5

Other administrative matters

Formal interviews

Background

5.1 The ATO has significant evidence-gathering powers. An important provision is section 264 of the *Income Tax Assessment Act 1936.* Notices under the section allow the Commissioner to require a person to provide information that the Commissioner requests or to attend an interview, give evidence, and produce records under that person's custody. The ATO can require that the evidence be given under oath or affirmation. Refusal to take an oath or affirmation is an offence.[1]

5.2 The ATO has published a guide for taxpayers on these interviews. Features of the process include:

- the ATO may bring a lawyer to the interview, such as when the matter is complex or the interviewee plans to bring their lawyer
- the ATO can ask wide-ranging questions
- the interviewee may bring a support person to the interview, but if they have a close connection to the facts, such as participating in transactions of interest, they will be excluded and the interviewee can arrange another support person
- the ATO will usually record the interview and provide the person (hereafter referred to as a taxpayer) with any resulting transcript

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1 Section 8D of the *Taxation Administration Act 1953.*

- the taxpayer can claim legal professional privilege, but not common law rights against self-incrimination.[2]

5.3 A tax barrister, Mr Graeme Halperin, described the effect of such a formal interview on most taxpayers as 'an absolutely harrowing experience.'[3] Mr Matthew Wallace from BDO stated in evidence that the use of formal interviews intimidated taxpayers and that the ATO had other powers it could rely on:

> The concern is that as soon as those powers are relied upon—because there are criminal penalties if those requirements are not complied with—it brings an element of fear and compulsion into the negotiation of an outcome. That makes it difficult for the taxpayer. There are alternatives in that, if any taxpayer provides a false or misleading statement to a tax officer, the taxpayer is still guilty of an offence, but by bringing to bear the section 264 powers, an element of fear and compulsion is brought into the negotiations that would not otherwise be there.[4]

5.4 The Committee also received the complaint that the ATO used formal interviews just before an objection was decided. This provides the ATO with an additional opportunity to question a taxpayer when a matter is expected to be litigated, in the presence of an ATO lawyer who would be involved in the litigation. This would not be permitted in a court of law.[5]

Analysis

5.5 During the inquiry, while there was general acceptance that the interviews were stressful, there was no theme in the evidence that the interview power should be revoked. However, the Committee did receive evidence that the questions could be confusing, especially where technical issues were involved. For example, a taxpayer might be asked whether they did something and give an incorrect answer because they did not distinguish between themselves or a trust or a corporation.[6] Mr Graeme Halperin

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2 ATO, *Guide for taxpayers: Our approach to information gathering,* November 2013, pp. 22-26. Legal professional privilege relates to the confidentiality of communications between a lawyer and their client. Rights against self-incrimination relate to a person not being required to give evidence or produce a document where that would tend to incriminate them.

3 Mr Graeme Halperin, *Transcript of Evidence,* 14 August 2014, p. 21.

4 Mr Matthew Wallace, BDO, *Transcript of Evidence,* 18 August 2014, p. 3.

5 Ms Justeen Dormer, Dormer Stanhope, *Transcript of Evidence,* 1 October 2014, pp. 1-2; Mr John Hyde Page, *Transcript of Evidence,* 29 October 2014, p. 10.

6 Mr Chris Wallis, *Transcript of Evidence,* 14 August 2014, p. 35.

stated to the Committee that taxpayers can give wrong answers to interview questions through not understanding the tax system:

> We are not told about the questions beforehand. I might ask the ATO beforehand: 'What are you going to ask about?' They give you the most broad, general answer which is very, very vague. So you can certainly rest assured that the client is not prepped when they walk into the interview. They are basically taken cold. They are answering a question without really understanding it. Sometimes I will say to the tax officer: 'Can you just restate that question, because I'm not sure that my client really understands what you're getting at.' Because they have not had the opportunity to consider the matter, they will give an answer off the cuff. Then, when they get into court, that answer will be quoted back to them when they give a different answer in the courtroom after having had the opportunity to consider the matter and understand what the ATO was really driving at.[7]

5.6 The Committee is concerned that a taxpayer could be asked a question that they did not understand and then have their answer quoted back at them in court. This breaches fundamental principles of fairness. The idea that a witness needs to understand questions put to them is also reflected in the laws of evidence.[8] The ATO's guidance states that taxpayers should explain in an interview if they do not know or remember the answer to a particular question.[9] However, it appears that, in the heat of the moment, taxpayers' misunderstanding may lead them to answer questions incorrectly.

