REVIEW OF THE AUSTRAC INDUSTRY CONTRIBUTION LEVY ARRANGEMENTS

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Competition and Regulatory Economics

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The Hon Peter Dutton MP
Minister for Home Affairs
Parliament House
CANBERRA ACT 2600

Dear Minister

In accordance with the requirements of s.17 of the *Australian Transaction Reports and Analysis Centre Supervisory Industry Contribution (Collection) Act 2011*, as amended in 2014, and pursuant to the conditions of my appointment, attached is my report into the Industry Contribution Levy arrangements of the Australian Transaction Reports and Analysis Centre (AUSTRAC).

I would like to acknowledge the contributions of industry stakeholders to this review and the assistance provided by AUSTRAC.

Yours sincerely,

Darryn Abraham

Dr Darryn Abraham

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EXECUTIVE SUMMARY

The Australian Transaction Reports and Analysis Centre (AUSTRAC) is Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regulator and specialist financial intelligence unit (FIU). A significant part of its activities is notionally financed through an industry contribution levy (IC levy) authorised and administered by the *Australian Transaction Reports and Analysis Centre Industry Contribution Act 2011* (Levy Act) and the *Australian Transaction Reports and Analysis Centre Industry Contribution (Collection) Act 2011* (Collection Act). In introducing the legislation amending those Acts in 2014, the government made it clear that the IC levy was not a cost recovery regime and that its objectives were to raise revenue equivalent to AUSTRAC's appropriation whilst minimising the regulatory impact on small business.

As amended in 2014, the Collection Act contains a provision for an independent review of the operation of the levy after four years, and the preparation of a report to the Minister. AUSTRAC commissioned Acacia CRE Pty Ltd (Acacia CRE) to undertake the review and prepare this report.

Industry consultation was via assessment of written submissions from stakeholders currently or potentially impacted by the levy and from other interested parties, following publication of an Issues Paper, and through direct consultation with AUSTRAC.

The review was hampered by the absence of any substantive evidence, from stakeholders or other sources, that would have allowed a proper assessment of the relative efficiency of the IC levy, compared with other sources of funding, or of the efficiency impact of alternative levy structures and parameters. In part, the lack of evidence stems from the limits of the data collected by AUSTRAC. A detailed assessment would also have required substantial information gathering and analysis by industry.

AUSTRAC's processes for introducing the IC levy were open and transparent. It consulted extensively and, within the bounds of the objectives of the 2014 amendments, generally responded to stakeholder concerns and suggestions. The transition comprised minimal changes to the original cost recovery levy structure and some initial changes in associated levy parameters. Absent any substantial stakeholder comment to the contrary, the task appears to have been undertaken smoothly and with minimal disruption to industry.

The Collection and Levy Acts in their current form do not bind AUSTRAC to any particular levy structure, and consequently generally provide an appropriate legislative framework for the IC levy. Subject to the recommendations herein, there is no need for major changes to the current structure, rates or thresholds of the IC levy unless the government decides to substantially expand the scope of AUSTRAC's activities or otherwise revisits the objectives of the levy.

AUSTRAC's current consultation processes continue to be open and transparent, allowing opportunity for stakeholder input, however the annual modelling of levy parameters by AUSTRAC is necessarily opaque. The cost to AUSTRAC of administering the IC levy compares favourably with the overall cost to revenue ratio of general taxation.

Stakeholders raised a number of concerns about the current arrangements, including:

- the perceived inequitable nature of the IC levy, associated with an argument for lowering the $100 million earnings component threshold;
- non-adherence of the IC levy to cost recovery principles and policy; and
- the case for abolishing the IC levy in favour of funding from other sources.

These issues arise directly from, and contrary to, the objectives of the levy. Other concerns addressed aspects of AUSTRAC's consultation and invoicing processes, including its inability to issue single invoices to groups of affiliated reporting entities. None of the submissions from stakeholders mounted substantial or substantiated arguments in favour of major changes to the current legislative framework or levy arrangements.

The distribution of the current bases for the IC levy (reported earnings and transactions report volumes and values) are highly concentrated in a small percentage of reporting entities. Modelling of revenue-neutral alternative levy parameters demonstrated that there is considerable scope to redistribute the burden of the levy, albeit largely between currently liable entities. A more wide-spread distribution of levy contributions is likely to significantly increase total administrative and compliance costs.

Major changes to the legislative arrangements for the IC levy might only be required if there are significant changes to the government's objectives for the levy; if a future government reconstituted the levy as a cost recovery program; or if there is a significant expansion of AUSTRAC's operations, requiring greater total contributions. Even in that latter case, the current arrangements could be adapted to a higher revenue target although it may not be appropriate or efficient to further burden existing paying entities.

An extension of the AML/CTF framework to include regulation of the Tranche II sectors will significantly increase the number of reporting entities and the cost of AUSTRAC's monitoring and regulatory activities, but will not commensurately increase the current IC levy bases. The structure of the levy would have to be changed to continue to notionally recover AUSTRAC's costs from regulated entities. Substituting a flat registration fee for the current IC levy structure, or adding it to that structure, is an obvious option, but would have significant administrative and compliance costs.

RECOMMENDATIONS

As a consequence of their claims that the burden of the IC levy was inequitable and should be more widely distributed, many stakeholders argued that the $100 million domestic earnings threshold for the earnings component should be lowered. As with other suggestions to distribute the impact of the levy more widely, the effect of this is likely to be an increase in overall compliance costs for no revenue gain. However, the potential impact cannot be properly assessed with currently available data because, as the reporting rules are currently framed, entities below the threshold do not have to report their earnings.

Recommendation: There is no strong argument for changing the $100 million domestic earnings threshold applied in the IC levy on equity grounds, however AUSTRAC should consider revisions to the reporting requirements (AML/CTF Rules, Chapter 63) that would allow the collection of earnings data from reporting entities below the current earnings threshold. This would allow a more informed consideration of the impact of any future changes in the earnings threshold for levy liability, albeit at some additional cost of compliance for the entities that would have to supply the information.

The Collection Act requires that AUSTRAC issue an invoice to each leviable reporting entity, regardless of whether that entity is a stand-alone corporation or, for the purposes of its liability, a member of a Designated Business Group (DBG). Several stakeholders noted compliance costs could be reduced if there was an option for DBGs to receive a single group invoice.

Recommendation: Although worthwhile, making the appropriate legislative changes to allow the option of issuing a single invoice to a DBG probably cannot be justified as a stand-alone amendment to the Collection Act and should only be implemented in the event that a major change in the levy scheme is required. AUSTRAC should nevertheless clarify the current legal obstacles to issuing DBG invoices, with a view to ensuring the changes (if any prove to be required) are made as soon as an opportunity arises.

Despite AUSTRAC's best efforts and the general adequacy of the annual consultation processes, the methods it uses to set the parameters recommended to the Minister are, possibly unavoidably, opaque.

Recommendation: AUSTRAC could improve its consultation processes, when parameter changes are necessary, by outlining the reasons for the changes and, more importantly, by giving some indication of what viable alternative approaches to the changes were considered and how it chose between them. To that end, AUSTRAC should include some of the distributional consequences of current and proposed levy parameters in the annual levy consultation papers or AUSTRAC's annual report.

As currently implemented by AUSTRAC, the $5 billion transactions value threshold for the maximum payment amount of IC levy is set to isolate the DBGs of the four major banks and the maximum payment is set as the average of the levy amounts otherwise separately payable by those four groups. This objective is neither explicitly stated in, nor obvious from the provisions of, the Ministerial Determination, and is not otherwise mentioned in the associated Explanatory Statement. Inclusion of this component of the IC levy is unusual and horizontally inequitable. It also raises in-principle competition policy issues, although these are unlikely to have any practical substance.

Recommendation: AUSTRAC should reconsider the role and appropriateness of the maximum payment amount provision of the Ministerial Determination.

Some parameters of the IC levy have not been changed in nominal terms since the first collections in 2015 and will have decreased in real terms, changing the effective structure and impact of the levy.

Recommendation: While an automatic indexation process is unnecessary, AUSTRAC should monitor the real effects of diminishing nominal limits and thresholds over time, with a view to periodically raising them to maintain the real structure of the levy.

1. BACKGROUND

The Australian Transaction Reports and Analysis Centre (AUSTRAC) is Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regulator and specialist financial intelligence unit (FIU). The agency was initially established in 1989 as a statutory authority. It was continued in existence by the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act) as an agency within the Attorney-General's portfolio. Today, AUSTRAC sits within the Home Affairs portfolio, with the AUSTRAC CEO reporting to the Minister of Home Affairs.

A significant part of the activities of AUSTRAC is notionally financed through an Industry Contribution (IC) levy authorised and administered by the *Australian Transaction Reports and Analysis Centre Industry Contribution Act 2011* (Levy Act) and the *Australian Transaction Reports and Analysis Centre Industry Contribution (Collection) Act 2011* (Collection Act). The levy was first collected in 2012 to recover the cost of AUSTRAC's regulatory activities and was based on a structure that determined the liabilities of reporting entities based on factors including earnings and transaction values and volumes.

After an independent review of the operation of the levy in 2013 and amendments to both the Levy and Collection Acts in 2014 to implement policy changes announced in the May 2014 Budget (referred to below as the 2014 amendments), a new levy structure was first applied to industry contributions in 2015 and continued in subsequent financial years. Compared with the original Cost Recovery (CR) levy legislation, the 2014 amendments provided greater flexibility to change the levy structure by allowing more of the details (such as limits and thresholds) to be set in the annual Ministerial Determination required by the Levy Act. In its present form, the Levy Act does not proscribe any particular structure of or basis for the levy.

An objective and significant effect of the new structure was to shift more of the financial burden of the levy onto the largest reporting entities. As a consequence of the combination of the adoption in the current model of a $1,000 minimum payment and the concentration of transactions reporting in a small percentage of reporting entities, the levy is currently paid by only 561 of the more than 14,000 entities reporting to AUSTRAC, compared with a total of 4,667 contributing entities in the last year of the CR levy.

The change in levy structure in 2014 was also accompanied by an increase in the range of AUSTRAC's operating costs to be recovered, adding the cost of the financial intelligence function. This latter change was not applied immediately. The recovery target started at 70 per cent of AUSTRAC's budgeted operating expenditure (including depreciation and amortisation) in 2014-15 and transitioned to full recovery from 2016-17 onwards.

The structure and details of the levy are currently defined each year by a Ministerial Determination, following consultation between AUSTRAC and industry stakeholders. AUSTRAC initially publishes a stakeholder consultation paper that contains draft rates and thresholds within the levy structure that are expected to raise sufficient revenue to match the agency's cost recovery target and the appropriation set in the Commonwealth Budget. These rates and thresholds are refined in light of details received from reporting entities at the time of the annual census day and then form the basis of the Ministerial Determination.

As amended in 2014, the Collection Act includes a provision (s.17) for an independent review of the levy arrangements four years after commencement of the amendments (on 22 October 2018), and the presentation within six months of a report to the Minister. AUSTRAC commissioned Acacia CRE Pty Ltd (Acacia CRE) to undertake the review and prepare the report. The relevant sections of the Collection Act and the Terms of Reference for the review are set out in Appendix 1.

The balance of the report is organised as follows:

- Section 2 outlines the key features of the original CR levy, the 2014 legislative amendments, the new IC levy and AUSTRAC's processes for transition to, and currently setting, the structure and parameters of the IC levy;

- Section 3 briefly describes the consultation process and summarises and assesses some of the major issues raised in stakeholders submissions;
- Section 4 presents an analysis of the distribution of the bases of the IC levy (domestic earnings; and reportable transaction volumes and values) and the results of simulations of revenue-neutral changes in the various levy parameters; and
- Section 5 specifically addresses the matters required by s.17 of the Collection Act and by the Terms of Reference, but not answered or assessed elsewhere.

A detailed outline of the consultation process; an example of the possible balance of efficiency costs of the IC levy and funding from general taxation; and a Glossary are included in Appendices.

2. SUMMARY OF THE LEVY PRE- AND POST-AMENDMENTS

As background to the remainder of the report, this section outlines the key features of the original CR levy, the 2014 legislative amendments, the new IC levy and AUSTRAC's processes for transition to, and currently setting, the structure and parameters of the IC levy.

2.1 ORIGINAL COST RECOVERY LEVY

The original CR levy was intended to recover a limited portion of AUSTRAC's operating costs, directly related to the oversight and regulation of reporting entities. Table 2-1 below summarises the structure and parameters of the original CR levy, as set out in the various Ministerial Determinations between 2011-12 and 2013-14.

TABLE 2-1: LEVY PARAMETERS FROM 2011-12 TO 2013-14

	2011-12	2012-13	2013-14
Statutory limit	$33 million	$33.232 million	$34.062 million
Base component			
fewer than 5 employees	$0		
5 or more employees	$300		
Large entity component			
Earnings threshold	$100 million		
Total earnings greater than $6 b Total earnings $5 b - $6 b Total earnings $4 b - $5 b Total earnings $3 b - $4 b Total earnings $1.5 b - $3 b Total earnings $700 m - $1.5 b Total earnings $350 m - $700 m Total earnings $150 m - $350 m Total earnings $100 m - $150 m	$2,300,000 $1,950,000 $1,450,000 $950,000 $450,000 $300,000 $130,000 $60,000 $20,000		
Definition of earnings	Australian entities: Total earnings Foreign entities: Based on domestic earnings from operations		
Transaction reporting component			
Transaction report volume	$0.01 per report		
Transaction report value	0.0005991%	0.0005739%	0.0006130%
Statutory minimum payable	$100.00	$101.60	$103.22
Maximum transaction reporting charge threshold	$200 billion	$220 billion	$250 billion
Maximum transaction reporting charge	$1,346,000	$1,400,000	$1,568,000

The maximum amount to be recovered was set by statute at $33 million initially, indexed annually by reference to changes in the All Groups Consumer Price Index. A base component levy of $300 was applied to all reporting entities with more than five employees.

"Earnings" were defined for the CR levy in the same way as in c.63.5(8) of the current AML/CTF Rules, as follows:

> *(8) 'earnings', in relation to a leviable entity, means:*
>
> > *(a) if the leviable entity is an ADI or a registered financial corporation – the total profit before tax, depreciation and amortisation (PBTDA), not adjusted for significant items; or*

> *(b) if the leviable entity is a member of a group of leviable entities and any member of that group is an ADI or a registered financial corporation – PBTDA, not adjusted for significant items; or*
>
> *(c) in any other case – the total earnings before tax, interest, depreciation and amortisation (EBITDA), not adjusted for significant items;*
>
> *of the leviable entity, for a year ending in the previous financial year, the details of which have been recorded in accordance with the requirements for the roll maintained by the AUSTRAC CEO under section 51C of the AML/CTF Act;*

The earnings of foreign entities were based only on their domestic Australian operations. The earnings component of the levy applied only to entities with earnings in excess of a $100 million threshold and was applied as fixed amounts within each of a number of earnings ranges. This had the consequence of setting high effective marginal rates of levy on relatively small increases in reported earnings that took entities from one range to the next, and also meant the average transaction value factor (the liability percentage of reported earnings) varied significantly across the whole range. These earnings component parameters were unchanged over the three years of the CR levy.

The transactions reporting component was based on both reported transactions[1] volumes (at $0.01 per report) and values (initially 0.0005991 per cent - $59.91 for $10 million - of report values). This component was subject to an indexed minimum payment (initially $100) payable regardless of whether the entity was liable for the base levy, however entities with fewer than five employees were unlikely in practice to report enough transactions to make them liable for more than the minimum. Finally, there was a maximum transaction reporting charge (initially $1,346,000) for entities with reported transactions in excess of a maximum reporting charge threshold (initially $200 billion).

