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Mr Jason Falinski MP  
Chair  
Standing Committee on Tax and Revenue  
House of Representatives  
Parliament of Australia

Dear Mr Falinski,

**Inquiry into the 2016-17 Annual Report of the Australian Taxation Office – additional questions**

The Inspector-General of Taxation (IGT) is pleased to provide his responses to the additional questions of the House of Representatives Standing Committee on Tax and Revenue (the Committee) following its public hearing on 28 March 2018.

The responses are provided under the respective Committee headings, being:

- debt collection;
- data and reportage;
- data management and privacy; and
- fairness to taxpayers.

**Debt collection**

1) *The IGT's January 2015 Report on the Management of Tax Disputes states that 'submissions have expressed concerns against the use of garnishee notices during tax disputes, especially where these were issued against taxpayers' business accounts, effectively hampering business as usual and denying access to necessary funds to challenge ATO decisions'.*

- *During the hearing the staff of the ATO said that they don't garnish while a dispute is in process except in some circumstances such as organised crime or the likelihood that money was to be transferred elsewhere. It is now a full two years after release of your report – based on feedback your office receives; do you believe the situation has changed since the 2015 report?*
- *Is feedback similar regarding insolvency action?*

Since inception of the IGT's complaint handling service, we continue to receive complaints about debt collection, with it accounting for approximately 31.4 per cent, 23.1 per cent, 21.9 per cent and 22.6 per cent of all complaints about the Australian Taxation Office (ATO) in the 2014-15,<sup>1</sup> 2015-16, 2016-17, financial years and the 2017-18 financial year to date, respectively. Of the debt complaints, garnishee actions were amongst the top three most commonly raised. Across all years mentioned above, garnishee action accounted for 18.6 per cent, 14.9 per cent, 8.8 per cent and 11.2 per cent. The complaints received about garnishee actions include concerns where garnishee notices have issued to taxpayers during tax disputes.

The IGT had already made preliminary enquiries of the ATO regarding developments in the area of garnishee notices, but has not taken any further action at this time pending the outcome of the inquiry being undertaken by the Secretary of the Treasury at the request of the Minister for Revenue and Financial Services into allegations raised in the ABC Four Corners program recently reported in the media. Importantly, in relation to garnishee notices, the allegations made by an ATO officer regarding the so-called 'hour of power' or 'cash grab', require an independent investigation to promptly establish findings along with any recommended action to ensure confidence and that trust of the community is bolstered. Given the complaints feedback, the IGT continues to maintain a watching brief regarding the broader debt management issues and will consider it in relation to the next review work program to be established in the new financial year.

The IGT also receives complaints about ATO insolvency action being taken whilst taxpayers are trying to get their tax affairs in order. Such complaints have accounted for approximately 4.7 per cent, 8.2 per cent and 9.7 per cent of debt complaints received by the IGT during the 2014-15,<sup>2</sup> 2015-16 and 2016-17 financial years. During the 2016-17 financial year, insolvency actions were categorised along with other litigation and prosecution issues. During the 2016-17 financial year, the IGT received additional complaints concerning insolvency action which amounted to approximately 22.7 per cent of litigation and prosecution issues. For the 2017-18 year to date, insolvency actions accounted for approximately 72.7 per cent of litigation and prosecution issues.

For general reference, the two ATO policies relevant for issuing a garnishee notice on a debt which is the subject of a dispute are noted below.

The first policy is *Practice Statement Law Administration PS LA 2011/4: Collection and recovery of disputed debts* (PS LA 2011/4). The relevant paragraphs state:

The Commissioner may initiate recovery action for collection of unpaid disputed debts at any time, even before determining an objection, based on an analysis of the risk associated with the case. This risk analysis continues during the various stages of the dispute resolution process while a debt remains unpaid...

The Commissioner will only agree to a deferral of recovery action where:

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<sup>1</sup> The IGT's complaints handling service commenced operation on 1 May 2015. Accordingly, the statistics for the 2014-15 year only include complaints received between 1 May 2015 and 30 June 2015.

<sup>2</sup> The IGT's complaints handling service commenced operation on 1 May 2015. Accordingly, the statistics for the 2014-15 year only include complaints received between 1 May 2015 and 30 June 2015.