5.7 We have a complex tax system and the great majority of taxpayers now use advisers. Therefore, it is unclear to the Committee why the ATO would ask taxpayers questions they may not understand when their adviser is more likely to give an accurate response.

Committee comment

5.8 The Committee appreciates that the ATO requires a range of powers to collect information and gives in-principle support to the ATO retaining the legal power to request a person to attend an interview and answer questions. However, the Committee is concerned that, in a complex tax system where the reliance on advisers is institutionalised, taxpayers are

7 Mr Graeme Halperin, *Transcript of Evidence,* 14 August 2014, p. 22.

8 For example, sections 12 to 14 of the *Evidence Act 1995.*

9 ATO, *Guide for taxpayers: Our approach to information gathering,* November 2013, p. 24.

asked questions that they do not understand and then, in some cases, their answers are being quoted back at them in court.

5.9 The Committee accepts that taxpayers are responsible for their tax returns. However, it believes that these interviews can be made fairer to taxpayers and other persons by giving them advance notice issues and topics to be raised.

Recommendation 15

5.10 **The Committee recommends that, as much as practicable, the Australian Taxation Office should give taxpayers written notice of issues and topics to be raised in section 264 interviews.**

Compensation

Background

5.11 Since 1995, the Commonwealth has had a general arrangement for compensating individuals called the Scheme for Compensation for Detriment caused by Defective Administration (CDDA).[10] The scheme is based on sections 61 and 64 of the Constitution, which vest the executive power of the Commonwealth in the Sovereign and is exercisable by the Governor-General on their behalf. Ministers, and officials where authorised, can compensate persons who have suffered loss caused by an agency's defective administration.[11]

5.12 The scheme operates where a person (hereafter referred to as a taxpayer) suffers detriment due to the defective administration of an agency and the taxpayer has no legal recourse. It is a last resort. If a taxpayer has alternative means of obtaining redress from the ATO, then that should be attempted first.[12] Previous guidance referred to a moral obligation to pay

10 Commonwealth Ombudsman, *Putting things right: compensating for defective administration,* Report 11/2009, August 2009, p. 2.

11 Department of Finance, *Resource Management Guide No. 409: Scheme for Compensation for Detriment caused by Defective Administration,* June 2014, p. 3.

12 Department of Finance, *Resource Management Guide No. 409: Scheme for Compensation for Detriment caused by Defective Administration,* June 2014, pp. 2, 4.

compensation, but this has not been carried through to the current policy.[13]

5.13 The Department of Finance has carriage of the policy of the scheme. It defines defective administration as:

- a specific and unreasonable lapse in complying with existing administrative procedures that would normally have applied to the claimant's circumstances; or
- an unreasonable failure to institute appropriate administrative procedures to cover aclaimant's circumstances; or
- giving advice to (or for) a claimant that was, in all circumstances, incorrect or ambiguous; or
- an unreasonable failure to give to (or for) a claimant, the proper advice that was within the official's power and knowledge to give (or was reasonably capable of being obtained by the official to give).[14]

5.14 The Department of Finance provides that the main principle in determining the level of compensation should be 'to restore the claimant to the position they would have been in had defective administration not occurred.' The offer should also be fair and reasonable in the circumstances and the Commonwealth should not use its position of strength to reduce the payment.[15]

5.15 If a taxpayer is not happy with an offer, they may complain to the Ombudsman, who can investigate the complaint under their general powers. The Ombudsman cannot vary a decision, but can make suggestions to the agency or report the matter to the minister, the agency CEO, or the Parliament.[16]

5.16 In 2009, the Ombudsman released a report about the CDDA scheme that focussed on three agencies, including the ATO. The report found that all the agencies in the study had 'well developed systems in place to handle CDDA claims.' However, the report also noted that there was a bias to protecting the revenue:

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13 Department of Finance and Deregulation, *Discretionary Compensation and Waiver of Debt Mechanisms,* Finance Circular No. 2009/09, p. 7.