Both earnings and transactions reporting components were based on the earnings and transactions reports of either individual entities or the sum across a group of affiliated entities (a Designated Business Group (DBG)). In the latter case, the individual group members incurred a levy liability that was an equal share of the group liability.

2.2 2014 LEGISLATIVE AMENDMENTS

Following an independent review of the operation of the levy in 2013[2] and the May 2014 Commonwealth Budget, two Acts (the *Australian Transaction Reports and Analysis Centre Supervisory Cost Recovery Levy Amendment Act 2014*; and the *Australian Transaction Reports and Analysis Centre Supervisory Cost Recovery Levy (Collection) Amendment Act 2014*) amended the original Levy and Collection Acts to enable the introduction of a new Industry Contribution scheme, replacing the previous Cost Recovery model.

The rationale for the 2014 amendments to the Levy and Collection Acts and explanation for the changes to the levy structure were provided in the supporting Explanatory Memoranda and Statements to the amending legislation and the stakeholder consultation papers issued by AUSTRAC. In summary, the amendments were intended to give effect to the decisions announced in the Budget: to remove the $300 minimum levy paid by the 3,638 smallest reporting entities with

[1] The levy does not distinguish between Threshold Transaction Reports (TTR) and International Funds Transfer Instructions (IFTI). Both types are referred to interchangeably here as “reported transactions”.

[2] J. Flaye, *AUSTRAC supervisory levy review report: The independent review 2013*, 18 December 2013. https://parlinfo.aph.gov.au/parlInfo/download/publications/tabledpapers/72397/upload_pdf/supervisory_levy_review_report.pdf;fileType=application%2Fpdf#search=%22publications/tabledpapers/72397%22.

more than five employees and ensure that they were no longer subject to any charge; and to eventually increase the revenue collected to the whole of AUSTRAC's operating budget[3].

The progression in revenue collected originally proposed was a recovery rate of 70 per cent of appropriation in 2014-15, 90 per cent in 2015-16 and 2016-17, and full recovery from 2017-18 onwards. This was subsequently revised. In the Mid-Year Economic and Fiscal Outlook (MYEFO) of 15 December 2015 the government announced its decision to bring the scheduled increase to the levy forward by one year to enable full recovery from 2016-17 onwards[4].

As noted in Section 1 above, the 2014 amendments to the Levy and Collection Acts also provided greater flexibility to change the levy structure by allowing more of the details (such as minimum payment limits and other thresholds) to be set in the annual Ministerial Determination.

The changes to the Levy model were explicitly intended to reduce compliance costs for business by reducing the burden on smaller reporting entities. As noted by Senator Cash (representing the Minister for Justice in the Senate)[5]:

> *The new industry contribution regime provides a number of efficiency and deregulatory benefits for business, particularly small businesses. The new arrangements reduce red tape as they are considerably simpler for reporting entities to understand than the complex 'cost recovery' arrangements currently in place. This in turn reduces costs as the industry contribution model is more streamlined for AUSTRAC to administer.*
>
> *Approximately 3000 reporting entities will no longer be required to pay the AUSTRAC Industry Contribution levy. The number of reporting entities required to pay the industry contribution is estimated to be less than 900 entities. This represents a meaningful step in reducing the burden on small business.*

Although the concentration of the burden of the levy on a small proportion of reporting entities is viewed by some stakeholders as an inequitable flaw of the current arrangements, this quote makes it clear that concentrating the burden was a deliberate policy choice at the time of the 2014 amendments.

When introducing the suite of 2014 amendment Bills, the Minister for Justice[6] (the Minister) said it:

> *... transitions AUSTRAC from its current cost-recovery arrangements to a model that enables an industry contribution...*

The need for the levy, and the transitioned increase in its coverage to the whole of AUSTRAC's operating budget, was justified by the Minister as necessary because of the state of the Commonwealth Budget at the time, and he stated that government:

> *... would not normally have to move to a situation where we would need 100 per cent cost recovery from an agent like AUSTRAC.*

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[3] Commonwealth Budget Paper No. 2, 2014-15, 13 May 2014, page 9. https://www.budget.gov.au/2014-15/content/bp2/download/BP2_consolidated.pdf.

[4] Mid-Year Economic and Fiscal Outlook 2015-16, 15 December 2017, page 106. https://www.budget.gov.au/2015-16/content/myefo/download/MYEFO_2015-16_Final.pdf.

[5] The Senate Bills, *Australian Transaction Reports and Analysis Centre Supervisory Cost Recovery levy Amendment Bill 2014*, *Australian Transaction Reports and Analysis Centre Supervisory Cost Recovery levy (Collection) Amendment Bill 2014*, Second Reading Speech, Wednesday, 1 October 2014. https://parlinfo.aph.gov.au/parlInfo/genpdf/chamber/hansards/4630d1fc-e7c9-4b04-8c13-d1aa918c703f/0150/hansard_frag.pdf;fileType=application%2Fpdf.

[6] House of Representatives Bills, *Australian Transaction Reports and Analysis Centre Supervisory Cost Recovery levy Amendment Bill 2014*; and *Australian Transaction Reports and Analysis Centre Supervisory Cost Recovery levy (Collection) Amendment Bill 2014*, Second Reading Speech, Tuesday, 30 September 2014. https://parlinfo.aph.gov.au/parlInfo/genpdf/chamber/hansardr/424ea1a9-5ac4-4b91-b18e-c93201d11e75/0120/hansard_frag.pdf;fileType=application%2Fpdf.

This was consistent with criticism[7] the Minister had previously made of the 2011 cost-recovery regime as inappropriate for an agency like AUSTRAC, where he had argued:

> *It is not reasonable for the government to recoup the costs of running every government agency if that government agency is providing a public service rather than providing direct services to the people who are being asked to pay for them.*

The levy was explicitly described as a "revenue measure" in the Explanatory Statement accompanying the Ministerial Determination for the 2014-15 year issued on 8 April 2015 (page 3). Similarly, when the timetable for progression to full recovery of AUSTRAC's appropriation was revised in the December 2015, the government stated[8]:

> *The increased revenue from this measure will be redirected by the Government to repair the Budget and fund policy priorities.*

Clearly, AUSTRAC's appropriation and the revenue from the IC levy are treated separately in Commonwealth Government accounts. IC levy revenue is interchangeable with the rest of Consolidated Revenue.

Unlike an agency charging for services, AUSTRAC's operating budget is determined externally and is driven, amongst other factors, by the number of reporting entities it must monitor and the depth of analysis (and numbers) of reported transactions required of it by the government. There is no natural demand from reporting entities for the AML/CTF services provided by AUSTRAC, other than the generalised recognition of the broad public interest in transaction reporting and analysis.

Consequently, the IC levy should not be thought of as a form of cost recovery, in the sense of a set of fees for service based on, or related to, identifiable costs of provision. Rather, it is more appropriately analysed as an industry-specific tax, hypothecated to recover AUSTRAC's operating budget.

In very simple terms, the objective of the AUSTRAC IC levy is therefore to raise revenue equivalent to AUSTRAC's appropriation from the largest reporting entities, with the caveat that, in meeting the revenue target, the levy should also be designed to minimise its regulatory burden (compliance costs[9]).

2.3 CURRENT INDUSTRY CONTRIBUTION LEVY STRUCTURE

Although AUSTRAC had considerable leeway to propose a markedly different levy model, the new IC levy was similar in structure to the original CR levy. As noted above, the main change was to adopt rates and thresholds that shifted more of the financial burden of contributions onto the largest reporting entities.

Table 2-2 below summarises the structure and parameters of the IC levy applied by the various Ministerial Determinations since 2014-15. It also notes the pattern of transition of total levy contributions.

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[7] House of Representatives Bills, Australian Transaction Reports and Analysis Centre Supervisory Cost Recovery levy Bill 2011, Second Reading Speech, Monday, 30 May 2011. https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;db=CHAMBER;id=chamber%2Fhansardr%2F192727b3-7d58-404e-8db3-7962618aea19%2F0114;query=Id%3A%22chamber%2Fhansardr%2F192727b3-7d58-404e-8db3-7962618aea19%2F0116%22.

[8] Mid-Year Economic and Fiscal Outlook 2015-16, op. cit.

[9] Note that the costs of general compliance with the AML/CTF Act, including monitoring for and reporting of reportable transactions, would be incurred regardless of the existence of the IC levy. Unless specified otherwise, references to compliance costs in this report are only to those costs due to fulfilling obligations arising from the Collection and Levy Acts.

TABLE 2-2: IC LEVY PARAMETERS SINCE 2014-15

	2014-15	2015-16	2016–17	2017–18	2018–19
Earnings component					
Earnings value factor	0.030%	0.030%	0.043%	0.043%	0.047%
Earnings threshold	$100 million				
Minimum earnings component	$30,000	$30,000	$43,000	$43,000	$47,000
Maximum earnings charge	$1,000,000				$1,500,000
Maximum earnings charge threshold	$2.000 billion	$3.350 billion	$2.330 billion	$2.330 billion	$3.190 billion
Definition of earnings	Australian entities: Total earnings				
	Foreign entities: Based on domestic earnings from operations in Australia				
Transaction reporting component					
Transaction report volume factor	$0.010 per report		$0.012 per report		
Transaction report value factor	0.00089680%	0.00109340%	0.00105436%	0.00110412%	0.00094705%
Transaction report value for reporting entities with total annual report value of $15 billion or more (SADAMLTF)	Not applicable				0.00112194%
Minimum charge and maximum amount payable					
Minimum charge	$1,000				
Maximum amount payable	$6,430,600.32	$9,361,237.15	$9,926,801.15	$9,814,148.11	$10,205,095.19
Test for applying maximum amount	Reporting entity or billable group has earnings of $5 billion or more				
Cost recovery target	70%	90%	100%	100%	100%

Sources: Ministerial Determinations, 2015 to 2018.

Note that many of the elements of the levy shown in Table 2-2 are a natural consequence of base parameter choices. For instance, the minimum earnings charge is simply the product of the chosen earnings factor and the $100 million minimum earnings threshold. Similarly, as discussed below, other elements arise immediately from the data in AUSTRAC's reporting database at the time that the parameters are calculated for the upcoming levy year.

The process followed by AUSTRAC to set the levy parameter values is described and discussed in more detail in Section 2.4 below.

Earnings component

The current levy model continues to use the definition of earnings employed under the CR levy.

The earnings reporting component was converted from fixed dollar amounts within value bands into a fixed percentage factor (initially 0.030 per cent of reported earnings), up to a maximum dollar amount (initially $1,000,000). This improved on this component of the CR levy by removing the inequitable variations in the average rate of the earnings component, as well as the high effective marginal rate on earnings for entities that crossed from one earnings band into the next highest.

Transactions reporting component

The new IC levy removed the statutory minimum transactions reporting charge that previously applied to the sum of the transactions reporting volume and value components.

The original transactions reporting volume factor of $0.01 per report was retained in the first two years, but increased to $0.012 per report from 2016-17.

The base transactions reporting value factor (initially 0.0008968 per cent - $89.68 for $10 million - of report values) has been set at rates higher than applied under the CR levy and, for reasons discussed in Section 2.5 below, has varied over the four years of the IC levy.

The IC levy set for 2018-19 adds another transactions reporting value component, a higher transaction report value factor for reporting entities (individually or a DBG) with a total annual report value of $15 billion or more. This component is intended specifically to recover the cost of the new funding measure: Strengthening Australia's Defences Against Money Laundering and Terrorism Financing (SADAMLTF) that was announced on 18 December 2017[10]. The higher transaction report value factor is simply the sum of the base transaction report value factor (set based on other criteria) and the percentage ratio of the SADAMLTF revenue target ($9.156 million) to the total value of reported transactions from entities or groups with reported transactions over $15 billion threshold ($5,235 billion).

Minimum levy

The new structure replaces both the $300 minimum levy paid by reporting entities with more than five employees and the minimum transactions reporting component of the old CR levy with a $1,000 minimum charge for the combined earnings and transactions reporting components. When those combined components sum to less than $1,000, the levy liability is nil.

As previously noted, individual members of groups of affiliated entities (DBGs) incur a levy liability that is an equal share of the group liability and is separately invoiced by AUSTRAC.

Maximum levy

The previous maximum transaction reporting charge was replaced by a maximum levy applied to individual entities or DBGs with reported earnings in excess of a $5 billion earnings threshold. As detailed in the discussion of AUSTRAC's levy methodology in Section 4 below, the levy that then applies to affected entities is not directly related to their basic liability for the earnings and transactions reporting components.

Exemptions

Exemptions from the IC levy (by setting their levy liability at "nil") are provided in Sections (5) to (7) of the Ministerial Determination for specialised remittance affiliates[11], electricity generators and Commonwealth public corporations. Specifically:

> *(5) For subsection 9(1) of the Act, the amount of the instalment of levy payable for the financial year by a leviable entity that, in the previous financial year:*
>
> > *(a) provided a designated service or services only in the capacity of a remittance affiliate; and*
> >
> > *(b) did not provide a designated service in any other capacity;*
> >
> > *is nil.*

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[10] Mid-Year Economic and Fiscal Outlook 2017-18, 18 December 2017, page 168. https://www.budget.gov.au/2017-18/content/myefo/download/MYEFO_2017-18.pdf.

[11] A "remittance affiliate" is defined in Chapter 5A of the AUSTRAC Compliance Guide (http://www.austrac.gov.au/businesses/obligations-and-compliance/austrac-compliance-guide):

An affiliate of a remittance network provider is a business that provides remittance services to customers as part of a remittance network operated by a remittance network provider.

A remittance affiliate will generally:

- *have a commercial agreement or contract with a remittance network provider to provide remittance services in the name of the remittance network provider*
- *use the platform or business system owned by the remittance network provider*
- *receive a commission from the remittance network provider on transactions conducted*
- *use the AML/CTF program provided by the remittance network provider.*

(6) For subsection 9(1) of the Act, the amount of the instalment of levy payable for the financial year by a leviable entity that, on the census day for the financial year, was a 'Market Generator' within the meaning of the National Electricity Rules, is nil.

(7) For subsection 9(1) of the Act, the amount of the instalment of levy payable for the financial year by a leviable entity that is a body corporate established for a public purpose by an Act passed by the Parliament of the Commonwealth is nil.

These sections have not changed since the original IC levy Ministerial Determination in 2015.

Remittance affiliates provide remittance services under the auspices of another reporting entity (a remittance network provider), so their services (and transactions) pass through that network. The basis for the exemption is that AUSTRAC's primary regulatory relationship will be with remittance network providers rather than remittance affiliates. Electricity generators enter into hedging contracts as part of their internal risk-management activities. The hedging contracts represent a designated service under the AML/CTF Act, however the earnings from providing that service comprise a very small proportion of total earnings from electricity generation, which is not a designated service.

2.4 AUSTRAC INDUSTRY CONSULTATION AND MODELLING

Following the 2014 legislative amendments, AUSTRAC consulted extensively with industry on the proposed calculation model for the initial 2014–15 IC levy, including directly through its on-going Industry Consultative Forums and by releasing a series of three consultation papers on: 26 June 2014; 25 September 2014; and 3 December 2014.

The basic changes required of the IC levy model were set out in the 2014 Budget and the 2014 legislative amendments provided AUSTRAC with flexibility to restructure the levy model accordingly. As noted above, there was considerable leeway for AUSTRAC to propose a markedly different model to the original CR levy, but the model proposed to industry in the initial June 2014 consultation paper was only a relatively minor evolution of the original. It retained earnings and transactions reporting volumes and values as its bases, and refined thresholds to implement the government's policy of reducing total compliance costs by shifting more of the burden of the levy onto larger reporting entities.