- the taxpayer has entered into a 50/50 arrangement and there is no evidence to suggest that payment of the amount deferred is at risk
- the Commissioner considers that a genuine dispute exists in regard to the assessability of an amount, or
- the Commissioner is pursuing arguments which are inconsistent with a previously published ATO view or go against the weight of precedent cases (that is, the Commissioner is challenging the previously accepted position).

Such an agreement will usually be expressed in writing.<sup>3</sup>

The second policy is *Practice Statement Law Administration PS LA 2011/18: Enforcement Measures used for the Collection and Recovery of Tax-Related Liabilities and Other Amounts* (PS LA 2011/18). The key paragraph states:

Where a tax debtor is appealing to a tribunal or court against the assessments that raised the debt, the Commissioner will consider whether a garnishee would significantly prejudice the tax debtor's rights in pursuing those appeals.<sup>4</sup>

- 2) *The IGT's 2015 Debt Collection report notes that 'a third-party survey reported that many small businesses have entered some form of insolvency administration. In another survey, over one-third of respondents had a supplier or customer who was unable to pay creating a domino effect of financial difficulty.'*
- *What is the IGT's assessment of the prevalence of small business insolvency as a result of garnishee notices to recover assessed tax debt?*

The IGT's 2015 *Debt Collection* report sets out ATO data on the number of cases where garnishee notices were issued and where the taxpayer subsequently became insolvent. This data is reproduced below.

**Table 1: Solvency following the use of garnishee notices**

Business segment	2011-12	2012-13	2013-14	Total	Percentage
<b>Gov</b>	<b>4</b>	<b>1</b>	<b>1</b>	<b>6</b>	<b>0.00%</b>
Insolvent	0	0	0	0	0.00%
Solvent	4	1	1	6	100.00%
<b>INB</b>	<b>6,485</b>	<b>13,878</b>	<b>8,965</b>	<b>29,328</b>	<b>14.15%</b>
Insolvent	0	3	0	3	0.01%
Solvent	6,485	13,875	8,965	29,325	14.15%

<sup>3</sup> Australian Taxation Office (ATO), *Collection and recovery of disputed debts*, PS LA 2011/4, 26 February 2015, paras [11], [43].

<sup>4</sup> ATO, *Enforcement Measures used for the Collection and Recovery of Tax-Related Liabilities and Other Amounts*, PS LA 2011/18, 3 July 2014, para [112].

**Table 1 (continued)**

<b>Business segment</b>	<b>2011-12</b>	<b>2012-13</b>	<b>2013-14</b>	<b>Total</b>	<b>Percentage</b>
<b>LGE</b>	<b>25</b>	<b>41</b>	<b>59</b>	<b>125</b>	<b>0.06%</b>
Insolvent	0	0	0	0	0.00%
Solvent	25	41	59	125	100.00%
<b>MIC</b>	<b>37,198</b>	<b>65,281</b>	<b>58,222</b>	<b>160,701</b>	<b>77.55%</b>
Insolvent	0	346	283	629	0.39%
Solvent	37,194	64,920	57,938	160,052	99.60%
Unknown	4	15	1	20	0.01%
<b>NFP</b>	<b>132</b>	<b>151</b>	<b>85</b>	<b>368</b>	<b>0.18%</b>
Insolvent	0	1	2	3	0.82%
Solvent	132	150	83	365	99.18%
<b>SME</b>	<b>5,024</b>	<b>5,979</b>	<b>5,692</b>	<b>16,695</b>	<b>8.06%</b>
Insolvent	0	79	67	146	0.87%
Solvent	5,024	5,893	5,621	16,538	99.06%
Unknown	0	7	4	11	0.01%
<b>Grand Total</b>	<b>48,868</b>	<b>85,331</b>	<b>73,024</b>	<b>207,223</b>	<b>100.00%</b>

Source: IGT, *Debt Collection* (2015) pp 98-99.

The table above shows that the majority of garnishee notices are issued to individual and small business taxpayers. A small proportion of all taxpayers subsequently became insolvent following the issuing of a garnishee notice based on the data provided.<sup>5</sup>

The *Debt Collection* report considered a wide range of debt related matters including the range of debt actions that the ATO may take in this regard. Accordingly, the report was not directed at establishing a causal link between garnishment and insolvency in isolation. To do so would be a challenging task as the full range of other debt actions as well as external factors unrelated to ATO action would need to be isolated or controlled for comparison against the specific and unfortunate business outcome being insolvency. To consider such a causal link, a specific review would be required.

