated with their measurement. State Revenue considers that tax gap analysis should only be published when the methodology and data is sufficiently robust to support the estimate. When this occurs, tax gap analysis should also be combined with other measures of effectiveness to give a more reliable indicator of performance. State Revenue is collaborating with its interjurisdictional counterparts to investigate a reliable methodology for estimating tax gaps on major State tax bases.

The report uses comparisons between revenue raised by State Revenue and the Government’s mid-year revenue estimates as an indicator of revenue office performance. The Quarterly Financial Results Report published on the Department of Treasury website already includes comparisons of revenue raised with Budget estimates. Including an additional State Revenue performance target that incentivises the achievement of collections against revenue forecasts has the potential to undermine the fair and equitable administration of the revenue laws and potentially compromise the Commissioner of State Revenue’s statutory independence.

State Revenue intends to publish more information on its website about its tax collection efficiency and effectiveness. In the longer term, the Department aims to complement this information with an improved suite of audited performance indicators in its Annual Report.