AUSTRAC did not follow any explicit guiding principles when moving between the two levy models. It was aware of the potential to impose large compliance and adjustment costs by making drastic changes and considered that retaining some consistency between the two regimes would be helpful for reporting entities. It was also concerned to reduce the overall compliance costs of the levy regime, principally by implementing the government's commitment to reduce the number of reporting entities liable for contributions.

The structure of the new levy was started by preserving some of the thresholds from the previous cost recovery arrangements and changing others to meet the compliance reduction objective. Consequently, the new regime retained the transactions reporting volume component of $0.01 per report and the $100 million earnings threshold, which had been the starting point for the Large Entity Component of the CR levy, but replaced the employment threshold and minimum transactions reporting component payment with the new $1,000 minimum levy payment.

Once a threshold structure was decided, and as with the previous levy regime, AUSTRAC then derived levy parameter values consistent with the contribution revenue target in a spreadsheet model. The model was populated with pre-census day data for the 2014-15 levy year.

The initial parameter values were set by seeking industry feedback over the three rounds of consultation that took place before the final amounts were set. After each round of consultation AUSTRAC reworked parameter values in response to stakeholder feedback and within the bounds created by the revenue target and census data. For instance, the maximum earnings payment was increased from $500,000 to $1 million after the first round consultation. AUSTRAC has advised Acacia CRE that, in general, the adjusting component was always the transaction report value element. That is, once other parameters were changed, the transaction report value factor was recalculated to ensure the revenue target was met.

As explained below, the maximum reporting charge was set as a residual parameter, once other levy factors were calculated to meet the revenue target. The method of its calculation means changes in this parameter have no net impact on the total of contributions.

Although the structure of the new levy outlined in the first consultation paper was retained, the final version incorporated changes in some of the parameter values (the proposed earnings factor was reduced from 0.05% to 0.03%) and thresholds (a second qualifying criterion for the maximum payment, a reported transaction report value of $200 billion or more, was abandoned, leaving only the $5 billion earnings threshold). In response to stakeholder concerns about the compliance costs of provisions in the Levy Act allowing multiple invoices in any financial year, AUSTRAC also made commitment to invoice no more than once a year.

Following this consultation and refinement to reflect stakeholder feedback, the final levy model for 2014–15 was released in March 2015. The census day was set by the AUSTRAC CEO as 16 March 2015. The Ministerial Determination was issued on 8 April 2015 and invoices for 2014–15 were issued later in that month. This meant there was a delay of more than 21 months between the last invoices of the CR levy and these first IC levy invoices. In subsequent years invoices were issued soon after the finalisation of the Ministerial Determination in mid-September.

2.5 CURRENT AUSTRAC PROCESSES

AUSTRAC provided Acacia CRE with a copy of the spreadsheet model used to calculate the rates and thresholds that were the basis for its recommendations of the values included in the 2018-19 Levy Ministerial Determination. It was clear from the calculations presented in the model, and the explanation provided by AUSTRAC, that the process currently used to update the levy parameters largely follows the process outlined above for setting the original IC levy parameters. Similar versions of this model have been used by AUSTRAC since the introduction of the CR levy and the version provided embodies methods followed by AUSTRAC since the introduction of the IC levy. The same process is also followed for calculating both the parameter set included in the consultation papers released after the Budget, when AUSTRAC's appropriation is known, and those in the final Ministerial Determination.

Data gathering and confirmation of structure

The process starts with extraction of a new data set from AUSTRAC's Reporting Entities Roll. At the time of the consultation paper this would include earnings data recorded on the Roll as at the date of the data extraction and transactions reports for the previous calendar year (the year ended on the previous 31 December). The transactions reports data would not generally change for the calculation of the final parameters for the subsequent Ministerial Determination. Any differences between the two data sets are generally only due to changes in the list of leviable entities on the 1 July census date, and/or changes to entities' declared earnings.

The extracted data populates a spreadsheet model that calculates the revenue raised by applying the various levy parameters, within the existing structure. Any major changes to the structure of the levy, such as removing a payment limit or a threshold, for instance, would have to be incorporated at this point in the process. As is clear from Table 2-2 above, AUSTRAC has, with the exception of the introduction of the high transactions value reporting factor (SADAMLTF), left the structure of the levy unchanged since 2015.

Threshold confirmation or revision

The next stage in the process is to choose to retain or revise the various threshold values. The maximum earnings charge was raised in 2018-19, for instance, however neither the $1,000 minimum levy payable nor the $100 million earnings thresholds have been changed since the first collections in 2015[12]. The effect of this has been to reduce the value of these thresholds in real terms. In principle, this means more reporting entities would be expected to exceed the $1,000 minimum payment or the $100 million earnings threshold than in 2015 because the value of earnings and all transactions should have increased in nominal terms. In practice, there is no obvious upward trend in the number of paying entities[13]. It is not obvious why this is the case, although increased concentration of the financial services industry would be one potential explanation.

Earnings and transaction report volume factors

The earnings value factor and transaction reporting volume factors are then set. AUSTRAC advises that there is no specific basis for this choice, other than ensuring broad consistency with the prior year and to respond to stakeholder feedback from the annual consultation process. Both of these factors were increased in 2016-17, and the earnings value factor was increased again in 2018-19. No explanation for these changes was provided in the contemporary consultation papers or Explanatory Memoranda for the Ministerial Determinations. However, if one or both of these factors had not been increased at some point since 2015, all of the growing revenue target would have had to have been raised from the increase in the transactions reporting value factor. Once these two factors are set, the earnings and transactions report data predicts a level of "raw" revenue across all reporting entities, after the effect of the maximum earnings component limit, but before the effect of the minimum payment limit.

Transaction report value factor

The "raw" earnings value factor and transactions reporting volume revenue then determines an initial residual revenue target to be generated by the transaction report value factor. That factor is initially set equal to the residual target divided by the total value of reported transactions. Once that factor is applied, the "raw" liability for each entity is checked against the $1,000 minimum payment threshold. This reduces total revenue below the target, so the transaction report value factor is increased to "top-up" total revenue and the process iterates until a final factor is determined. This process means, for any overall revenue target and threshold values, AUSTRAC has the flexibility to set only two of the three rate factors (earnings and transaction report volumes and values). AUSTRAC has advised that, of the three, the transaction report value element has always been the balancing factor.

The balancing role of the transactions reporting value factor is one reason it has moved up and down over the five years of the IC levy, driven by the growing overall revenue target and the timing of changes in the other two rate factors.

[12] The $100 million earnings threshold was carried over from the CR levy and, as shown in Table 2-1, has been in place since 2011-12. Note also that the nominal TTR threshold has been kept at $10,000 since the AML/CTF Act commenced in 2007, something that should also have increased the number (and total value) of reported transactions over time.

[13] AUSTRAC's consultation papers note "about 600" paying entities in 2016-7, "approximately 620" in 2017-18 and "approximately 570" in 2018-19. AUSTRAC has advised that the numbers of issued invoices were: 603 in 2015-16, 623 in 2016-17, 605 in 2017-18, and 561 in 2018-19. The drop in 2018-29 was largely due to the removal of cash-in-transit operators from the Reporting Entities Roll. AUSTRAC also advised that, without that change, invoice numbers would have been close to the same as in 2017-18.

Higher transaction report value factor

As discussed above, the IC levy set for 2018-19 adds another transactions reporting value component, for reporting entities (individual or group) with a total annual report value of $15 billion or more. This component is intended specifically to recover the cost of the new SADAMLTF program. The higher transaction report value factor is simply the sum of the base transaction report value factor and the percentage ratio of the SADAMLTF revenue target to the total value of reported transactions from entities or groups with reported transactions over $15 billion threshold. Consequently, like the base transactions reporting value factor, AUSTRAC has no leeway to recommend any other rate for the higher transaction report value factor, given the transaction reports data and the choices already made (the earnings value and transactions reporting volume factors; and the $15 billion report value threshold). No explanation was given for the choice of the level of the $15 billion transaction report value threshold. It has the effect of limiting the higher factor to the transaction reports of just under 300 entities (including those in DBGs).

Maximum levy payable

Finally, as noted previously, the maximum payment amount is then set as a residual parameter. As currently implemented by AUSTRAC, the maximum is set as the average of the levy amounts otherwise payable separately by the DBGs of the four major banks. The $5 billion threshold is a convenient means of isolating those four groups as they are the largest reporters. Because the maximum reporting charge is the average of the “raw” levy liabilities of the four major bank DBGs, this process serves only to redistribute their contributions and has no impact on either the total revenue raised from them or on the levies payable by other reporting entities.

There is no mention or explanation of this practice in the Ministerial Determination or associated Explanatory Statement for the IC levy. AUSTRAC has advised Acacia CRE that it was adopted in response to a request from the four major banks that they each pay the same amount of levy, on the grounds that a substantial portion of the relevant reported transactions are passing between their customers.

It nevertheless appears that AUSTRAC is facilitating a cost-sharing agreement between the four major banks. The effect of the maximum payment amount element of the IC levy on the four major bank DBGs is likely to be a minor distortion of the costs of facilitating reportable transactions, relative to other reporting entities; some possible minor saving of compliance costs; and, more relevantly, a redistribution of IC levy costs.

The distortion of costs arises because each group only bears a quarter of the cost that smaller entities would pay for any additional transaction reports, the rest being passed to the other three competitors. The possible reduction in compliance costs could arise because the method for setting the maximum makes it impossible for each of the four bank groups to verify their liability. Other reporting entities would, for internal auditing, incur compliance costs verifying their levy invoices against reported earnings and transactions and the factors in the annual Ministerial Determination. The four major bank DBGs cannot do this without sharing reporting information and confirming their joint liability. Finally, the method used causes a redistribution of levy liabilities because, despite being the largest reporting entities groups by earnings, they report volumes and values of transactions in very different levels and rankings. Consequently, AUSTRAC’s method for setting the maximum levy results in a significant percentage change in levy liabilities of at least two groups[14]. Despite this, the redistribution and other effects are insignificant compared with the scale of the turnover and profitability of the four major banks, and are unlikely to have a significant impact on their profitability, pricing or other behaviour.

[14] Compared to the “raw” levy liabilities in 2018-19, the effect of the process to set the maximum payment amount is to increase the liabilities of two groups, one by around 75 per cent, and decrease the liabilities of the other two, one by over 35 per cent.

Invoicing, disputes and collections

Once the final levy parameters are set and the Ministerial Determination is finalised and approved, AUSTRAC issues invoices to leviable entities, usually before the end of the first quarter of the financial year. Entities are then liable to pay within 30 days and may challenge their liability through the dispute process in that time. Disputes can be raised based on errors in enrolment details (newly enrolled entities commonly report earnings as gross revenue instead of EBITDA) or in records of reports. The process also allows for applications for waiver of payment based on a limited range of factors.

Once invoices are issued, final collected revenue will almost always be lower than the original appropriation target because of disputes, defaults and waivers. Target revenue may also prove to be more than required if AUSTRAC's budgeted depreciation is higher than actual depreciation expense. For instance, if actual depreciation proves to be lower than anticipated, AUSTRAC's net operating cost would be less than the target levy revenue and an over-recovery could be generated. Conversely, if actual depreciation proves higher than budget, an under-recovery would be generated.

Table 2-3 below summarises the differences between target and actual collections since 2014-15. The discrepancies to date are all relatively minor.

TABLE 2-3: BUDGETED AND ACTUAL LEVY COLLECTIONS, 2014-15 TO 2017-18 - $'000

	2014-15	2015-16	2016–17	2017–18
Original Budget ($'000)	$43,734	$58,198	$65,956	$65,507
Actual ($'000)	$43,584	$57,690	$65,316	$65,568
Difference	*-0.34%*	*-0.88%*	*-0.98%*	*0.09%*

Sources: AUSTRAC and AUSTRAC Annual Reports, various.

Mechanisms exist that would allow AUSTRAC to invoice more than its appropriation in any year[15] and this could be used to add a "buffer" to cover under-recovery of the types discussed above. Alternatively, the same provisions could be used to recover additional revenue in a subsequent financial year. AUSTRAC has advised that the Department of Finance has not enforced recovery of under-target revenues to date.

AUSTRAC administration costs

There are no records to definitively establish AUSTRAC's costs of administering these IC levy processes, as it does not account for those costs separately from its other activities. It has advised that setting the levy rates and thresholds is only a small part of the levy process which includes preparing the calculation model; preparing the consultation paper; receiving submissions and engaging with respondents as required; preparing the Ministerial Determination and generating and issuing invoices. The whole process usually occupies no more than five AUSTRAC staff intermittently over the course of around half a year. This also includes the handling of invoice disputes and requests for waiver. The number and complexity of disputes varies from year to year and the associated workload also varies depending on whether the entity is part of a group or is an individual. The majority of disputes are related to the earnings component, where entities declare the wrong amount and are easily resolved. To date, the most time-consuming dispute was assessed and responded to in less than two person weeks.

AUSTRAC has estimated that for the full levy cycle, the resourcing required to complete all tasks would equate to a full time equivalent (FTE) of approximately 1.1. On this basis, it would be reasonable to estimate the overall annual cost of IC levy administration at no more than

[15] S.7 and s.9(2)(b) of the Levy Act together allow AUSTRAC to issue invoices in any financial year up to a statutory limit that is twice its appropriation for that year.

$0.250 million, and most certainly less than 0.4 per cent of revenue collected. This compares favourably with the overall cost to revenue ratio of the Australian Taxation Office (ATO) which most recently reported[16] values of 0.74 per cent in 2016–17 and 0.67 per cent in 2017–18.

16 Australian Taxation Office, Annual Report 2017-18, page 58. https://www.ato.gov.au/uploadedFiles/Content/CR/Downloads/Annual_Report_2017-18/annual%20report%202017-18.PDF.

3. CONSULTATION AND ISSUES RAISED IN SUBMISSIONS

3.1 PROCESS

Industry consultation for this review was via assessment of written submissions from stakeholders currently or potentially impacted by the levy and from other interested parties.

On 19 November 2018, an Issues Paper was published on a dedicated page on the Acacia CRE website and AUSTRAC directly contacted 170 stakeholders to advise them of the commencement of the review, the availability of the Issues Paper and calling for submissions to be sent to a dedicated Acacia CRE e-mail address. Those stakeholders included individual leviable entities, the holding companies for entities within DBGs and representative industry organisations. AUSTRAC placed a similar notice on its website later in that week.

Only five organisations responded to the Issues Paper by the initial deadline on 21 December 2018. These were: the Australian Banking Association (ABA); the Australian Finance Industry Association (AFIA); the Australian Financial Markets Association (AFMA); Clubs Australia; and Perpetual Limited (Perpetual). One further and wholly confidential submission was received on 25 January 2019. That most of the submissions were received from representative organisations, rather than individual reporting entities, and the number of submissions was consistent with the level of industry engagement with AUSTRAC's annual IC levy consultation papers.

The response was, nevertheless, less than had been hoped for, both in terms of volume and content, given the nature of this Review and the range of questions asked and information requested in the Issues Paper. In particular, stakeholders did not provide any substantial data or anecdotal evidence that would have allowed a proper assessment of the costs of compliance with the IC levy or of the impacts on those costs of any changes to the current arrangements. A summary and discussion of the issues raised in the submissions is presented below.

Acacia CRE consulted with AUSTRAC over the whole of the review, both verbally and in writing. AUSTRAC provided a detailed written response to a series of questions drawn from the Issues Paper and also provided Acacia CRE with copies of spreadsheet models used in its internal policy processes and answered questions about the content and use of these models.