### **Data and reportage**

- 3) *The IGT's submission refers to the ATO estimates that 89 per cent of individual taxpayers had lodged returns by June 2017. (p. 5)*
- *Given the comments on the range of factors that might be implied in such a figure (such as late lodgement related to tax agents use, etc), does the IGT consider that the statistics provided in the ATO Annual Report for income tax and BAS reporting are accurate or, possibly, misleading?*

The IGT's submission noted that the ATO's 2016-17 Annual Report (Annual Report) states that 89 per cent of individual taxpayers who were expected to lodge a 2015-16 income tax

<sup>5</sup> Inspector-General of Taxation (IGT), *Debt Collection* (2015) p 99.

return had done so by 30 June 2017.<sup>6</sup> In this respect, it is not clear whether the number reported in the ATO's Annual Report, of individual taxpayers who were expected to lodge a 2015-16 income tax return, may also represent the rate of non-lodgment or whether the latter is lower due to late lodgment. Accordingly, the IGT would need to undertake a review to inquire into the current rate of non-lodgment to determine the accuracy of the figure reported.

The IGT, however, supports transparent disclosure in the Annual Report on a broad range of matters, particularly where these details promote efficiencies and increases confidence in the administration of the tax system. As the Committee is aware, we have supported increased public disclosures in the *Debt Collection* and *Non-lodgment* reports previously.

### Data management and privacy

- 4) *The IGT's 2009 review considered the Government should facilitate the ATO's use of third party data and data matching to better identify non-lodgers (p. 5). As a result of changes introduced to the Tax Act by the Tax and Superannuation Laws Amendment Bill (2015 Measures No. 5) Bill 2015 the ATO has a much expanded 'as-of-right' access to third party data.*
- *How might this legislation be expected to enhance the ATO's powers and the accuracy of its data analysis?*
  - *What commensurate obligations are implied both for ATO transparency in handling this information and the privacy of that information, including when managed by external (outsourced) staff?*
  - *Given the increased use of data technology and commensurate surveillance of taxpayers, is it the IGT's opinion that the ATO is presently honouring its obligations for sufficient and accurate reportage on outcomes for taxpayers in its annual report?*

The IGT had made observations, similar to those in the legislation's explanatory materials extracted later, regarding the quality of third party data and data analysis in his *Data Matching*<sup>7</sup> review:

The ATO receives data from third parties under specific legislative obligations (legislative data) and other arrangements such as a memorandum of understanding or a demand under the access provisions available to the ATO under certain tax legislation (non-legislative or special purpose data). In the case of the latter, the access provisions do not empower the ATO to request any information not already in existence or to compel information providers to comply with specific formatting. As such, the application of such information in the ATO's non-legislative data matching projects may vary due to quality and integrity issues.<sup>8</sup>

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<sup>6</sup> IGT, Submission No 1 to House of Representatives Standing Committee on Tax and Revenue, *Inquiry into the 2016-17 Annual Report of the Australian Taxation Office*, February 2018, p 5.

<sup>7</sup> IGT, *Review into the Australian Taxation Office's compliance approach to individual taxpayers – use of data matching* (2013).

<sup>8</sup> *Ibid* p 8.

The ATO discloses a range of information concerning its data matching programs on its website, for example, on specific data matching programs with public and private entities, the type of information provided by types of third parties and the protection and handling of third party provided information, such as the ATO's privacy policy.<sup>9</sup> In relation to the ATO's privacy and secrecy obligations, including ATO policy on third party data, the IGT observed in his the *Data Matching* review that:

Legislative data forms part of the ATO's corporate data holdings. As such, it is subject to privacy and secrecy rules contained in the relevant taxation legislation as well as other information management legislation which binds the ATO. Such legislation includes requirements under the Privacy Act 1988 and Division 355 of Schedule 1 to the Taxation Administration Act 1953 (the TAA 1953).

In addition, the ATO has also developed a number of internal policies and controls in relation to maintaining and protecting confidential data and limiting access to such data only to staff with appropriate security clearance levels who require access in the course of their duties. ATO officers who have such access must personally keep that data confidential and must not use it for any other purpose...

