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Commissioner of Taxation

ATO

The Secretariat
House of Representatives Standing Committee on Economics,
Finance and Public Administration
Parliament House
Canberra ACT 2600

Review of the ANAO Audit Report No. 37 1998-99 on the Management of Tax File
Numbers

Please find attached herewith the ATO responses to Questions on Notice arising from the
Committee's public hearing on 6 December, 1999.

If you require further assistance, please do not hesitate to contact Chris Marsden on 6216 2630, or
Cathy Denino on 6216 1878.

Yours sincerely

Dr Bob Webb
Deputy Commissioner of Taxation

AUSTRALIAN TAXATION OFFICE

House of Representatives Standing Committee on Economics, Finance and Public Administration.

Review of the ANAO Audit Report No. 37 1998-99 on Management of Tax File Numbers.

The Chair, Mr David Hawker (MP), asked the following question on notice at EFPA 25:

Could we come to one of the submissions from your office about the fraudulent use of tax file numbers previously allocated to temporary residents and international students that are then used to set up shelf companies for laundering money. What response have you got to that? What are you doing to look at that? To me, that sounds a serious point to be raised. Do you have a handle on it?

The response to the honourable member's question is:

Submission No. 1 makes reference to certain tax evasion practices under investigation by the ATO and the National Crimes Authority. There is evidence that the practices, in part, relate to the unlawful purchase and use of Tax File Numbers in an attempt to defeat TFN and income reporting systems administered by the ATO.

The submission does not provide a comprehensive account of the method by which such purchased TFN's have been used. The ATO acknowledges that "shell" entities or "shelf" companies have been used as a means by participants within certain industries to attempt to evade income tax responsibilities. Evidence of the use of such entities predates the expansion of the TFN quotation arrangements under the Reportable Payments System (RPS) which, upon introduction, served to eliminate many of the existing tax evasion techniques.

It is not a condition of the tax or corporations laws that a TFN be provided by an associated person to secure the registration of a company through the Australian Securities and Investments Commission.

Companies may need to obtain and quote a TFN under various reporting systems administered by the ATO to prevent the application of a withholding sanction. This is generally the case with accounts held in investment bodies under the company name. It is also the case in relation to transactions in those industries in which the RPS and the Prescribed Payments System (PPS) apply.

The RPS and the PPS were introduced to combat tax evasion practices known to exist in certain industries. To support these systems, and to increase confidence in the integrity of the Australian Business Number, the ATO has strengthened procedures to ensure that persons associated with a company that is seeking a TFN or ABN provide reasonable evidence of their identity before a number will be allocated.

A new practice, which is subject to continuing investigations, has almost certainly emerged as a result of the ATO resolve to crack down on the use of shelf companies as a means to evade tax liabilities. The practice relates to certain persons procuring a TFN that does not belong to them and directly quoting that TFN to a payer, ie the person who has the obligation to forward that quotation to the ATO. To assist the Committee to assess the relative significance of the issue, the ATO can offer the following information:

- Identified money laundering and certain tax evasion practices have been the subject of close ATO scrutiny over the past two decades. The ATO has employed a balance of risk assessment, improved audit technique, inter-agency cooperation and new legislation to combat many existing and emerging practices;
- The ATO is acting upon a practice that has emerged where certain members of the community, with the intent of circumventing ATO reporting systems and income tax obligations, seek to purchase the Tax File Number and identity details of another person;
- The practice appears confined to fewer than 500 individuals and to certain industries. Strong attention is being placed on persons believed to be promoting the practice.
- In a minority of cases, the person from whom the TFN is purchased intends to leave Australia and has little continued need for that TFN. The ATO's compliance programs would be assisted in this area by improved systematic access to the records of individuals permanently leaving the country.
- Taxpayers are generally assessed, for income tax purposes, on disclosed income and/or as the recipients of any payments reported to the ATO by third parties. Australian residents who "sell" their TFN and identity to another person will, prima facie, be taken to have received any payments reported by third parties under that TFN, irrespective that it is being used illegitimately by another person. In addition to income tax, reported information can also impact on social welfare entitlements. The ATO is attempting to raise community awareness of the potential consequences of a misused TFN.