More details of the consultation process and the requested content of submissions are set out in Appendix 2.

3.2 ISSUES RAISED OR ADDRESSSED IN SUBMISIONS

This section summarises and discusses the main issues raised by stakeholders in their submissions. In some cases analysis of the issues is presented in later sections, in the context of the assessment of AUSTRAC's methodology. Similarly, some peripheral stakeholder comments on issues have been included in the relevant discussion elsewhere. This is also the case for the information provided by AUSTRAC in ongoing consultation during this review, including its answers to the issues specifically mentioned in the 19 November 2018 Issues Paper.

3.2.1 CONCENTRATION OF LEVY BURDEN

Some responses to the Issues Paper argued that the concentration of the burden of payment with the introduction of the IC levy was inequitable. This issue has been raised since the government first announced the changes leading to the IC levy in the 2014 Budget.

The ABA noted that it had, in its previous submissions:

> *... expressed strong concern regarding the inequitable basis of the recovery of AUSTRAC's costs ... the major reporters bear the burden of the levy while around 96% of reporting entities are exempt from contributing*

Similarly, the AFMA said:

> *The fact that only 4% of the regulated population of reporting entities pays 100% of the industry contribution is inequitable and unfair, and remains of acute concern to us.*
>
> *In AFMA's view, all reporting entities that are subject to AML/CTF regulation should be required to contribute to the AUSTRAC levy on a more equitable basis.*

and

> *Overall, AFMA's view is that the current industry contribution levy is inequitable and imposes a significantly disproportionate burden on a very small proportion of the total population of regulated reporting entities.*

Consequently, it argued:

> *The levy arrangements should more appropriately reflect the level of regulatory and compliance resources applied to particular sectors or areas of business activity by AUSTRAC. Those who create the need for regulation should pay for that regulation, rather than being subsidised by other reporting entities who have a perceived capacity to pay.*

The first response to these points is that the changes to the levy model were explicitly intended by the government at the time of the 2014 legislative amendments to minimise the total compliance burden of raising industry contributions by concentrating liabilities on a smaller number of larger reporting entities. Reversing that decision would require the government of the day to make another explicit assessment of the balance between equity and efficiency. Moreover, there is nothing in the changes to the IC levy since its introduction that would suggest that the burden has become more concentrated with time, necessitating changes to restore the original equity/efficiency "balance". Indeed, subsequent increases in various levy component factors and the lack of changes to nominal thresholds, other things being equal, are already likely to have spread the burden to "smaller" entities.

Secondly, there is no clearly objective basis on which any consequent "inequity" of the current distribution can be assessed, other than to note that spreading the burden to more entities would likely be "fairer". However, the options for doing so (changing levy thresholds and factor values) come with risks that other problems are created. That is, improving vertical equity (the distribution between "large" and "small" entities) may create horizontal inequities (different treatment of entities that are "comparably sized", but differ in nature of their reports). Moreover, improving perceived equity may come at a significant cost of higher overall compliance costs.

A consequence of a more wide-spread distribution of levy contributions is likely to be a significant increase in the total administrative and compliance costs of the IC levy scheme. The nature of these compliance costs was well described in the submission from the AFIA.

> *AFIA understands additional accounting costs contribute a significantly to the overall compliance costs imposed by the IC levy.*
>
> *Accounting resources are required to assess every draft determination of its expected financial impact on the reporting entity. This work includes liaising with finance teams to understand exactly how earning are calculated for each reporting entity, consistent with AUSTRAC guidance. Of course, when the final determination is releases (sic), further analysis and action is required to ensure an appropriate budget allocation is in place to cover the levy obligation. Finally, and to a lesser extent, business resources are required to affect the levy payment.*
>
> *The entire assessment, budgeting and payment process needed for a reporting entity to fulfil its levy obligations requires specialist staff with a thorough understanding of the levy's legislative basis and how AUSTRAC's Rules must be applied. Such expertise comes at significant and ongoing costs to reporting entities.*

Some of these costs would already be incurred by currently non-liable reporting entities. Nevertheless, it is clear that entities freshly required to report earnings and check and process invoices would incur substantial on-going compliance costs.

Consequently, widening the burden of the IC levy means new contributors will face both financial and additional compliance costs. It will reduce the financial burdens of current contributors, but they will still need to report and to process invoices as at present and would not be expected to make any savings of compliance costs. The more equitable distribution would therefore increase compliance costs for no net gain in levy revenue. There may be some offsetting benefits, such as obtaining better information about the distribution of the earnings of smaller reporting entities, but it is unlikely that these would out-weigh the higher compliance burden of the levy.

Some stakeholders might argue that the value of a wider distribution of contributions justifies the higher overall administrative and compliance costs. It is impossible to refute such a subjective assessment, other than to note that it is inconsistent with the Potential Pareto, or hypothetical compensation, principle - the standard economic measure of policy efficiency. The newly burdened reporting entities could, in principle, pay existing levy contributors to retain the current distribution and still be better off than they would have been after the levy was spread more widely. That being the case, there is a net social benefit (a "free lunch") from retaining the existing distribution of the burden of the levy.

In addition, there are practical reasons for maintaining the existing concentration of the burden of the IC levy that are discussed in the context of the discussion in Section 4.1 below of the concentration of industry activity.

3.2.2 LOWERING THE $100 MILLION EARNINGS THRESHOLD

Despite the case above for not doing so, the burden of the levy could, in principle, be more widely distributed by, for instance, lowering the $100 million earnings threshold or the $1,000 minimum levy; or by abolishing the high transaction report value threshold and rolling SADAMLTF into the revenue generated from the base transaction report value factor.

Both Perpetual and the ABA focussed on the first of these possibilities in their submissions, specifically suggesting lowering the earnings threshold. Perpetual Limited argued:

> *... the current structure increases the compliance burden on larger entities and reduces burden on smaller entities. A key question for consideration would be whether the $100 million earnings threshold is appropriate, or whether a lower threshold would result in a more equitable spread of the earnings component of the levy.*

The ABA argued:

> *The current threshold of $100 million is excessively high and should be reduced. An assessment of risk should feature in the model for calculating who should pay the industry contribution and how much they should pay.*
>
> *In the past the ABA has expressed support for a position put by the Australian Financial Markets Association (AFMA) which advocates for a reduction of the earnings threshold to $10 million. The figure of $10 million aligns with the government's view of a 'small business'. The ATO also defines a small business as having an income of between $2 million and $10 million per annum.*
>
> *The ABA recommends that entities above that small business threshold of $10 million should therefore contribute to the cost of monitoring for illegal activity, this would sit alongside a base annual fee for each entity in AUSTRAC's growing regulated population.*

The AFMA submission included a reference to the content of all of its previous responses to AUSTRAC's consultation papers. On this point, in its 26 August 2015 submission in response to the first consultation paper after the commencement of the IC levy, it argued:

> *Under the current Industry Contribution model, and that proposed for 2015-16, there is an earnings threshold of $100 million. This means that the minimum earnings component is $20,000 (sic), based on a fixed percentage of 0.03%.*
>
> *This threshold is set significantly higher than the minimum charge of $1,000, and hence there are a significant number of leviable entities that do not pay any earnings component. Given the increase in the total amount to be recovered and the increased burden on larger institutions, we would advocate a reduction to the earnings threshold so as to spread the burden of the increase in a manner more commensurate to the risks posed. A reduction to, say, $10 million would ensure an earnings component payment for entities that may still be considered to be large.*

Against these views, Clubs Australia said it would not support any reduction in the current minimum earnings threshold.

As with the generic suggestions to distribute the impact of the levy more widely, the effect of lowering the $100 million domestic earnings threshold is likely to be an increase in overall compliance costs for no revenue gain.

Whatever the merits of arguments to lower the $100 million domestic earnings threshold, the potential impact cannot be assessed with the data used to populate the AUSTRAC levy parameter model because, as the reporting rules are currently framed, entities below the threshold do not have to report their earnings.

Acacia CRE was provided with work by AUSTRAC from 2016 that attempted to expand the earnings data and estimate the effect of lowering that threshold by drawing on Total and Taxable Income data from the ATO's *Corporate tax transparency report*, cross-matched against the registered company names of reporting entities.

Similar and more recent data is available from the ATO that might have allowed AUSTRAC's work to be reproduced. However, it was clear that, aside from needing to carefully filter ADIs and RFCs from the list of matched entities (as had been done in AUSTRAC's work, due to the different earnings reporting requirements for those classes of entities), the ATO data was likely to add information for only a few dozen additional entities. Consequently, it would have generated a misleading indication of the effect of setting a new threshold at particular levels. The results would depend heavily on where that threshold was set relative to the earnings estimates of the few additional entities.

Notwithstanding the efforts of AUSTRAC based on ATO data, there is no firm basis on which to make a reliable assessment of the impact of lowering the earnings threshold. Lowering the threshold would clearly increase the base for the transactions reporting component, but the size of the base at different levels of threshold and, subsequently, the appropriate rate at which to set the levy parameters will not be obvious until the earnings reporting threshold is lowered. For instance, around half of currently reporting entities and DBGs with earnings over the $100 million threshold do not report any transactions, so it is possible that a significant share of entities just below that threshold might only be liable for the earnings component of the levy, and not pay any transactions component.

Recommendation: There is no strong argument for changing the $100 million domestic earnings threshold applied in the IC levy on equity grounds, however AUSTRAC should consider revisions to the reporting requirements (AML/CTF Rules, Chapter 63) that would allow the collection of earnings data from reporting entities below the current earnings threshold. This would allow a more informed consideration of the impact of any future changes in the earnings threshold for levy liability, albeit at some additional cost of compliance for the entities that would have to supply the information.

Aside from their equity arguments for lowering the threshold, both the ABA and the AFMA also refer above to basing the levy, presumably in part, on the risks posed by entities. The rationale for this is that entities providing services with a higher risk of potential money laundering and terrorism financing (ML/TF) activities require more of AUSTRAC's operational resources, and therefore generate higher costs. Although this argument has merit in a cost-recovery context, as noted previously, the 2014 amendments explicitly moved the basis for the levy from cost recovery to an industry contribution model. In a purely revenue-raising instrument, albeit one hypothecated to AUSTRAC's appropriation, the risk level of entities is irrelevant compared with their capacity to pay and the availability of a suitable levy base (such as earnings and the transactions reports volume and value data collected as part of transactions monitoring).

In any case, the transaction reporting component may already serve as a proxy for risk. As noted by Perpetual:

> *The current transaction reporting component is therefore considered to achieve the desired outcome of attributing funding obligations to higher risk reporting entities.*

Moving, even in part, to a risk-based levy model would require AUSTRAC to develop and apply suitable risk rating categories. This would be a difficult, costly and potentially arbitrary exercise.

3.2.3 NON-ADHERENCE TO COST RECOVERY GUIDELINES

Despite the explicit establishment of the IC levy as a revenue-raising measure in the 2014 amendments, some stakeholders criticised the IC levy on the basis that it does not follow government policies for cost recovery schemes. For instance, the ABA claimed:

> *... the AUSTRAC Industry Contribution Levy arrangements do not comply with the Australian Government Cost Recovery Guidelines ... The Guidelines impose the appropriate discipline to ensure that the amount paid by industry is referable (sic) to the provision of government goods or services ...*

Similarly, the AFMA argued:

> *... the model is clearly full cost recovery. Consequently, the Australian Government Charging Framework should apply. AFMA has raised this in previous submissions, and the failure of the Government to acknowledge this position is disappointing. Whatever the outcome of this review, AFMA urges the Government to properly describe the model as cost recovery going forward.*

As previously noted, these arguments ignore the explicit establishment of the IC levy as a revenue-raising measure and not a cost recovery scheme, and are based a misconception of the types of government services that are appropriately covered by cost recovery schemes.

Assessing whether the regulatory and intelligence services provided by AUSTRAC should be financed by a cost recovery scheme is beyond the scope of this review. The level of reported transactions obviously influences the overall costs of monitoring and assessment, but is not reflective of the demand for or the types of services that AUSTRAC supplies. Consequently, both the Government Cost Recovery Guidelines and the Australian Government Charging Framework contain provisions that could be used to argue that those services are not suitable for cost recovery. In that sense, the decision to establish the IC levy scheme in its present form was entirely consistent with the relevant principles and policies.

Like other government agencies without a cost recovery program, the scope of AUSTRAC's activities and the size of the associated budget are in the hands of the government. The processes of parliamentary and ministerial oversight impose the discipline on its costs that, if they were appropriate, might otherwise have been applied by market forces.

3.2.4 SINGLE-INVOICING FOR DESIGNATED BUSINESS GROUPS

AUSTRAC's current practice is to issue an invoice[17] to each leviable reporting entity, regardless of whether that entity is a stand-alone corporation or, for the purposes of its liability, a member of a group of leviable entities (a DBG). Both the AFMA and the ABA have expressed, in nearly identical terms, their desire for, at least the option of, receipt of a single invoice for DBGs.

For instance, the AFMA said:

> *The existing administrative structure for the levy where an invoice is issued to each DBG member is time-consuming and costly.*

Similarly, the ABA noted:

> *... the existing structure for the levy (invoice to each Designated Business Group (DBG) member) is time-consuming and costly...*

In response to an Issues Paper question about form and level of compliance costs (initial and ongoing) imposed by the IC levy, the ABA noted:

> *... processing multiple invoices (one member noted in excess of 50 invoices). Depending on the amount of the invoice, approval may be up to the CRO or even, in some cases, the CEO.*

The issue is not new and has been raised with AUSTRAC previously. Both the AFMA and the ABA noted that they had requested the option of single invoices in the context of the consultation on and drafting of the 2014 amendments facilitating the transition from the CR levy to the IC levy. The ABA said:

> *... changes were suggested to promote efficiency and the issuing of one invoice for the DBG as opposed to an invoice per DBG member but again these were not considered.*

Similarly, the AFMA noted:

> *Additionally, changes were suggested to promote efficiency through the issuing of one invoice for the DBG as opposed to an invoice per DBG member, but again these were not considered. A legislative change was necessary but it was unclear why this change could not be incorporated in the 2014 amendments.*

Clearly some reporting entity groups can reduce the costs of complying with the requirements of the IC levy if they centralise administration tasks. Indeed centralisation already happens to a degree, as AUSTRAC advised that, for most groups, payment of individual entities' invoices is made by their holding company and it receives a single payment for all group members. AUSTRAC already incurs some record keeping and administrative costs of allowing for group membership as part of the levy calculations. Allowing reporting entities in groups to nominate their holding company as the entity responsible for the group IC levy liability to which AUSTRAC issues a single invoice therefore seems like a trivial change in processes and an obvious way to further reduce the overall (to both AUSTRAC and liable entities) compliance and administrative costs of the scheme.

The change nevertheless appears impossible within the provisions of the current IC levy legislation. Section 8(2) of the Collection Act already allows the entity to which the AUSTRAC CEO gives notice of the amount of the levy payable to nominate another entity to receive the notice and to assume liability for and discharge it. Nevertheless, the section seems to indicate that the levy notice still has to be generated for each entity. Moreover, the Collection Act links its definition of a leviable entity to the definition of a reporting entity in s.5 of the AML/CTF Act. Since the

[17] In the language of the Collection Act, this is the "notice that the AUSTRAC CEO gives to the person in relation to the instalment" of levy payable, where the "person" is a legal entity.

leviable entity is then legally liable for the IC levy it is the entity to which AUSTRAC must send an invoice. It appears that changes to the Collection Act would be needed to allow a provision for offering the option of DBG invoices.