Non-legislative or special purpose data is collected by the ATO at the request of specific business lines to address potential risks within certain ATO products or market segments. The ATO's processes for collection and management of this data are governed by its internal Corporate Management Practice Statement CMPS 2004/17 Special Purpose Acquisition Data.<sup>10</sup>

In relation to obligations of external or outsourced staff in handling data, the IGT had specifically considered the ATO's use of External Debt Collection Agencies (EDCA) in his 2015 *Debt Collection* report. The use of external staff more broadly has not been the subject of IGT review previously. In relation to the use of EDCAs, the ATO was of the view that,

the tax law [section 8WB(1A) of the Taxation Administration Act 1953] enables the Commissioner to disclose taxpayer information to third parties who have been appointed to carry out a duty or function under a tax law...

In handling taxpayer information, EDCAs are required to meet the same Commonwealth privacy and security requirements which apply to the ATO, such as the Privacy Act 1988 and section 16 of ITAA 1936, as they are performing a tax law function under authorisation by the ATO. The EDCA personnel are also subject to the same scrutiny as ATO employees, such as undergoing external police checks, and are also required to sign a secrecy declaration that sets out their responsibilities and obligations to safeguard information disclosed to them. The ATO also assures itself of the security of taxpayer information held by EDCAs through contractual terms which imposes obligations to protect this information at all times and only use it in relation to rendering services to the ATO. Before referring cases to EDCAs, the ATO also

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<sup>9</sup> See for example: <https://www.ato.gov.au/General/Building-confidence/In-detail/Data-matching/>.

<sup>10</sup> IGT, above n 7, p 11-12.

completes physical and technology security audits on each EDCA to ensure that all privacy and security requirements are in place.<sup>11</sup>

On the ATO's reportage of the outcomes of its data matching programs for taxpayers, the ATO's Annual Report, stated:

...We have an extensive data-matching program, in which data we receive from more than 640 million records from third parties is compared to information reported in tax returns. Where we see discrepancies, we bring them to the attention of the individual or their tax agent, and work with them to amend the return...

We use data-matching evidence to identify taxpayers with a requirement to lodge due to the receipt of income. For those who don't lodge on time, we make early contact via letter or SMS to remind them of key dates and encourage them to lodge without further delay...

...Our expanded data-matching capacity will eventually support the prefilling of income information and allow us to further reduce errors...

...Agencies share intelligence to consolidate understanding of the phoenix-related behaviours. Our phoenix risk model, together with sophisticated data-matching tools, identifies suspected illegal phoenix operators, and helps us to monitor their activities and target our compliance activities.<sup>12</sup>

The above extracts indicate that the ATO broadly uses third party data to both assist taxpayers to prepare their income tax returns as well as to inform its compliance activities. However, the effectiveness of the data matching programs is not clear, for example, it is not reported the proportion of taxpayers who accept pre-filled data or those who change it as well as the outcomes of the ATO's compliance activities which are based on third party data matching programs.

The IGT had made recommendations to the ATO in his *Data Matching* report including enhancing its reporting capability to identify and report on data matching projects generating the highest levels of dispute and the associated reasons as well as the rate of objection and litigation from data matching decisions and the outcomes of these cases.<sup>13</sup> As noted earlier, the IGT supports transparency as a means to improve community confidence in the administration of the tax system.

By way of reference and convenience, an extract from the Explanatory Memorandum to the Tax and Superannuation Laws Amendment (2015 Measures No. 5) Bill 2015 is listed below:

[t]he objective of an efficient tax administration is to collect the maximum amount of revenue with minimum administration and compliance costs...

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<sup>11</sup> IGT, above n 5, pp 138, 140.

<sup>12</sup> Commissioner of Taxation, *Annual Report 2016-17* (2017) pp 15, 18, 25, 60.

<sup>13</sup> IGT, above n 7, p 85.

Starting in 2007, the Australian Taxation Office (ATO) has offered individual taxpayers a pre-filling service to assist them in voluntarily meeting their obligations... by using the information it has received for compliance purposes...

The usefulness of pre-filling, and therefore the availability of future pre-prepared tax returns, depends on the ATO receiving relevant and timely information from third parties... However, whilst information gathered through existing legislative reporting regimes is generally of a high quality, information collected under the Commissioner's general information gathering powers tends to have shortcomings in relation to timeliness, data formats and the ability to readily match it to the relevant taxpayer.

