

EXECUTIVE SUMMARY

Inquiry Origins (chapter one)

This inquiry had its origins in the *Sunday* television program screened by the Nine network in mid-1998. In essence, the program alleged that the ATO treats small taxpayers unfairly and inequitably while it goes soft on the “big end of town”. It also made a number of particularly serious allegations, including that ATO staff disregarded hardship provisions in dealing with some small taxpayers; that some senior ATO managers had improperly and corruptly influenced audit activity; and that “organised crime” had infiltrated the ATO.

On the balance of the evidence received, the Committee considers that the *Sunday* program allegations were largely without substance.

The Committee is of the view that inaccurate reporting of such matters can undermine public confidence in the integrity of the ATO. The Committee considers that to offset the negative impact on public confidence, the ATO should respond more actively to correct the public record when required and to publicise initiatives and positions on various issues. The ATO already does this to some extent through its website. Tax Pack and other ATO mailouts may provide further avenues for conveying the ATO’s message.

The Committee received 141 submissions that covered a range of issues including some similar to those raised in the *Sunday* program. The Committee conducted nine hearings in total. These hearings included a significant proportion of *in camera* evidence, reflecting the sensitivity of the subject matter of the inquiry. Witnesses comprised a relatively broad cross section of the community, including current and former ATO employees, private individuals, investment and financial advisory firms, the Taxation Institute of Australia, unions, and both the current and former Special Taxation Advisers to the Office of the Commonwealth Ombudsman. The cross section of witnesses reflected the range of submissions to the inquiry.

Equitable treatment of taxpayers (chapter two)

The law constrains the ATO to protect the Commonwealth’s revenue base, a requirement that obliges it to ensure taxpayer compliance. However, the ATO is also directly accountable to the community through the Taxpayers’ Charter which stipulates the philosophy and standards of treatment taxpayers can expect to receive from the ATO.

The Committee’s assessment of the ATO’s approach to taxpayer equity is that corporately the ATO is committed to treating taxpayers fairly, professionally and equitably; establishing programs and services to support its commitment to equitable treatment; allocating resources appropriately according to identified areas of risk; and addressing problems, improving practices and skills and being responsive to taxpayer concerns.

Most ATO staff have succeeded in managing the challenge of balancing the interests of the revenue with the interests of individuals. However, the evidence shows that some individual officers and local work areas have concentrated solely on the goal of revenue collection, contravening clear ATO corporate guidelines. Pockets remain among ATO staff that are

resistant to the spirit and approach exemplified in the Taxpayers' Charter.

As well, the Committee is disturbed by the comments of the former Special Taxation Adviser to the Ombudsman, Mr Peter Haggstrom, that the ATO was in some cases he investigated intractable and obstructive. The matters Mr Haggstrom raised go to the very heart of concerns that government agencies invested with wide powers discharge those powers properly and fairly, and are subject to adequate levels of transparency and accountability to ensure that this happens.

This underscores the importance of the role of a strong, well resourced and independent Ombudsman as a counterweight to the ATO's powers, an avenue of redress in instances when its powers are misapplied and thus as a check against improper and prejudicial conduct. **The Committee requests that the Ombudsman consider including in his annual reporting on the ATO cases involving prejudicial action by ATO officers and the ATO's response to address such actions. The Committee further requests the Ombudsman to also consider reporting instances where ATO officers have acted to obstruct his investigations** (paragraph 2.42).

The Committee emphasises the point that it considers the ATO to be a highly professional organisation committed to treating taxpayers fairly and appropriately. The Committee does not accept the thesis that there is a systematic prejudice among the majority of ATO staff that treats taxpayers as cheats. That said, it takes only a minority of officers to act prejudicially and improperly for the organisation's public reputation to be marred.

Factors causing inequity (chapter three)

The Committee identified three major factors – inconsistency, taxpayer access to professional advice and administrative unfairness – that lead to or influence cases of inequitable taxpayer treatment.

Inconsistency is seen as the most fundamental cause of inequity in the ATO's operations. The evidence suggests inconsistent practices affect all taxpayer segments, including large business, although there were indications that the problem is less pronounced under the High Wealth Individuals Program.

The differing degrees of taxpayer access to professional tax advice and representation are viewed as a primary cause of inequity in the tax system. Some taxpayers can afford professional assistance in managing their tax affairs, others cannot. Large corporations and certain high wealth individuals are said to employ top-level tax practitioners to out manoeuvre the ATO's compliance strategies.