Recommendation: Although worthwhile, making the appropriate legislative changes to allow the option of issuing a single invoice to a DBG probably cannot be justified as a stand-alone amendment to the Collection Act and should only be implemented in the event that a major change in the levy scheme is required. AUSTRAC should nevertheless clarify the current legal obstacles to issuing DBG invoices, with a view to ensuring the changes (if any prove to be required) are made as soon as an opportunity arises.

3.2.5 ASIC-STYLE LEVY SCHEME

As a consequence of their arguments for a wider distribution of the levy burden, both the ABA and the AFMA suggested that the Australian Securities and Investments Commission (ASIC) Supervisory Cost Recovery (SCR) levy was an appropriate alternative to the IC levy. It is worth considering that levy briefly as background to the discussion in Section 5 below of the current and future suitability of the IC levy legislation.

The basic features of the ASIC SCR levy were outlined in the AFMA submission:

> *The model for industry funding of ASIC, which commenced in financial year 2017/18 along with fees for service for certain applications and document lodgement activities, is in our view a better (but not perfect) model for cost recovery.*
>
> *Under the ASIC industry funding model, all regulated entities (with a small number of exceptions such as charitable organisations) pay at least a small flat levy, with additional components charged depending on the nature of the entity's business activities. Under this model, ASIC's regulatory costs in relation to particular activities are recovered from the entities that undertake those activities. This is more consistent with the concept in the Australian Government Charging Framework that those who create the need for regulation should pay for it.*

In introducing this levy, ASIC identified 48 sub-sectors of regulated entities, covering: Corporations, Auditors, Insolvency Practitioners, Australian financial services licensees and other regulated entities and individuals. The various sub-sectors include anywhere from one to more than 16,000 entities. ASIC has allocated its costs across those sub-sectors and the entities and individuals within each sub-sector pay levies to recover those costs. Entities active in more than one sub-sector are liable for the levies associated with each type of activity. The levy calculation methods are unique to each sub-sector, depending on the types of activity monitored in, and information gathered from, each sub-sector in the previous financial year. The types of levies include flat fees, graduated (variable) levies (some with activity thresholds) and mixes of these two.

ASIC's total budget is around $250 million, more than three times AUSTRAC's appropriation and industry contributions. According to the ASIC Cost Recovery Implementation Statement for its 2018–19 levies[18], those costs are attributed to sub-sectors:

> *... using a weighted average hourly rate. The hourly rate is calculated for each team involved in the business process and includes indirect costs (made up of property, IT and corporate services costs), apportioned according to average full-time equivalent (FTE) staff.*

[18] Cost Recovery Implementation Statement: Fees for service under the ASIC industry funding model (2018–19), June 2018, page 19. https://download.asic.gov.au/media/4797008/cris-fees-for-service-under-asic-industry-funding-2018-19-published-03-july-2018.pdf

That is, all costs (direct and indirect) are allocated in proportion to the staffing costs associated with each sub-sector. Based on this description alone, this method of allocating indirect costs is unlikely to be either efficient or indicative of commercial practice (since it fails to include allowance for any demand-side factors).

It is not obvious how the ASIC SCR levy provides a model for AUSTRAC that is significantly better than the existing IC levy. The relevant features appear to be the allocation of costs to sub-sectors and the requirement that, with only one minor exception, all reporting entities contribute to the costs allocated to their sub-sector. The design of the individual sub-sector levies suggests nothing that is not already feasible or implemented by AUSTRAC (levies based on measured activity), although ASIC's sub-sector levies are tied to bases, and set at rates, that reflect perceived drivers of staff levels (and therefore, given ASIC's method, costs).

As noted above, assessing whether the regulatory and intelligence services provided by AUSTRAC should be financed by a cost recovery scheme is beyond the scope of this review. Similarly, assessing the suitability of the current earnings and transactions reports volume and values as suitable base for a cost recovery levy would require a detailed analysis of the drivers of AUSTRAC's costs. It would also need to take into account that a large part of AUSTRAC's costs arise from the demand for the intelligence derived from reported transactions, rather than the creation of those transactions, per se. This raises questions that are also outside the terms of reference for this review and the requirements of s.17 of the Levy Act.

If an explicit cost recovery basis was to be re-imposed, it is likely that significant (relative to operating costs) compliance and administrative costs would be created. In present circumstances, before considering any expansion of AUSTRAC's operations, just the introduction of a flat-fee plus volume or value component levy for all reporting entities would add significantly to the compliance and administrative burden on AUSTRAC. It would face a 25-fold increase[19] in the number of invoices that would have to be issued, with a similar expansion of its internal administration costs, and reporting entities currently exempt from the levy would similarly face the additional administrative costs of processing an invoice (albeit for probably no more revenue than a few thousand dollars each[20]). If AUSTRAC also gathered the information that would allow classification of entities into risk-related or other cost-driver types of groups, reporting requirements, and therefore total costs, would also increase both within AUSTRAC and for reporting entities.

Once it is accepted that the IC levy is not supposed to be a cost recovery mechanism, the usefulness and relevance of ASIC's SCR levy model disappears.

3.2.6 DIFFERENCES BETWEEN CONSULTATION AND FINAL DETERMINATION RATES

The stakeholder consultation papers issued by AUSTRAC each year include draft Ministerial Determinations showing indicative levy parameter values for the coming year, based on the agency's known Budget appropriation and estimates of entities' earnings (since the consultation papers are generally released before the annual census date). Reporting entities can only know the final parameter values, and therefore their liabilities, with certainty when the Ministerial Determination is finalised, usually in mid-September.

Two stakeholder submissions mentioned the impact of differences between consultation and final determination levy parameters.

The AFMA noted that:

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19 As noted previously, invoices are currently issued to 561 out of more than 14,000 reporting entities.

20 Averaging the 2017-18 non-SADAMLTF program revenue target across all reporting entities, with no other transactions value or volume-related components, would imply a uniform fixed charge of close to $4,700.

Budgeting within a reporting entity often occurs well before the date of the CRIS/consultation paper so when a ministerial determination is released the amount can differ and can impact the budgeting process.

Similarly, the AFIA noted that:

Based on member feedback, AFIA understands there has been at least one occasion where the final determine (sic) has varied materially from the draft version that was subject to consultation, causing a significant budgetary issue.

However, they went on to say that:

Generally, where the consultation papers have been released in advance of the census date, and there is not material change between the indicative and final rates set in the determinations, we understand reporting entities are able to accurately estimate their obligations and plan accordingly.

The AFIA also noted that problems can arise if AUSTRAC does not convey levy details to financial institutions in a timely manner.

Only two of the levy parameters have been changed between the draft and final versions of the Ministerial Determinations – the transactions report value factor[21] and the maximum payment amount. All other parameters and thresholds remained unchanged, reflecting AUSTRAC's approach to setting parameters to reach the appropriation revenue target. The changes in parameters are summarised in Table 3-1 below.

TABLE 3-1: CHANGES IN IC LEVY PARAMETERS BETWEEN CONSULTATION AND DETERMINATIONS

	2014-15	2015-16	2016–17	2017–18	2018–19
Transaction report value factor					
Consultation Paper	0.00088770%	0.00110220%	0.00103074%	0.00105415%	0.00098488%
Ministerial Determination	0.00089680%	0.00109340%	0.00105436%	0.00110412%	0.00094705%
Change	*1.01%*	*-0.80%*	*2.24%*	*4.53%*	*-3.99%*
Maximum amount payable					
Consultation Paper	$6,368,341.00	$9,237,246.55	$9,735,648.90	$9,417,302.46	$10,497,020.54
Ministerial Determination	$6,430,600.32	$9,361,237.15	$9,926,801.15	$9,814,148.11	$10,205,095.19
Change	*0.97%*	*1.32%*	*1.93%*	*4.04%*	*-2.86%*

Sources: AUSTRAC Consultation Papers and Ministerial Determinations, 2015 to 2018.

The variations between draft and final parameters have not been particularly significant until the 2017-18 and 2018-19 years. Even then, the changes were well within the bounds that might be expected when forecasting other business expenses that have to be managed similarly by businesses' internal budget processes.

Although the budgeting problems created by the uncertainty surrounding the finalisation of these parameters, and the associated levy liability, add to the compliance costs faced by reporting entities, it is not clear how AUSTRAC could change its processes to improve the accuracy or timeliness of the estimates included in the draft Ministerial Determination. None of the submissions made specific suggestion on the issue.

[21] Strictly, three parameters changed in the 2017-18 Determination, however the third, the high transactions report value factor, changed in absolute terms by the same amount as the base transactions report value factor, reflecting the method of its calculation described previously.

Estimates of the parameters cannot be produced until after the Commonwealth Budget is brought down (usually on the second Tuesday in May) and AUSTRAC's appropriation is known with certainty. Even then, not all relevant data is available with certainty until after the levy census date on 1 July. Estimates provided any earlier would necessarily be less accurate, as they would pre-empt the Budget. In any case, given that large listed companies often begin the internal budgeting process for a new financial year six months or more beforehand, it is unlikely that the problems created for reporting entities' internal budgeting could be avoided without basing the levy on prior years' data and/or fixing AUSTRAC's appropriation (or at least its revenue target) more than half a year ahead of time. This raises the prospect that policy changes could lead to revisions in collections, and revised levy liabilities, defeating the purpose of changing the basis or timing of any parameter forecasts.

Delaying the issuing of invoices for several months after the finalisation of the Ministerial Determination, rather than sending them almost immediately, would give entities more time to incorporate the final liabilities into their budgets, particularly where these are reworked quarterly. It is unclear whether the benefits of this to industry would outweigh the cost to the government of delaying receipt (the interest cost and the increased risk of default).

To the extent that this problem exists, it is not any worse than the uncertainty surrounding budgeting for normal business expenses. Given that the potential solutions are unwieldy and impractical, there is no strong basis for recommending any changes to the timing of AUSTRAC's current processes.

3.2.7 FUNDING FROM CONSOLIDATED REVENUE

As discussed previously, the need for the levy, and the transitioned increase in its coverage to the whole of AUSTRAC's operating budget, was justified at the time the 2014 amendments by the state of the Commonwealth Budget.

The Issues Paper consequently noted an intention to address briefly in this review the issue of whether the levy is the most efficient form of financing of AUSTRAC. The issue is relevant to the question of the extent to which the levy arrangements remain appropriate to meet the objectives of the IC levy, where those objectives include recovery of AUSTRAC's costs from industry (in lieu of funding from other sources). It is important to recall here the point made in Section 2.2, that the IC levy is appropriately analysed as an industry-specific tax, hypothecated to recover AUSTRAC's operating budget.

It was also noted in the Issues Paper that any analysis of this issue will necessarily be cursory unless substantial empirical evidence comes to light that would allow a proper assessment of the relative efficiency of the levy compared with alternative forms of financing (in particular, funding through general taxation).

Although many other factors influence tax policy in practice, a general economic principle is that revenue should be raised from taxes with low marginal efficiency costs before resorting to those with higher marginal efficiency costs. Consequently, if there is evidence of the efficiency costs of the IC levy, these can be compared with the costs of general taxation to test its suitability as a revenue source. A very simplified, although inconclusive, example of the type of assessment needed is presented in Appendix 3.

In the event, none of the submissions provided or referred to evidence that would allow a detailed consideration of the issue. In acknowledging the absence of substantive evidence, the AFIA stated:

> *AFIA is not aware of substantive comparisons between the compliance costs of the current IC levy and alternatives. ... we believe such a comparison is warranted.*
>
> *... AUSTRAC should commission and fund an independent comparison of the compliance costs of the current IC levy and alternatives. Such work could be a useful reference point for deliberations about the size and scope of future changes to the current levy structure.*

Such a study would be a major project and would require industry support and cooperation to collect and collate the detail of information needed. Given that, it would probably be better if the work was commissioned by one or more industry groups.

Three stakeholders nevertheless raised the possibility of or argued for alternative sources of funding.

Given its recognition of the absence of substantive evidence on efficiency costs, the AFIA simply stated that:

> *... AUSTRAC's supervisory activities of industry should be funded through the government's consolidated revenue, given that reporting entities are already subject to Australian taxation obligations.*

Perpetual argued a more substantial in-principle case against the industry contribution, by noting the significant returns to AUSTRAC analysis in the form of revenue collected or expenditure avoided by the Commonwealth:

> *The financial intelligence collected from reporting entities results in significant financial benefits to government. As noted in AUSTRAC's annual report 2017-18, AUSTRAC has worked closely with the Australian Taxation Office, the Department of Human Services and the Serious Financial Crime Task Force and provided valuable assistance to help them achieve operational objectives. In 2017-2018, AUSTRAC's financial intelligence protected Australian Government revenue by contributing to $208.8 million in income tax assessments and $26.67 million in savings from the detection of welfare fraud (AUSTRAC's annual report 2017-18).*
>
> *While these benefits and savings are recognised in AUSTRAC's annual report, they are not considered when determining the extent to which reporting entities are required to fund AUSTRAC's operating costs. These financial benefits are well in excess of AUSTRAC's 2018 operating costs ($67.8 million), raising the question as to why reporting entities are required to fund AUSTRAC's operating costs when the financial benefits of the intelligence provided by these reporting entities exceed AUSTRAC's operating costs.*
>
> *The primary beneficiaries of Australia's AML/CTF regulatory environment and related controls is the broader community, due to the disruption of predicate crimes and the financial benefits to government derived from the intelligence collected from reporting entities. The AUSTRAC Levy places the financial burden of funding AUSTRAC's operating expenses exclusively on large reporting entities and their shareholders, rather than the broader community.*

Perpetual also noted the significant revenues attributed to AUSTRAC, in the first instance, from recent penalties:

> *AUSTRAC's annual report 2017-2018 discloses a large financial surplus, largely due to penalties applied in 2017 and 2018. It is not clear how this surplus will be considered in assessing the amounts to be raised under the AUSTRAC Levy in future years. While AUSTRAC should not be required to apply penalties to fund operating costs, where penalties are applied, there should be consideration of whether AUSTRAC's surplus mitigates the need to collect a levy from reporting entities in future calendar years.*

In a similar vein, the AFMA noted that:

> *There have been proposals put forward that the agency budget could be funded from the proceeds of asset confiscation. It is not clear whether this proposal is being actively considered as an alternative to the existing levy arrangements.*

Nothing more was included on this point in the AFMA submission. It is important to understand that the proceeds of penalties and asset confiscation do not contribute to AUSTRAC's budget in any way. Under Commonwealth financial management processes, the proceeds of penalties are administered by AUSTRAC on behalf of the Commonwealth, and *must* be returned to Consolidated

Revenue. Similarly, the proceeds of crime are managed centrally by the Attorney General's Department (under the *Proceeds of Crime Act 2002*) through the Confiscated Assets Account which, although it funds specific anti-criminal programs run by multiple agencies over a limited duration, does not fund AUSTRAC. Consequently, unless the AFMA is suggesting hypothecation of all such proceeds, this comment simply highlights another category of financial benefits associated with AUSTRAC's operations.

These contributions to Consolidated Revenue are clearly significant and demonstrate that, in the absence of industry contributions and independently from the reduction in ML/TF activity, AUSTRAC's operations would still be worth funding. Nevertheless, the financial value of AUSTRAC's services to the rest of government is irrelevant to the assessment of whether the IC levy is an efficient source of funding because it adds nothing to the assessment of the relative efficiency costs of the IC levy and other sources of Commonwealth Consolidated Revenues.

Consequently, Perpetual's request that Acacia CRE:

> *... proposes a review of the underlying principles associated with the levy, specifically whether the financial benefits achieved from the intelligence collected from reporting entities should be considered when determining the amount to be raised in the AUSTRAC Levy.*

is largely moot. The underlying principles of the IC levy are effectively as described in Section 2.2 - to raise revenue equivalent to AUSTRAC's appropriation from the largest reporting entities, with the caveat to that, in meeting the revenue target, the levy should also be designed to minimise its regulatory burden; and the financial benefits achieved from the intelligence collected from reporting entities are irrelevant to the question whether, or how much, the Commonwealth should raise revenue from the IC levy.