14 Department of Finance, *Resource Management Guide No. 409: Scheme for Compensation for Detriment caused by Defective Administration,* June 2014, pp. 2-4.

15 Department of Finance, *Resource Management Guide No. 409: Scheme for Compensation for Detriment caused by Defective Administration,* June 2014, p. 9.

16 Department of Finance, *Resource Management Guide No. 409: Scheme for Compensation for Detriment caused by Defective Administration,* June 2014, p. 11.

> A major theme in this report is that, while there is general acceptance by agencies of the CDDA Scheme, there is still a reluctance by agencies to admit error and to approve worthy claims. More can be done within agencies to facilitate greater acceptance of the scheme, its principles and purpose. The impression at times is that the balance between fiscal prudence and justifiable compensation has not been properly struck: the balance is tilted towards protecting government revenue to the detriment of proper assessment of claims. Adverse assumptions are too often made about the unreliability of claimants' accounts; and positive assumptions, unsupported by evidence, are too often made about the reliability of agency actions.[17]

5.17 CDDA payments by the ATO over the past three years are set out in the table below. The average payment is much higher than the median payment, which indicates that the ATO makes a large number of small payments and a small number of large payments.

Table 5.1 CDDA payments, 2011-12 to 2013-14

Year	Unpaid claims	Paid claims	Total Payments ($)	Average Payment ($)	Median Payment ($)
2011-12	172	162	773,857	4,777	571
2012-13	192	147	363,617	2,474	267
2013-14	105	79	841,754	10,655	300

Source ATO, Annual Reports, 2011-12 to 2013-14, Appendix 6, Compensation Statistics

Analysis

5.18 The main issue in the inquiry was the claim that either the ATO does not agree to compensation, or the compensation amounts offered were insufficient.[18] The Committee heard of one taxpayer who won a large number of cases against the ATO. He received standard costs and when he lodged a compensation claim the ATO offered him $20,000:

> To give you an example, I had a client who had eight matters through the various levels of courts, including the High Court. He won every single one... But he was still roughly a million dollars out of pocket by the time the legal fees had been reimbursed in

17 Commonwealth Ombudsman, *Putting things right: compensating for defective administration,* Report 11/2009, August 2009, p. 32.

18 Mr Gary Kurzer, *Transcript of Evidence,* 18 August 2014, pp. 48-49; Mr Grahame Pilgrim, *Transcript of Evidence,* 16 October 2014, p. 22.

> part under the standard basis. We put in a compensation claim for that gentleman and were offered $20,000. So there is a massive discrepancy between what people can recover in those situations and what they have actually outlaid.[19]

5.19 The Committee raised the operation of the CDDA scheme with the Ombudsman. Mr Neave stated that he refers taxpayers to the scheme if they have a compensation claim but no legal avenue through which to pursue it. The Ombudsman also stated that he would be able, if asked by the ATO, to comment on any particular offer that the ATO might make to a taxpayer.[20]

5.20 In its submission, the ATO commented on the importance of feedback loops in the context of separating the deciding of objections from audit activity.[21] The Committee notes that the idea of a feedback loop also applies to the CDDA scheme. If the incidence of defective administration increases, then compensation amounts should also increase, sending a signal back to the relevant parts of the ATO. This can be used to improve performance in the long run.

Committee comment

5.21 The evidence to the Committee suggests that, where defective administration has been involved, compensation amounts do not always restore taxpayers to their original position and this situation has occurred for some time. Where this occurs, it is not fair to taxpayers. The Committee is also concerned that this impairs a feedback loop whereby the ATO can measure its performance in dealing with taxpayers fairly.

5.22 The compensation amount, if any, for a taxpayer will depend on the facts of each case. Therefore, the Committee is very pleased that the Ombudsman has offered to assist the ATO in assessing compensation amounts. The Ombudsman has significant expertise in this area and the Committee would like the ATO to invite the Ombudsman to assist.

19 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 16.

20 Mr Colin Neave, Commonwealth Ombudsman, *Transcript of Evidence,* 24 September 2014, p. 10.

21 ATO, *Submission No. 10.2,* p. 4.

Recommendation 16

5.23 **The Committee recommends that the Australian Taxation Office invite the Commonwealth Ombudsman to advise on improving its compensation processes, including compensation liability and amounts.**

Alternative dispute resolution

Background

5.24 Alternative dispute resolution (ADR) is a process where parties use an impartial third party, other than the courts, to help resolve their dispute.[22] The main types of ADR are outlined in the table below.