The main body of evidence to the Committee reflected complaints about administrative unfairness, that is, ATO actions that were said to be at odds with the commitments and spirit of the Taxpayers' Charter. Some of the criticism alleged highhanded behaviour on the part of some ATO officers or sections.

The ATO's tax penalty system is the most common issue of aggravation for taxpayers. The complexity of the penalty system means that it is poorly understood by many taxpayers. Inconsistent ATO practices have also led to inequities in the administration of penalties.

The introduction in 1999 of the General Interest Charge simplifies a large amount of the penalty tax regime and therefore should diminish some of the confusion surrounding tax penalties. **The Committee recommends that the ATO monitor the effect of the General Interest Charge (GIC) on taxpayers, focusing in particular on the extent to which it results in a decline in mistakes and complaints attributed to the complexity of tax penalties; and that the ATO report on its findings in the Commissioner’s annual report to the Parliament** (paragraph 3.40).

The ATO’s debt collection practices are another area where its operations have been criticised. In particular, different practices at the branch and office level of the ATO can impact on the treatment provided to taxpayers, in some instances resulting in action that is either disproportionately harsh or lenient in relation to the revenue at stake. The Committee notes that both the ANAO and the Ombudsman report that the Commissioner has been receptive to recommendations to improve compliance strategies and administrative practices. Significant improvements in debt collection levels reflect this point.

The Committee found that the ATO is addressing the compliance risks posed by persistent tax debtors and serial bankruptcy. Persistent tax debtors in particular include a high number of tax professionals, such as lawyers and accountants, who are in a position to promote or undermine the tax system. To strengthen the measures available to the ATO to counter this problem, **the Committee recommends that the ATO formulate advice to the Government on potential legislative responses to the compliance problem of persistent tax debtors, and in that have regard to the inadvisability of persistent tax debtors and serial bankrupts continuing to practice as tax advisers** (paragraph 3.59).

Mass-marketed schemes (chapter four)

The ATO’s treatment of mass-marketed schemes, such as Budplan and Sentinel, has generated a significant degree of controversy. The ATO portrayed its actions as being consistent with the principles of the Taxpayers’ Charter, ie, balancing the interests of compliance with those of individual taxpayers. In contrast, the ATO’s actions have been challenged and criticised by both promoters and those caught up in the schemes. Over 40 per cent of the submissions to the inquiry concentrated on Budplan and Sentinel.

Mass-marketed schemes pose a major risk to the revenue: to date the ATO has disallowed tax deductions worth \$1.5 billion claimed by 22,000 taxpayers.

The ATO’s approach to handling mass-marketed schemes modified during the time of the Committee’s inquiry. The most notable developments involved the introduction of the Product Rulings System and issuing of consultation draft guidelines on settlement of mass-marketed schemes. The Product Ruling System aims to provide certainty to scheme promoters and investors. It should reduce the risk of taxpayers falling unwittingly into aggressive schemes.

The settlement guidelines are intended as a mechanism which will enable the ATO to treat taxpayers according to the individual circumstances and the “level of mischief” or aggressiveness of the scheme. When implemented, the guidelines should provide relief for

investors caught unwittingly in schemes such as Budplan and Sentinel.

To reduce the risk of improper settlements, **the Committee recommends that the ATO, in finalising the Guidelines on Settlement Principles for Mass-marketed Aggressive Tax Planning Schemes, ensure that in cases involving revenue fraud or other criminal or regulatory offences it is mandatory for case officers to consult with the relevant prosecution, law enforcement and regulatory authorities prior to concluding a settlement** (paragraph 4.55).

The Committee also requests that the Australian National Audit Office consider conducting a performance audit of the Guidelines on Settlement Principles for Mass-marketed Aggressive Tax Planning Schemes one year after they come into force (paragraph 4.57).

The Committee also makes a number of recommendations to improve taxpayer protection and education and address the role of aggressive tax planning designers and promoters:

- **The Committee recommends that the ATO require tax effective scheme promoters to advise existing and prospective scheme participants that a scheme is under consideration by the ATO due to concerns about the scheme’s compliance with the law** (paragraph 4.32).
- **The Committee recommends that the ATO produce improved information to educate taxpayers on their obligations under the self assessment tax system, with particular focus on taxpayer responsibilities when using tax advisers, exercising “reasonable care” and Section 221D tax variations** (paragraph 4.62).
- **The Committee recommends that the Government with input from the ATO formulate legislative measures to deter aggressive tax planning, particularly in relation to persons responsible for designing and promoting such arrangements** (paragraph 4.65).