It is impossible to draw strong conclusions about the efficacy of the IC levy, and the case for abandoning it, without more substantive evidence of the nature and magnitude of its efficiency costs, particularly compliance costs imposed on industry. As noted above, such a study to gather and assess that evidence should probably be commissioned by one or more industry groups rather than AUSTRAC or the government.

4. MODELLING ALTERNATIVE LEVY PARAMETERS

As noted previously, AUSTRAC provided Acacia CRE with a copy of the spreadsheet model used to calculate the rates and thresholds that were the basis for its recommendations of the parameter values included in the 2018-19 Ministerial Determination.

The data included in that model allowed an analysis of the distribution of the bases of the IC levy – domestic earnings; and reportable transaction volumes and values – across the more than 14,000 reporting entities. It was also possible to reproduce the levy calculations, in slightly simplified form[22], and to then test the impact of revenue-neutral changes in the various parameters on the distribution of total revenue between the various components of the levy and on the distribution of the burden of the levy across the reporting entities.

This work forms part of the basis assessment of the suitability of the current levy model, of AUSTRAC's methodology and of options for restructuring the levy.

4.1 CONCENTRATION OF ACTIVITY

A fundamental problem with spreading the burden of the IC levy is that the distributions of its measurable and reported bases are highly concentrated in only a small percentage of reporting entities.

This can be seen below in Figure 4-1 which is based on the data underlying AUSTRAC's levy calculations for the 2018-19 Ministerial Determination[23]. It illustrates the cumulative shares of total earnings and transaction report volumes and values for the largest five percent of reporting entities in each category (those entities, including those in groups, with the largest numbers of reportable transactions, for instance[24]). For each category, the reported shares are effectively zero for the remaining 95 per cent of entities.

The 97 per cent of reporting entities with the smallest values still account for less than one per cent of the total in each case. This is not entirely surprising in the case of reportable domestic earnings, since only 48 DBGs or individual entities (representing 471 individual reporting entities in total) had domestic earnings over the $100 million threshold, and no earnings data is recorded for entities below that level. Nevertheless, as Figure 4-1 shows, even shares of the totals of the numbers and values of transactions reports do not become noticeably greater than zero before the contributions of the 430 reporting entities with the largest values (individually or in groups), roughly the last three per cent of the total. Moreover, those transaction report shares do not exceed 10 per cent of the total until after the contributions of the first 98.3 per cent of all reporting entities. Put another way, more than 90 per cent of all reported transactions, either by volume and value, are attributable to only around 225 entities in 8 groups or 251 entities in 10 groups, respectively.

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22 The AUSTRAC model includes several cross-checks of the status of specific groups and entities that were not amenable to scenario modelling. Consequently, although AUSTRAC's revenue calculations could be reproduced with margins of less than 0.001 per cent, minor differences remained. In particular, the size and composition of some DBGs could not be fully reconciled with AUSTRAC's model, so the figures presented here of the impacts on entity and group numbers are estimates only, and not definitive.

23 These were reportable transaction volumes and values in the 2017 calendar year and reported earnings at the 1 July 2018 census date. For entities with a standard 30 June balance date, reported earnings would be for the 2016-17 financial year. Note, however, that there are many entities that have different balance dates, e.g. 31 December or 31 March. Reported earnings for those entities should have been updated before the census day, and would therefore reflect more recent levels of activity than entities with a standard 30 June balance date.

24 Note that the order of the entities with the largest values is not the same in each category. There is very little correlation between values in each category – that is, higher earnings does not necessarily imply higher reportable transaction volumes or values, nor does a higher reportable transaction volume correspond to proportionally higher value.

FIGURE 4-1: CUMULATIVE DISTRIBUTION OF 2018-19 IC LEVY BASES

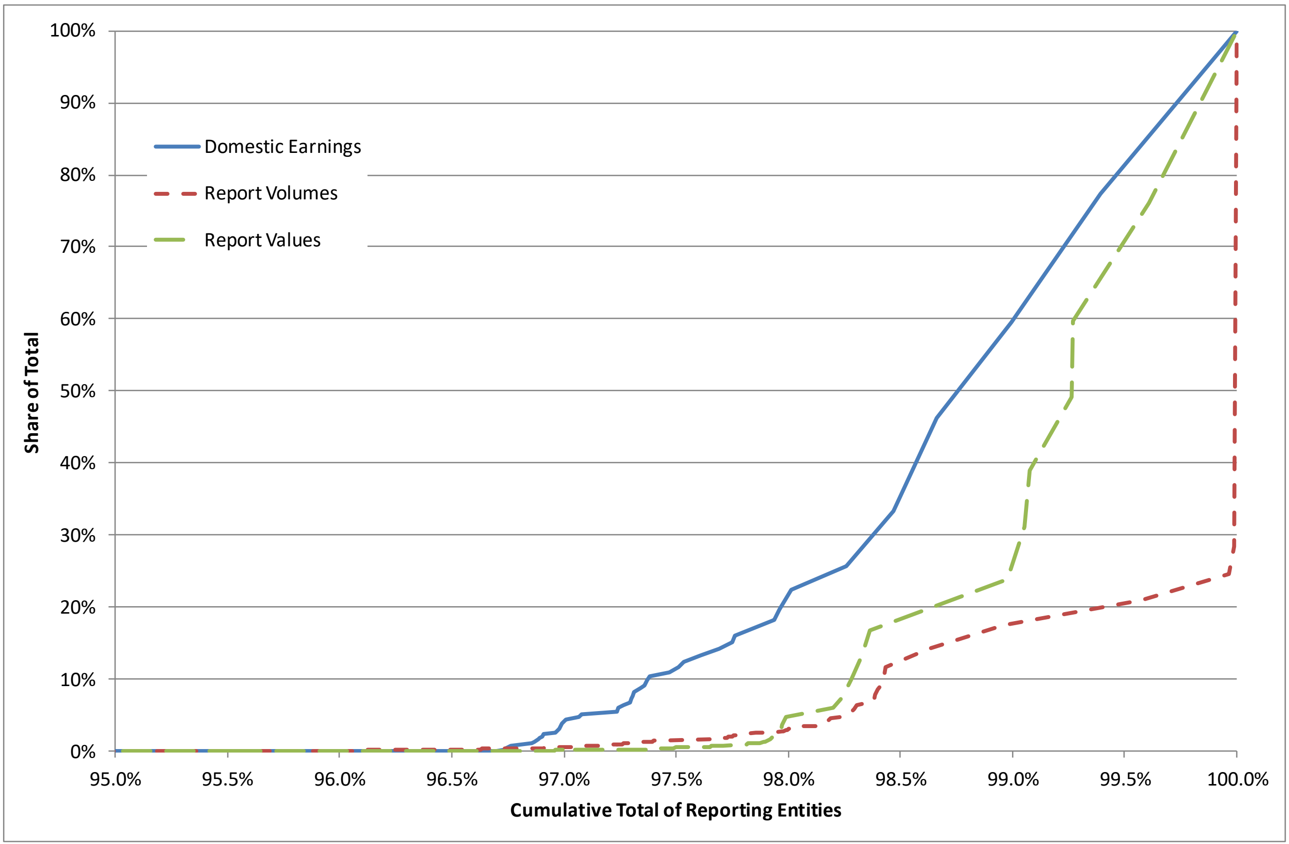

Table 4-1 below shows the values associated with selected levels of the cumulative shares of reporting entities illustrated in Figure 4-1. Of all reporting entities, the smallest 95 per cent accounted for just 0.02 per cent (one in 5,000) of the total number of report transactions in the 2017 calendar year, and an even smaller share of the total value of those transactions. The largest one per cent of reporting entities (fewer than 150 entities, including those in groups) accounted for more than 75 per cent of both the volume and value of reportable transactions.

TABLE 4-1: CUMULATIVE DISTRIBUTION OF 2018-19 IC LEVY BASES AT SELECTED SHARES

Share of Accumulated Total Entities	Reportable Domestic Earnings Amount		Reportable Transaction Volumes		Reportable Transaction Values	
	Cumulative Total ($m)	Percent of Total	Cumulative Total (m)	Percent of Total	Cumulative Total ($m)	Percent of Total
90%	$0	0.00%	0.0	0.00%	$0	0.00%
95%	$0	0.00%	0.0	0.02%	$230	0.00%
98%	$11,818	19.72%	3.8	3.07%	$259,754	4.85%
99%	$35,723	59.61%	21.3	17.47%	$1,278,988	23.87%
100%	$59,923	100.00%	122.2	100.00%	$5,358,682	100.00%

Not only are transaction reports concentrated in the largest reporting entities, almost all of the reporting entities from which AUSTRAC might draw the IC levy are currently completely unaffected by variations in the parameters of the transactions component of the levy. More than 13,000 reporting entities, over 92 per cent of the total, did not report any transactions in 2017. Of those, around 100 were entities which, individually or in groups, exceeded the $100 million earnings threshold and consequently paid only the earnings component of the IC levy.

The significance of this concentration of the measurable and reported bases for the current IC levy is that it is almost impossible to distribute the burden across more than a small percentage of reporting entities by varying only the parameters of the transaction reporting component of the levy (the transaction report volume and value factors). That is, no matter how high the minimum levy payable, entities that do not report transactions will not contribute through the transactions component of the levy. They will only contribute through an earnings component or, as was the case prior to 2014-15, some form of base levy on all reporting entities. Thus, as foreshadowed in Section 3.2.1, there are practical reasons for maintaining the existing concentration of the burden of the IC levy on a small percentage of currently reporting entities.

As discussed below, lowering the minimum levy payment (from $1,000) will therefore do little to increase the proportion of contributing entities in the total of reporting entities. Consequently, without implementing some form of base levy or otherwise drastically changing the current structure of the IC levy, lowering the $100 million earnings threshold appears to be the only practical means of distributing its burden more widely.

4.2 VARYING EXISTING IC LEVY PARAMETERS

AUSTRAC's levy spreadsheet was reproduced using the original data to test the impact of revenue-neutral changes in the various parameters. As noted previously, it was not possible to properly test the impact of lowering the $100 million domestic earnings threshold, because no earnings data is collected from entities below the threshold and no other comprehensive source of the information is available. Similarly, the limits on earning data mean there was no point in modelling reliance on the earnings component alone, since the entire burden of the levy fell immediately onto the large earnings entities and DBGs that already contribute to that component. The method used by AUSTRAC to set the maximum levy payable means there was also nothing to be gained by varying that limit or its qualifying threshold.

$1,000 minimum payment

Removing the minimum levy payment (lowering it from $1,000 to $0) roughly doubles number of contributing entities, but this still represents less than 10 per cent of the total. The initial revenue gain from of lowering the limit is around $70,000, about $125 per newly liable entity. All other parameters held constant, the transactions report value factor needs to decrease from 0.0000094705 to 0.0000094570, by about 0.15 per cent, to reverse this revenue gain.

This is entirely as might be expected from the discussion above of the concentration of transactions reporting activity, and demonstrates the likelihood that attempting to broaden the distribution of the levy other than by reducing the earnings threshold will simply raise compliance costs significantly (albeit for a still relatively small number of newly liable entities) without reducing the financial impact of the levy on existing paying entities.

No high transactions report value factor

If SADAMLTF is absorbed in to the base transactions report value factor (or, equivalently, the $15 billion transactions report value threshold is set to zero), that factor would have to increase from 0.0000094705 to 0.0000111801, by about 18 per cent, to reverse the revenue loss. Entities over the $15 billion transactions report value threshold would have their transactions report value factor reduced from 0.0000112194 to 0.0000111801, by about 0.35 per cent. Entities under the $15 billion transactions report value threshold would bear the whole of the 18 per cent increase in their transactions report value component. This would lead to an increase in their levy liability of a similar magnitude, depending on existing liabilities from the earnings and transactions reporting volume components.

The only other impact would be to push a few entities over the $1,000 minimum payment threshold and simultaneously increase the revenue foregone from the entities that remain under the threshold, by about $4,000.

Clearly, the approach taken to SADAMLTF has quarantined the financial impact to a relatively small number of entities and DBGs. The approach will have slightly complicated the verification of liabilities for entities over the $15 billion transactions reports value threshold, but is unlikely to have had any significant impact on total IC levy compliance costs.

Reliance on the transactions report volume factor

Setting the earnings and transactions report value components (both base and high value) at zero requires the transactions report volume factor to rise from $0.012 per report to $0.623, a more than fifty-fold increase. This produces a significant redistribution of the burden of the levy onto the smaller currently liable entities although, as noted above, without affecting the bulk of reporting entities because they report no transactions. As also noted above, around half of entities or DBGs over the earnings threshold report no transactions, so their liabilities fall by about $2.5 million to zero, further increasing the burden on reporting entities with earnings below $100 million.

Over 100 entities would be drawn over the $1,000 minimum, contributing less than $2 million in total, but significantly increasing their compliance costs.

The maximum levy payable is reduced by about 75 per cent, as the four major bank DBGs no longer make their maximum earnings payments and nearly 40 per cent of the financial burden of the levy is shifted from them and onto other entities.

Reliance on the transactions report value factor – high value factor retained

Setting the earnings and transactions report volume components at zero requires the transactions report value factor to rise by about 32 per cent, from 0.0000094705 to 0.0000124916. The high value transactions reporting value factor increases by the same absolute amount, although this is a smaller percentage increase of around 25 per cent. As with reliance on the transactions report volume factor, this does not affect the bulk of reporting entities because they report no transactions and around half of entities or DBGs over the earnings threshold report no transactions, and again their liabilities fall by about $2.5 million to zero, further increasing the burden on reporting entities with earnings below $100 million.

Unlike reliance on the transactions report volume factor, only a few entities would be drawn over the $1,000 minimum payment threshold, largely because the proportionate increase in the transactions reporting component is not as large.

The maximum levy payable increases slightly, by about 7.7 per cent.

There is clearly some redistribution of the burden of the levy, but the change is not as marked as with the shift to reliance on the transactions report volume factor.

Reliance on the transactions report value factor – high value factor removed

As might be expected, this causes changes that are a combination of the shift to reliance on the transactions report value factor and the removal of the high transactions report value factor.

The base transactions report value factor rises by about 50 per cent, from 0.0000094705 to 0.0000142009. Again the bulk of reporting entities are not affected because they report no transactions and around half of entities or DBGs over the earnings threshold report no transactions, and again their liabilities fall by about $2.5 million to zero.

Similarly, only a few entities would be drawn over the $1,000 minimum payment threshold, again largely because, although bigger, the proportionate increase in the transactions reporting component is not as large as when shifting to reliance on the transactions report volume factor.

The maximum levy payable increases slightly but less than when retaining the high value transactions report factor, by about 7.4 per cent.

There is clearly some redistribution of the burden of the levy, but the change is again not as marked as with the shift to reliance on the transactions report volume factor.

Summary

These exercises demonstrate that there is considerable scope to redistribute the burden of the levy with alternative earnings and transactions report volume and value factors, albeit largely between currently liable entities.

The $1,000 minimum levy remains effective in most cases, with very few entities are drawn over that limit as the various factors were increased. Even in the case of shifting to reliance on the transactions report volume factor, the number of newly liable entities did not increase by a significant proportion of total reporting entities numbers.