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The Chair, Mr David Hawker, raised the issue of changing residency status to get a better rate of tax, at EFPA 25. Dr Bob Webb offered to provide the Committee with additional information covering residency risk assessment.

The response to the honourable member's question is:

The tax that applies to taxable income depends on a taxpayer's residency status. Non-residents are not entitled to a tax-free threshold. Australian residency status is as defined on page 8 of Taxpack 99.

Taxpayers identify their residency status in the annual tax return.

Since December 1997, "residency status" has been a self assessment system with penalties imposed for false or misleading information.

Prior to bringing residency status into line with the general self assessment regime, follow up of apparent residency status anomalies and related taxpayer objections was a large and unproductive workload. The anomalies and objections were largely caused by system over-rides of returned residency status, reverting taxpayers to the "status" which existed when they first requested their TFN.

A formal risk assessment was conducted on this work and it was found that the cost and effort of continuing with a non-self assessment policy was not justified. Nearly all possible "non residents" queried had in fact become Australian residents subsequent to their applying for a tax file number and before the lodging of their returns. The revenue risk. was assessed as low.

Since December 1997, as with all aspects of self assessment compliance, risk assessments of residency self-assessment have been conducted twice a year. The most recent risk assessment review was completed in June 1999.

Submission no.3, from an ATO staff member, specifically deals with the risk of a non-resident abusing the self assessment process and lodging their return as a resident in order to receive the benefits of the tax free threshold. We have followed up that submission and, as with other cases where specific details could be pinpointed, we have found no evidence of residency abuse commensurate with any significant risk to the revenue.

The residency risk assessment that we completed in June 1999 saw 290 taxpayers with possible anomalies in residency status, selected and examined by Compliance Management staff. 280 of these taxpayers were found to have correctly self-assessed their residency status. Of the ten taxpayers who had (initially) incorrectly self-assessed, in seven cases they voluntarily amended their returns prior to being contacted by the compliance project team. Of the three remaining cases. one was a credit amendment; the other two were debit assessments totalling \$3,209.

Ongoing risk assessment of residency will continue as part of our Individuals Compliance Management Strategy and, should objective evidence of any significant risk be identified, our self assessment policy can be modified.

Finally, in terms of responding to taxpayer questions on the status of the residency box on the income tax return, it is our policy to explain that residency status is not simply determined by which box is ticked on a return form but by the facts of each case. If a person were to deliberately claim residency status knowing this to be false, substantial penalties could result.

Residency Risk Assessment

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Mrs Hull (MP) asked the following question on notice at EFPA 30, in relation to Annual Investment Income Reports (AIIR), and the instances found by the ANAO of non compliance of remitters with the reporting requirements over several years:

Is the ATO moving to act on financial institutions in order to get them to comply more readily in order that we can have more success with this?

The response to the honourable member's question is:

On this issue of non compliance, the ATO does take annual demand action (usually in February) where active financial institutions have not lodged an Annual Investment Income Report for the previous year. Our demands for 1999 will issue shortly. For 1998, we issued demands to 352 reporters. It is estimated that these organisations had an average of 1100 outstanding transactions and were typically smaller financial institutions. Still outstanding from our 1997 demand run are 169 institutions with an average of 166 transactions. Note that the annual AIIR pool of active financial bodies total some 7,200 institutions who between them cover 32 million transactions.

In terms of the banks and larger reporting bodies, the reporting performance is generally satisfactory. The improved reporting from the larger financial organisations over recent years has largely come from a combination of improved data specifications, use of newsletters highlighting data issues and direct liaison via the ATO data integrity staff. Further, we have improved our processes for identification of potential data problems and our response time to reporters of the problems. For example, we have set up a forum that includes all of the larger institutions and we use this forum for feedback on new specifications and other matters.