The introduction of formal third party reporting regimes has the potential to further reduce the compliance costs for individual taxpayers by increasing the range of information reported to the ATO. It also has the ability to be an effective compliance response to deal with some taxpayers omitting or underreporting income.<sup>14</sup>

### Fairness to taxpayers

- 5) *The IGT's submission notes further reductions in externally referred disputes under new ATO mechanisms to improve perceived fairness and efficiency in processing for individuals and businesses. (p. 9)*
- *The IGT submission proposes that these methods could be expanded to cover disputes with 'all taxpayers'. Would you clarify what this recommendation implies, both in terms of taxpayer groups, purpose and the business case for it?*

The IGT observed in the *Tax Disputes*<sup>15</sup> report that there were a range of processes which operated at different points during a dispute with the ATO. However, some of these processes, such as the ATO's internal independent review, where the merits of the ATO's position is considered by a senior ATO officer unconnected with how that position was initially established, are only available to large taxpayers. The IGT believed that, as a matter of fairness and equity, all taxpayers should have access to such pre-assessment review mechanisms. In fact, it was noted that it is even more important for small business and individual taxpayers to have such access given their limited resources to progress disputes through more formal channels.

Furthermore, tax debt crystallises at the point that a notice of assessment is issued following which the ATO can commence a range of recovery actions. Therefore, while a taxpayer may challenge an assessment through the objection and litigation processes under Part IVC of the *Taxation Administration Act 1953*, these courses of action may impose significant costs which are exacerbated by collateral debt collection action, or the risk of it, by the ATO. Accordingly, pre-assessment reviews are an important safeguard, particularly for small businesses and individuals, against such recovery action taking place based on an incorrect assessment and the cost of challenging that assessment.

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<sup>14</sup> Explanatory Memorandum to Tax and Superannuation Laws Amendment (2015 Measures No. 5) Bill 2015, para [4.3]-[4.7].

<sup>15</sup> IGT, *The Management of Tax Disputes* (2015).

Lastly, while the ATO's current independent review processes are worthwhile and should be encouraged, the IGT considers that a separate Appeals area within the ATO would provide for more optimal approach, which the Committee has also previously supported.

6) *The IGT notes that the Committee's recommendation for reporting on fairness measures for taxpayer and tax agent experience in its last Annual report review, was supported by the ATO but is not addressed in the current annual report.(p. 14) Would you comment on the merit of the Committee's recommendation and the ATO's present capability to meet it?*

A self-assessment tax system design accepts that revenue authorities, such as the ATO, do not verify every taxpayer's compliance with their tax obligations but rather seeks to foster voluntary compliance. A key driver in fostering voluntary compliance is the perception of *fairness* amongst taxpayers, as noted by the Organisation for Economic Co-operation and Development and others.<sup>16</sup>

The growing interest and research into taxpayer rights illustrates the importance of treating taxpayers fairly and being seen to be doing so. The IGT has also been working extensively in this area with his international counterparts. Such work includes a 2016 comprehensive review into the *Taxpayers' Charter and Taxpayer Protections*. In that review, the IGT's recommendations included ensuring that the Charter is at the forefront of the ATO's interactions with the community and its performance against the Charter's principles is appropriately measured and publicly reported.<sup>17</sup> The IGT does receive a range of complaints, including from small business, concerning issues of fairness. Some do express significant levels of concern in this regard.

To date, the ATO has only reported that it has developed an organisational fairness framework and implemented relevant strategies. Its most recent findings show that more than half of individuals surveyed believe that the ATO is fair and professional in administering the system. No information is provided about perceptions amongst other taxpayer categories such as small business.

The ATO's present capability to meet the Committee's recommendation is not clear. The IGT when formulating the future work program would welcome submission from the Committee on this matter or any other that members may wish to put forward.

We trust this assists the Committee by providing additional information on the above areas of the tax administration system.

Yours faithfully,

  
Andrew McLoughlin  
Acting Inspector-General of Taxation

<sup>16</sup> IGT, *Taxpayers' Charter and Taxpayer Protections* (2016) p 3.

<sup>17</sup> *Ibid* pp 71-97.