Unfortunately, this analysis is obviously hampered by the absence of information about the level and distribution of compliance costs across entities and DBGs. Without that, only a broad indication of the redistribution of the burden of the levy can be inferred, and nothing can be said about the effects of the changes on the overall efficiency the levy. Consequently, no real guidance can be gleaned about how, or whether, to set the levy parameters differently.

5. ASSESSMENT AND SUMMARY

The discussion and analysis in previous sections now allows the requirements of s.17 of the Collection Act and of the Terms of Reference to be specifically addressed.

5.1 REQUIREMENTS OF S.17 OF THE COLLECTION ACT

The essential requirements of s.17 are to:

- s.17(2)(a) consult with industry participants about the impact of the levy and the costs of complying with the Levy Act;
- s.17(2)(b) provide a report by the six month deadline;
- s.17(4)(a) review the methodology used to calculate instalments of levy; and
- s.17(4)(b) summarise the consultations undertaken with industry participants.

Consultation with industry has occurred and, where appropriate, the issues raised and information provided has been incorporated into the analysis and conclusions of this report. Details of the process are provided in Section 3 and Appendix 2. This addresses the first and last of the points above.

This report satisfies the second point.

Finally, the third point is substantially addressed by the descriptions of and commentary on AUSTRAC's methods and associated issues in the previous three Sections. The remaining assessment and conclusions are included in the balance of this Section.

The next three sub-Sections in turn address each of the major points of the Terms of Reference.

5.2 METHODOLOGY USED TO INTRODUCE THE LEVY AND TRANSITION

The first point in the Terms of Reference requires:

- A review of the methodology used to introduce the IC levy and to transition away from the previous Cost Recovery arrangements, and the extent to which the levy arrangements remain appropriate.

5.2.1 METHODOLOGY USED TO INTRODUCE THE IC LEVY

The methodology used by AUSTRAC in introducing the IC levy was outlined in Sections 2.3 and 2.4. That method was driven and constrained by the objectives set out in the 2014 Budget.

The 2014 amendments still provided AUSTRAC considerable leeway to restructure the previous CR levy, although constrained to some degree by the objectives of the 2014 Budget and the existing tax bases (earnings and transactions reports volumes and values).

Prior to commencement of the 2014 amendments on 22 October 2014, AUSTRAC started a six-month consultation period by proposing what were necessary and almost obvious modifications to the previous levy to meet the objectives of the 2014 Budget. These included changing the structure of the earnings component to a uniform rate over the threshold; removing the statutory minimum transactions reporting charge; and replacing the previous $300 minimum levy and associated employment test with a blanket $1,000 minimum payment limit.

As noted in Section 3.2.4, the consultation processes leading to the drafting of the subsequent 2014 legislative amendments were clearly not perfect, inasmuch as problems with the CR levy that were previously raised and likely to reduce compliance costs, such as the inability to receive unified DBG invoices, were not addressed in the amendments.

AUSTRAC sought industry input, both directly from stakeholders and their representatives and indirectly through the publication of the series of three consultation papers. It met repeatedly with stakeholder representatives at its on-going Industry Consultative Forums over the course of the consultation and provided ample feedback and information to industry. This allowed AUSTRAC to modify the initial levy design, and the parameters within it (increasing the maximum earnings payment and reducing the earnings factor, for instance), to address the concerns of stakeholders.

These processes occupied a substantial part of the 2014-15 financial year, with the Ministerial Determination was not finalised until 8 April 2015 and invoices issued soon after.

AUSTRAC's processes for introducing the IC levy were open and transparent. In this context the AFIA noted:

> *Through a combination of written submissions and direct stakeholder engagement, AFIA believes AUSTRAC's consultation processes have adequately enabled industry to communicate its key concerns to the agency.*

Within the bounds of the objectives of the 2014 amendments, AUSTRAC made only necessary changes to the original CR levy processes and structures. This is likely to have minimised the impact of the introduction of the IC levy on stakeholders. Nevertheless, adjustments to the levy structure and rates were almost inconsequential for the larger entities and DBGs that continued to pay the levy, making no real impact on their costs of compliance. Comments in submissions generally suggest that the introduction of the IC levy did not represent either a major improvement or worsening of the arrangements for those entities.

5.2.2 Methodology used to transition away from the previous arrangements

The methodology used by AUSTRAC to transition to the IC levy was also outlined in Sections 2.3 and 2.4.

The IC levy retained most of the features of the CR levy, but was no longer hampered by the problems of trying to make a link between the costs of its operations and the structure of the levy and its bases (earnings and transactions report volumes and values). The transition therefore comprised minimal changes to the levy structure and some initial changes in associated levy parameters. The subsequent changes to levy parameters, to meet the predetermined increases in contributions to transition total levy revenue to hypothecate the whole of AUSTRAC's appropriation, are discussed below in the assessment of the levy methodology.

The transition to raising all of AUSTRAC's operating costs would have mitigated the compliance and efficiency costs impact of the new levy regime. Those costs would have grown because, as the higher revenue target also increased the required levy factors, this would have drawn more reporting entities in over the $1,000 minimum payment threshold. They would then be forced to face the associated compliance costs of checking and processing invoices and raising prices or otherwise recovering the cost of the levy and compliance.

As noted previously, AUSTRAC initially adopted almost all of the previous CR levy rates and thresholds, making only the changes necessary to accommodate the new minimum payment limit and proportional earnings component. This would have had the benefit of minimising the impact of the IC levy on the liabilities of individual entities and DBGs. As is clear from the modelling in the previous Section, changing the reliance on the various components of the levy can lead to substantial changes in the distribution of the burden across paying entities. Although the introduction of the IC levy necessarily increased the burden on larger contributing entities initially, AUSTRAC's approach likely minimised the "sticker shock" of the first round of invoices.

Apart from the necessary delay in issuing 2014-15 invoices, payment processes were unaffected by the introduction of the IC levy, and this also helped to minimise the adjustment costs imposed on stakeholders. Despite minor concerns about the timing and accuracy of the provisional levy parameters issued in the annual consultations papers, and the inability to issue DBGs with unified invoices, stakeholders raised no concerns about AUSTRAC's invoicing and collections processes.

For most part, stakeholder submissions did not address AUSTRAC's approach to the transition to the IC levy. Comments on the issue were largely directed at arguing against the objectives of the changes in arrangements, rather than the methods used to bring them about.

For instance, Perpetual simply noted that it:

> *... has limited feedback on the 2014 transitional process as this did not have a material impact on Perpetual's AUSTRAC Levy arrangements.*

Given that AUSTRAC made minimal changes to the levy arrangements to introduce the IC levy, and absent any substantial stakeholder comment to the contrary, the task appears to have been undertaken smoothly and with minimal disruption to industry.

5.2.3 EXTENT TO WHICH THE LEVY ARRANGEMENTS REMAIN APPROPRIATE

Only one stakeholder submission explicitly endorsed the current levy arrangements. Clubs Australia said:

> *... the current collection arrangement ... is an appropriate means to levy industry.*

Despite the lack of endorsement, none of the submissions mounted substantial or substantiated arguments in favour of alternative arrangements. At best, stakeholders raised issues related to the appropriateness of the current arrangements, including the perceived inequitable nature of the IC levy and the associated argument for lowering the $100 million earnings threshold; non-adherence of the IC levy to cost recovery principles and policy; and the case for abolishing the IC levy in favour of funding from other sources. The discussion of submissions in Section 3.2 largely dismissed these issues as contrary to the objectives of the levy and providing no basis for changing the levy arrangements in current circumstances.

The Collection and Levy Acts in their current form do not bind AUSTRAC to any particular levy structure, and consequently generally provide an appropriate legislative framework for the IC levy in the immediate future.

Major changes to the legislation might only be required if there were significant changes to the government's objectives for the levy (raising an amount equivalent to AUSTRAC's appropriation and minimising the regulatory impact on small business); if a future government reconstituted the levy as a cost recovery program; or if there is a significant expansion of AUSTRAC's operations, requiring greater total contributions. Even in that latter case, the current arrangements could be adapted to a higher revenue target although it may not be appropriate to further burden existing paying entities. These issues are discussed in more detail in Section 5.4 below.

5.3 LEVY CALCULATION METHODOLOGY

The second point in the Terms of Reference requires:

- A review of the levy calculation methodology (which will cover the earnings component, the transaction reporting component, exemptions and the external transparency of the methodology), having regard to the impact of the levy on reporting entities, including small businesses, and the costs of complying with the Australian Transaction Reports and Analysis Centre Industry Contribution Act 2011.

The levy calculation methodology is interpreted here as the processes currently used by AUSTRAC to set the parameters for the IC levy, as previously outlined and discussed in Section 2.5.

As previously argued, there is no substantive evidence to allow a proper consideration of the impact of the levy on reporting entities, including small businesses, or of the costs of complying with the Levy Act. As in Section 4.2, some incidental inferences can be drawn about the effects of alternative levy parameters on compliance costs, but only to the extent that the alternatives are likely to substantially change the number of leviable entities.

Assessment of the levy calculation methodology must therefore be limited to some observations on the transparency of AUSTRAC's methods to stakeholders and a general critique of some components of the levy; and, as already provided in Section 4.2, comments on the distributional impact of alternative factors, limits and thresholds within the current levy structure.

External transparency

The main weakness of AUSTRAC's approach to setting levy parameters is that there is no objective basis on which to criticise its choices. The process lacks a clear set of guiding principles or criteria for the established sequence of threshold and rates setting. As described previously, and obvious from its spreadsheet model, the "how" of the process is clear, but AUSTRAC has nowhere set out the "why".

Although it had the advantage of reducing the initial impact of the IC levy, AUSTRAC's continuation of many of the threshold and parameter values from the old CR levy had no real justification. While the change in levy regime could have been used as an opportunity to reconsider the distribution of collections across the various components, possibly shifting the balance towards or away from earnings, for instance, there was no reason or rationale for making or investigating such a change.

Despite AUSTRAC's best efforts and the general adequacy of the annual consultation processes, the methods it uses to set the parameters recommended to the Minister are, possibly unavoidably, opaque.

Whilst they were able to influence the level of some parameters during the consultation prior to the commencement of the IC levy, stakeholders appear to have been presented with the results of AUSTRAC's parameter setting in subsequent years with little or no prospect of influencing or altering the proposed values. Similarly, although the process AUSTRAC follows to set the parameters is sensible and appropriate to the task, it has not been outlined or explained to stakeholders.

This is understandable to a degree, since stakeholders are not in a position to recommend alternative parameters without access to the data that underlies AUSTRAC's modelling. Nor are there any objective grounds for arguing changes to the parameters, since the efficiency impacts of redistributing the burden cannot be calculated without augmenting AUSTRAC's model with some form of compliance or efficiency cost evidence. It is consequently unlikely that stakeholders could suggest changes other than on the basis of equity, as was largely the case in submissions to this review.

Although it is clear that those parameter choices have significant impacts on the distribution of the financial burden of the levy across leviable entities, no explanation was given by AUSTRAC for the timing or magnitudes of the changes made over the course of the last five years of the IC levy. The changes that were made were necessary to transition levy contributions to the increased revenue targets and, as best as can be assessed, were made in ways and at times that largely maintained the original balance of contributions from the various levy components.

Recommendation: AUSTRAC could improve its consultation processes, when parameter changes are necessary, by outlining the reasons for the changes and, more importantly, by giving some indication of what viable alternative approaches to the changes were considered and how it chose between them. To that end, AUSTRAC should include some of the distributional consequences of current and proposed levy parameters in the annual levy consultation papers or AUSTRAC's annual report.

As Perpetual suggested:

> *In terms of the transparency of the levy calculation methodology, the methodology is relatively clear, however understanding of the spread of the burden across reporting entities could be improved through publishing of additional information in AUSTRAC's annual report (the contribution made by reporting entities in various tranches such as the top 10, top 100, etc.).*

Another useful exercise might be to test the relative revenue-neutral substitutability of the current parameters. That is, compare the changes in each of the other rate factors, thresholds or limits needed to offset a given change in one particular factor. For instance, based on the reproduction of AUSTRAC's modelling used in Section 4.2, restoring the loss of revenue from a 10 per cent decrease in the earnings value factor (from 0.047 per cent to 0.0423 per cent) requires either a 50 per cent increase in the transactions reporting volume factor (from $0.012 per report to $0.018 per report) or a 1.4 per cent increase in the transactions reporting value factor (from 0.0000094705 to 0.0000096054).

Maximum Levy payable

As explained in Section 2.5, the maximum payment amount is set as a residual parameter. As currently implemented by AUSTRAC, the maximum is set as the average of the levy amounts otherwise payable separately by the DBGs of the four major banks and, as they are the largest reporters, the associated $5 billion transactions value threshold is a convenient means of isolating those four groups.

Consequently, the levy maximum serves only to equalise the amounts paid by the four major banks. This is neither explicitly stated in, nor obvious from the provisions of, the Ministerial Determination, and is not otherwise mentioned in the associated Explanatory Statement. The large volumes of reportable transactions between these institutions and the one-sided nature of the IC levy mean there is some equity basis for "flattening" the impact of the levy (especially because their share is more than half of the total). Nevertheless, the inclusion of this component of the IC levy is unusual and horizontally inequitable. It also raises in-principle competition policy issues, as it could be construed as an anti-competitive agreement to share costs, although these issues are unlikely to have any practical substance.

Recommendation: AUSTRAC should reconsider the role and appropriateness of the maximum payment amount provision of the Ministerial Determination.

Expanding exemptions

Aside from Clubs Australia, which expressed a cost recovery rationale for a blanket exemption from the levy for all not-for-profit clubs ("a complete exemption for not-for-profit clubs ... regardless of the club's size" on the basis that "the risk of ML/TF activity remains extremely low, irrespective of the scale of the club"), none of the stakeholders responding to the Issues Paper addressed the nature and extent of exemptions.

The impact on contributions of exemptions arising from s.8 of the Ministerial Determination cannot be assessed because, as with effect of the $100 million earnings threshold, no data is collected from exempt entities. Whether those exemptions are warranted is a policy matter for AUSTRAC and the government and, although it impacts the number of potentially liable reporting entities and the size and distribution of reported transactions, is beyond the scope of this review. Nevertheless, the rationales provided for those exemptions, as summarised in Section 2.3, suggests that it would be unwise to reverse them.

Indexation

As noted in Section 2.5, neither the $1,000 minimum levy payable nor the $100 million earnings thresholds have been changed since the first collections in 2015. The effect of this has been to reduce the value of these thresholds in real terms. In principle, this means more reporting entities would be expected to exceed the $1,000 minimum payment or the $100 million earnings threshold than in 2015 because the value of earnings and all transactions should have increased in nominal terms. There is nothing stopping AUSTRAC from proposing increases in these nominal values, as part of an annual parameter update, to restore their real values.

Recommendation: While an automatic indexation process is unnecessary, AUSTRAC should monitor the real effects of diminishing nominal limits and thresholds over time, with a view to periodically raising them to maintain the real structure of the levy.

5.4 OPTIONS FOR IMPROVEMENT AND THE SUITABILITY OF THE LEVY ACT

The final point in the Terms of Reference requires:

- Recommendations to improve the levy regime, including whether the provisions of the Australian Transaction Reports and Analysis Centre Industry Contribution Act 2011 remain appropriate to meet the objectives of the AUSTRAC industry contribution levy.

Recommendations to improve the levy regime have been summarised at the beginning of the report and have been highlighted in the body of the relevant parts of the preceding text.

As concluded above, the levy arrangements established by the Collection and Levy Acts in their current form generally provide an appropriate legislative framework for the IC levy in the immediate future.

Minor levy regime improvements

In the absence of any major changes in AUSTRAC's present activities, there are two minor aspects of current arrangements that could be addressed to improve the levy regime.