Table 5.2 Types of alternative dispute resolution

Type	Description	Examples
Facilitative	The third party encourages dialogue and helps the parties in dispute work through the issues in a structured manner.	Mediation, facilitation
Advisory	The third party is usually a subject expert who appraises the dispute and proposes solutions.	Case appraisal, conciliation
Determinative	The third party evaluates the dispute, perhaps taking evidence, and makes a determination which would often have legal standing.	Arbitration, expert determination

Source *Attorney-General's Department, Office of Legal Services Coordination, Guidance Note 12, September 2013, p. 7; Allessandra Sgubini et al, 'Arbitration, Mediation and Conciliation: differences and similarities from an international and Italian business perspective,' viewed at www.mediate.com on 4 February 2015.*

5.25 The key difference between ADR and the early engagement discussed in chapter 4 is that ADR requires a third party, whereas early engagement can simply involve the ATO and the taxpayer discussing a review, audit, or dispute. PricewaterhouseCoopers (PwC) stated that early engagement, as opposed to ADR, is preferable in resolving issues[23] and the Committee endorses this statement. A simple conversation can happen earlier and involves less process and cost than ADR.

5.26 A breakthrough in ADR at the ATO occurred with the 2012 report by the Inspector-General of Taxation (IGT). This review was also requested by the ATO. The IGT directed 21 recommendations to the ATO, which agreed

22 Attorney-General's Department, Office of Legal Services Coordination, *Guidance Note 12,* September 2013, p. 1.

23 PwC, *Submission No. 23,* p. 17.

with 14, partly agreed with four, agreed in principle with two and disagreed with one. This last recommendation covered internally separating the objection and litigation functions within the ATO and is discussed in this report in chapter 6.[24]

5.27 The influence of the IGT's report was reflected in the ATO's submissions to the inquiry. Many current or anticipated ATO programs are directly or partly attributable to the IGT's recommendations. Examples are:

- asking teams that audit individual taxpayers to adopt early dispute resolution principles[25]
- in-house facilitators for less complex matters[26]
- feedback surveys for taxpayers involved in ADR[27]
- a Dispute Resolution Charter.[28]

5.28 The ATO has issued a practice statement in relation to ADR. It encourages ATO staff to engage in ADR where there is scope for negotiation within existing policies and there are identified ways in which the dispute can be progressed, such as narrowing the facts in dispute. The guidance sets out a number of instances where ADR would be inappropriate. These are:

- resolution can only be achieved by departure from an established 'precedential ATO view' and there is no material difference between the facts in dispute and the facts which form the basis of the 'precedential ATO view'
- the cost and delay involved in ADR is disproportionate to the likely benefit
- the dispute turns on genuine and fundamental issues of law or is otherwise straightforward and there is a clearly identified public benefit in having the matter judicially determined
- the facts are clear and the application of the law is straightforward, or
- there is a genuinely held concern that the case involves serious criminal fraud or evasion.[29]

5.29 The ATO commissioned the Australian Centre for Justice Innovation at Monash University to conduct an evaluation of ADR. The Centre released

24 Inspector-General of Taxation, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution: A report to the Assistant Treasurer,* May 2012, pp. ii, v.

25 ATO, *Submission No. 10.2,* p. 6; IGT recommendation 4.1 on p. 146.

26 ATO, *Submission No. 10,* p. 18; IGT recommendation 3.6 on p. 44.

27 ATO, *Submission No. 10.2,* p. 9; IGT recommendation 5.4 on p. 95.

28 ATO, *Submission 10.2,* p. 4; IGT recommendation 5.2 on p. 87.

29 ATO, *Alternative Dispute Resolution (ADR) in ATO disputes,* PS LA 2013/3, August 2013, para. 9.

a report in November 2014 covering the period from July 2013 to June 2014 for 118 matters, 92 per cent of which had already progressed to the Administrative Appeals Tribunal (AAT) or Federal Court. It found that over 40 per cent of matters completely resolved during ADR and 25 per cent appeared to resolve afterwards. Some respondents commented on cost savings when a matter was successfully resolved, typically giving an amount of $70,000.[30]