First, as mentioned above and discussed in detail in Section 3.2.4, the consultation on and drafting of the 2014 amendments failed to address the problems that prevent AUSTRAC from issuing a single invoice to DBGs and the practice appears impossible within the provisions of the current IC levy legislation.

As concluded previously, although appropriate legislative changes to the Collection Act would be worthwhile, they probably cannot be justified as a stand-alone amendment and should be implemented in the event that a major change in the levy scheme is required. AUSTRAC should nevertheless clarify the current legal obstacles to issuing DBG invoices, with a view to ensuring the changes (if any prove to be required) are made as soon as an opportunity arises.

Secondly, although lowering the $100 million domestic earnings component threshold would likely raise the overall compliance costs of the IC levy, there is limited scope to assess the possibility in the absence of earnings data from entities below the threshold. As discussed in Section 3.2.2, AUSTRAC could consider revisions to the reporting requirements (AML/CTF Rules, Chapter 63) that would allow the collection of earnings data from reporting entities below the current $100 million earnings threshold.

Tranche II expansion of reporting

While the levy arrangements provide an appropriate legislative framework for the IC levy in the immediate future, the extent to which the levy arrangements remain appropriate must necessarily be forward-looking. That is, ongoing appropriateness can only be judged in the context of expected future circumstances. One prospective change in the scope of AUSTRAC's activities is likely to trigger a reconsideration of the suitability of the levy framework.

Extension of the AML/CTF framework to include regulation of the Tranche II sectors will amend the definition of designated services currently set out in s.6 of the AML/CTF Act, expanding the classes of providers of designated services which are required to be regulated. The aim of the Tranche II reforms is to extend regulatory and reporting obligations to specified transactions conducted by a range of businesses and professions, in particular: dealers in precious metals and stones, lawyers, accountants, real estate agents and trust and company service providers. Draft legislative provisions which would amend the AML/CTF Act to implement the second tranche of reforms were first publicly released in August 2007[25].

The regulation of Tranche II sectors creates challenges for the levy arrangements because of the volume of newly regulated entities that would be drawn into the AML/CTF regime. It is expected that AUSTRAC would have to expand its monitoring to approximately 90,000 additional entities, with the associated increases in its costs and appropriation. Consequently, as noted by the AFMA:

> *To the extent that this (Tranche II) is ultimately implemented, it will considerably expand the regulated population. We believe that such an expansion should be a trigger-point for a wholesale re-evaluation of the industry contribution model.*

Perpetual also noted the implementation of Tranche II reporting as a potential trigger for a reconsideration of the approach to the levy arrangements.

An additional 90,000 entities would be a six-fold increase in AUSTRAC's monitoring workload. The exact impact of that on operating costs it is not clear, although it would be substantial.

The current levy arrangements could, in principle, still be used to raise a higher appropriation for AUSTRAC. In practice, the likely distribution of transactions reports and the potential for substantially higher efficiency costs mean the current model will almost certainly have to be replaced.

Tranche II would significantly increase the number of reporting entities but not necessarily commensurately increase the levy bases. The Tranche II entities are likely to be similar to current small reporting entities, of which only a few report any transactions. Consequently, although the currently levy arrangements might still be applied, preserving the levy structure (the earnings and transactions report components and associated limits and thresholds) and raising component factors, the levy would have to yield a significantly larger revenue target from the essentially same paying entities as at present. That would be manifestly more inequitable than the current distribution of the IC levy burden.

In the absence of evidence on which to base estimates, the earlier discussions of the efficiency costs of the IC levy (and the simple comparison in Appendix 3) have concentrated on potential compliance costs, although efficiency costs also include deadweight and collection costs. Compliance costs are the administrative (account-keeping and form-filling) costs of complying with the tax requirements. Collection costs are incurred by firms and individuals when they arrange their affairs (either legally or illegally) to avoid paying taxes or, on the other hand, are incurred by government agencies to administer and enforce those taxes. Deadweight costs arise from distortions to consumption or production patterns when relative prices are altered.

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25 At the time of writing, the Australian Labor Party has announced its intention to implement the Tranche II reforms if it forms government after the forthcoming Federal election. “Labor proposes crackdown on 'dirty money' laundered through Australian real estate”, ABC News online 25 February 2019. https://www.abc.net.au/news/2019-02-25/money-laundering-laws-chris-bowen-dirty-money/10846552.

It is a general principle of tax analysis that deadweight costs generally rise (and grow exponentially) as tax rates increase. Consequently, even if that element of the efficiency costs of the IC levy is small now, the higher rates (component factors) required to fund Tranche II activities from the existing IC levy structures would probably create significant price distortions between liable and exempt entities. This would potentially add large and growing deadweight costs to the already substantial compliance costs of the levy, making a stronger case for funding from other sources.

Alternatively, if the government wishes to continue to notionally recover AUSTRAC's costs from regulated entities, the nature of AUSTRAC's activities and services, and of its relationship with regulated entities, mean that the ASIC SCR levy would still not be an appropriate model for the new structure. Moreover, the skewed distribution of transactions reports volumes and values makes them unsuitable bases for the bulk of the levy. This leaves substituting some form of flat registration fee for the current IC levy structure, or adding it to that structure, as one obvious option, albeit one with a significant cost of compliance.

Note that a flat fee could already be included as part of the current IC levy. Whilst the Tranche II expansion would require a reconsideration of the structure and objectives of the levy regime, it would not necessarily require changes to the legislative framework for the levy.

APPENDIX 1. TERMS OF REFERENCE

As amended in 2014, the Collection Act includes a provision (s.17) for an independent review of the levy arrangements four years after commencement of the amendments, and the preparation of a report to the Minister. Specifically, s.17 requires:

> *(1) The Minister must cause an independent review of the operation of the levy to be undertaken as soon as possible after the fourth anniversary of the commencement of the Australian Transaction Reports and Analysis Centre Supervisory Cost Recovery levy (Collection) Amendment Act 2014.*
>
> *(2) The person who undertakes the review must:*
>
>> *(a) consult with industry participants about the impact of the levy and the costs of complying with the Australian Transaction Reports and Analysis Centre Industry Contribution Act 2011; and*
>>
>> *(b) give the Minister a written report of the review within 6 months after the fourth anniversary of the commencement of the Australian Transaction Reports and Analysis Centre Supervisory Cost Recovery levy (Collection) Amendment Act 2014.*
>
> *(3) The Minister must cause a copy of the report of the review to be tabled in each House of Parliament within 15 sitting days of receiving it.*
>
> *(4) A report prepared under subsection (2) must include (but is not limited to):*
>
>> *(a) a review of the methodology used to calculate instalments of levy; and*
>>
>> *(b) a summary of the consultations undertaken under paragraph (2)(a).*

The fourth anniversary of the commencement of the Collection Act amendments was 22 October 2018, so the review must be completed and a report presented to the Minister by no later than 22 April 2019.

The statutory review requirements in s.17(2) and s.17(4)(a) of the Collection Act are very general. In commissioning the review AUSTRAC has specified several tasks that encompass and expand on those legislative requirements. Specifically, Acacia CRE is required to provide:

- A review of the methodology used to introduce the IC levy and to transition away from the previous Cost Recovery arrangements, and the extent to which the levy arrangements remain appropriate;
- A review of the levy calculation methodology (which will cover the earnings component, the transaction reporting component, exemptions and the external transparency of the methodology), having regard to the impact of the levy on reporting entities, including small businesses, and the costs of complying with the Australian Transaction Reports and Analysis Centre Industry Contribution Act 2011; and
- Recommendations to improve the levy regime, including whether the provisions of the Australian Transaction Reports and Analysis Centre Industry Contribution Act 2011 remain appropriate to meet the objectives of the AUSTRAC industry contribution levy.

APPENDIX 2. CONSULTATION

PROCESS

Industry consultation was via assessment of written submissions from stakeholders currently or potentially impacted by the levy and from other interested parties.

On 19 November 2018, an Issues Paper[26] was published on a dedicated IC levy review page on the Acacia CRE website and AUSTRAC directly contacted 170 stakeholders to advise them of the commencement of the review and the availability of the Issues Paper and calling for submissions to be sent to a dedicated Acacia CRE e-mail address. Those stakeholders included individual leviable entities, the holding companies for entities within DBGs and representative industry organisations. AUSTRAC placed a similar notice on its website later in that week.

The information sought from stakeholders primarily related to the experience of reporting entities in adapting to and complying with the current levy arrangements. Because the assessment of the current levy structure was expected to necessarily be qualitative, not quantitative, stakeholders were invited to include anecdotal and/or quantitative evidence in their submissions.

Without limiting the content of submissions, the Issues Paper posed a series of questions for stakeholders related to the various task required by the Terms of Reference for the review, covering, amongst other things:

- the nature and extent of compliance costs, before and after the implementation of the current IC levy model;
- the impact of the transition processes adopted by AUSTRAC;
- the nature and extent of efficiency (deadweight) costs created by the levy and what, if any, information was available to substantiate comparisons between the compliance costs of the current IC levy and alternative forms of funding;
- whether substantive evidence existed that would allow an empirical assessment of the likely impact of broadening the effective contribution base to include smaller entities;
- the strengths and weaknesses of the current IC levy structure and arrangements as a means of recovering AUSTRAC's operating costs, both in current circumstances and the likely future; and
- the changes, if any, that might be required to the levy structure or underlying legislation in order to address any current or potential future problems with the levy.

Only five organisations responded to the Issues Paper by the initial deadline on 21 December 2018 and their submissions were published soon after on the Acacia CRE website. Two organisations sought and were granted extensions, although only one other submission was subsequently received on 25 January 2019. This submission was marked as containing confidential information and was not published in any form. Where possible, some of the arguments made in that submission have been incorporated into this report, although without attribution.

Provision had been made, if it appeared warranted after the receipt and review of submissions, for further consultation to be arranged. This was to take the form of either written requests for clarification or more information; and/or via telephone or teleconference discussions with specific stakeholders. After review of all of the submissions it was considered that no further consultation was required.

[26] http://www.acacia-cre.com.au/review_files/AUSTRAC Levy Review Issues Paper Nov 2018.pdf

Acacia CRE consulted with AUSTRAC over the whole of the review, both verbally and in writing. A series of questions drawn from the Issues Paper were put to AUSTRAC in writing on 18 January 2019 and a detailed response was received on 21 January. In the days following AUSTRAC also provided Acacia CRE with copies of the spreadsheet models used to:

- calculate the rates and thresholds that were the basis for its recommendations of the values included in the 2018-19 Levy Determination; and
- estimate the impact of lowering the $100 million earnings threshold, based on the modelling for the 2014-15 Levy Determination and Australian Taxation Office corporate income data for 2013-14.

AUSTRAC subsequently also answered questions about the content and use of these models.

A copy of a draft final report was provided to AUSTRAC on 26 March 2019 for comment and correction of any factual errors.

NON-CONFIDENTIAL SUBMISSIONS RECIEVED

Organisation	Date
Clubs Australia	20/12/18
Australian Banking Association	21/12/18
Australian Financial Markets Association	21/12/18
Perpetual Limited	21/12/18
Australian Finance Industry Association	21/12/18

APPENDIX 3. AN ESTIMATE OF RELATIVE EFFICIENCY COSTS

The IC levy in its current form was intended to be a revenue-raising measure introduced at a time of significant pressure on the Commonwealth Budget. As such, and notwithstanding the hypothecation to AUSTRAC's appropriation, it is effectively a substitute for other contributions to Consolidated Revenue. Whether it is an efficient and desirable source of revenue is another question entirely.

As discussed in Section 3.2.7, a general economic principle of taxation policy is that revenue should be raised from taxes with low marginal efficiency costs before resorting to those with higher marginal efficiency costs. However, because there is no substantial evidence of the efficiency costs of the IC levy, any comparison with the costs of general taxation must be a rough "back of the envelope" estimate.

The efficiency costs of levies and taxes include deadweight, collection and compliance costs. The former arise from distortions to consumption or production patterns when relative prices are altered. Collection costs are incurred by firms and individuals when they arrange their affairs (either legally or illegally) to avoid paying taxes or, on the other hand, are incurred by government agencies to administer and enforce those taxes. Compliance costs are the administrative (account-keeping and form-filling) costs of complying with the tax requirements.

Estimates of the marginal deadweight costs of the major sources of Commonwealth revenues are available from a number of studies[27]. Personal income taxes are widely estimated to have a marginal deadweight cost of around 20 to 25 per cent, between the estimated costs of the GST and company income tax. That cost means taxpayers would be willing to pay around $1.20 to $1.25 for each additional $1 raised to avoid the associated distortion of relative prices and loss of purchasing power. Depending on the estimation methods used, these deadweight costs may or may not also include collection and compliance costs. The estimates of marginal deadweight costs will also generally change for significant changes in the level or structure of taxes.

In the context of the Commonwealth Budget, AUSTRAC's appropriation (just over $75 million) is a "marginal" amount. That is, it is a small addition to the total. Based on the figures above, funding it from additional personal income taxes would have an economy-wide marginal efficiency cost between $15 million and $18.75 million per annum. Ignoring deadweight costs, there would be an efficiency argument for abandoning the IC levy if it had total compliance costs higher than that. Adding any deadweight costs arising from the IC levy would reinforce the argument.

Averaged over the 561 entities paying the IC levy in 2018-19 the efficiency cost of AUSTRAC's appropriation above is around $30,000 per entity, equivalent to about a quarter of the annual cost of a FTE staff member in a major Australian bank[28]. Together, the administrative costs of the IC levy (such as were described by the AFIA and quoted in Section 3.2.1); the likelihood that the associated staff would have higher than average FTE costs; and the potential need for high-level executive approval of significant invoices all suggest the compliance costs of the IC levy could exceed that level. Nevertheless, other factors, such as the potential for DBGs to reduce compliance costs through centralisation, work in the opposite direction. Consequently, it is not immediately obvious that the net balance supports funding from Consolidated Revenue.

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[27] One recent example is *Understanding the Economy-Wide Efficiency and Incidence of Major Australian Taxes*, Treasury Working Paper 2015-01, April 2015. https://treasury.gov.au/publication/understanding-the-economy%25e2%2580%2591wide-efficiency-and-incidence-of-major-australian-taxes.

[28] See, for instance, the FTE staff cost estimates in: "Big four banks must cut staff costs as revenue growth slows: Macquarie", *Australian Financial Review*, 15 September, 2016. https://www.afr.com/business/banking-and-finance/big-four-banks-will-need-to-cut-staff-costs-as-revenue-growth-slows-macquarie-20160915-grh05r.

APPENDIX 4. GLOSSARY

Abbreviation/acronym	Description
ABA	Australian Banking Association
ADI	Authorised Deposit-taking Institution
AFIA	Australian Finance Industry Association
AFMA	Australian Financial Markets Association
AML/CTF	Anti-Money Laundering and Counter-Terrorism Financing
AML/CTF Act	*Anti-Money Laundering and Counter-Terrorism Financing Act 2006*
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
AUSTRAC	Australian Transaction Reports and Analysis Centre
Collection Act	*Australian Transaction Reports and Analysis Centre Industry Contribution (Collection) Act 2011*
DBG	Designated Business Group
FIU	Financial Intelligence Unit
IC levy	Industry Contribution Levy
IFTI	International Funds Transfer Instruction
Levy Act	*Australian Transaction Reports and Analysis Centre Industry Contribution Act 2011*
ML/TF	Money Laundering/Terrorism Financing
RFC	Registered Financial Corporation
SADAMLTF	Strengthening Australia's Defences Against Money Laundering and Terrorism Financing
TTR	Threshold Transaction Report (under the AML/CTF Act)