5.30 There was a general acknowledgement during the inquiry that the ATO is now more likely to engage in ADR. CPA Australia stated:

> As an overall comment we strongly believe that the Commissioner should be commended for the recent performance of the Australian Taxation Office (ATO) in resolving tax disputes through negotiation and the use of Alternate Dispute Resolution (ADR) processes. This has involved a considerable paradigm shift by all parties and our members note that its roll-out across all market sectors including SMEs has typically led to the more expeditious resolution of disputes by the ATO.[31]

5.31 However, the problem is that it can still be difficult to convince ATO auditors and other staff to engage in ADR. Mr Graeme Halperin commented that the ATO does not routinely advise taxpayers of their ADR options and an individual involved in the early stages of a dispute 'did not know such a thing existed.'[32] The Committee also heard that, in some instances, the ATO does not fully engage in ADR. Mr John Hyde Page, a tax barrister, stated to the Committee:

> There has been a change. I do not know whether or not you could properly characterise it as a cultural change, but about a year ago in just about every tax dispute that was going on across Australia people started getting phone calls from the ATO saying, 'We want to mediate this.' Some of those mediations have been quite constructive. Some of the others that I have attended, frankly, have just been a waste of time. In one case in particular, the ATO started off the mediation by saying: 'We're here because our policy is we have to be. But, you're a bunch of crooks and we're not going to abandon our assessments.'[33]

30 Tania Sourdin and Alan Shanks, *Evaluating ADR in ATO Disputes: Executive Summary,* Australian Centre for Justice Innovation, Monash University, November 2014.

31 CPA Australia, *Submission No. 7,* p. 1.

32 Mr Graeme Halperin, *Transcript of Evidence,* 14 August 2014, p. 18; Mr Mark Fletcher, *Transcript of Evidence,* 18 August 2014, p. 32.

33 Mr John Hyde Page, *Transcript of Evidence,* 14 August 2014, p. 10.

Analysis

5.32 In terms of increasing the use of ADR, the Committee took evidence that the ATO is undergoing a process of cultural change and that it takes time for this to occur. Mr David Hughes stated, 'if the current commissioner stays for a long tenure, then the culture will change over time.'[34] Mrs Sarah Blakelock and Mr Mark West from McCullough Robertson made similar comments, in particular that ADR is more prevalent in the large market and should eventually filter down:

> There has been quite a significant change in approach over the last maybe two or three years and a significant amount of people have been trained as accredited mediators within the ATO. I am finding that is more often in the public groups and international space—large business rather than in the small to medium enterprise space. It takes a while for these things to filter down.[35]
>
> I have a similar experience that it is still patchy but certainly efforts are being made. I think it still has a way to go to filter all the way down.[36]

5.33 Progress with ADR has been occurring during the inquiry. In a supplementary submission, the ATO stated that it now advises taxpayers about facilitation in GST audit letters before the audit is concluded. This is being expanded to individuals, small business and income tax letters.[37]

Committee comment

5.34 The Committee commends the ATO for making greater use of ADR over the past few years and looks forward to the ATO building on this achievement. The Committee does not believe that a recommendation on this matter is required because the main goal for the ATO is to continue along its current path of increasing the use of ADR.

5.35 Although ADR is much preferred over court proceedings, the Committee would like to reiterate PwC's comment that direct discussion and early resolution in most cases will be more even more advantageous. If taxpayers and the ATO can save $70,000 by resolving a matter through ADR once it has proceeded to the AAT, then the savings in resolving a matter before objection must be substantial as well.

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34 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 16.

35 Mrs Sarah Blakelock, McCullough Robertson, *Transcript of Evidence,* 16 October 2014, p. 12.

36 Mr Mark West, McCullough Robertson, *Transcript of Evidence,* 16 October 2014, p. 12.

37 ATO, *Submission No. 10.2,* p. 6.

5.36 Finally, the Committee recognises the IGT's contribution to these reforms through the 2012 ADR report. The Committee would certainly support the IGT in revisiting this matter at a later date if the IGT thought this was warranted.