Large Business and International Division (chapter five)

Assessing the performance of the Large Business and International (LB&I) Division is central to considering the wider issue of the ATO’s equitable treatment of taxpayers. Effective revenue collection from the large business sector is essential if the ATO is to demonstrate to other sections of the community that it is committed to treating all taxpayers equitably.

The soon to be introduced new business tax system has changed the picture significantly from that which faced the Committee at the start of the inquiry. For instance, the “integrity measures” introduced under the new system should not only strengthen the ATO’s ability to address compliance risks but also provide greater certainty and clarity for taxpayers on the intent of the law.

In assessing LB&I’s performance, the Committee found that since 1993-94 growth in total company tax collections has been at a rate higher than growth in Gross Domestic Product. Particular ATO measures behind this growth include a significant increase by 60 per cent in audit coverage of large corporate groups. At the same time, compliance activity has also

raised in additional tax and penalties \$370.8 million in 1995-96 financial year, \$1430 million in the 1996-97 financial year and \$793 million in the 1997-98 financial year.

Technical skills and service are also central to LB&I's performance. Business and tax professionals pointed to general improvements in the ATO's approach but criticised the quality of technical skills in LB&I and the delays in producing assessments and rulings. In contrast, the ATO reported that Quality Assurance reviews show a trend of continuing improvement in LB&I's technical decisions. The Committee considers that the ATO's use of private sector and academic experts to review cases should help promote the technical quality and business relevance of the ATO's decision making.

Concern was raised that the ATO was losing key staff to the private sector. This was seen as not only a factor behind a loss of technical skills but also a threat to the ATO's ability to manage the tax system, particularly large business. The Committee considers, however, that on the basis of the ATO's evidence, the movement of specialist staff from the ATO is not of the magnitude to seriously erode the technical capacity of LB&I.

Nonetheless, the Committee notes the high demand for experienced tax specialists during the current transition phase with tax reform implementation. The ATO needs to monitor the situation closely to ensure that it maintains both adequate expertise and experience and the ability to attract staff with appropriate skills.

Access to taxpayer information is a general problem but is said to be particularly acute for auditors working in the LB&I division. An ATO review revealed, however, that part of the problem lies with audit team work. The ATO has introduced measures to improve audit case management and resolve delays. The Commissioner also signalled in September 1999 a tougher approach by the ATO towards the misuse of privilege to obstruct or mislead compliance audits. The new approach involves more specialist support to field staff and the use of strategic litigation to resolve grey areas of the law and prosecute cases where audit activity is obstructed. **The Committee requests that the Australian National Audit Office consider monitoring the measures proposed by the ATO in respect of Legal Professional Privilege and Accountants Working Papers** (paragraph 5.51).

High Wealth Individuals Program (chapter six)

The High Wealth Individual (HWI) program began in May 1996. It involves an ATO Taskforce engaged in an extensive compliance program. The aim of the program is to enhance the ATO's understanding of the tax planning techniques used by HWIs and the resulting compliance risks. Both the targeting of HWIs and the alleged revenue at risk (estimated originally at \$800 million per year) have been hotly disputed.

The Taskforce's compliance work and results in terms of risk identification reflect, according to research with HWI tax advisers, an overall improvement in the ATO's risk management strategies. The Taskforce played an important role in advising the Ralph Review of Business Taxation. Its research into HWI tax planning has also contributed to other significant tax reforms.

The ATO also reports improvements in revenue collection as a result of the Taskforce's

operations. However, doubt exists over the extent to which revenue has been collected as opposed to being tax in dispute. **The Committee requests that the Australian National Audit Office consider examining the HWI Taskforce’s approach towards handling tax in dispute in the context of its current performance audit of the Taskforce** (paragraph 6.39).

The Committee considers that the ATO has an important role to play in educating the public about the nature and complexity of HWI tax issues. It is important for voluntary community compliance that HWIs are seen to be conforming with the tax system and paying their fair and proper share of tax. Any erosion in community confidence that the tax burden is shared equally is likely to have ramifications for compliance behaviour across society. **The Committee recommends that the ATO include in the Commissioner’s annual report to the Parliament an explanation of the principles which underlie differences between the accounting profits and taxable incomes of HWI controlled entities** (paragraph 6.55).

Client Settlement Guidelines (chapter seven)

A settlement involves the ATO agreeing with a taxpayer to compromise on a “disputed liability to tax”. In other words, the taxpayer’s tax assessment is amended for a lower sum than was raised in the original ATO assessment. The use of settlements is seen by the ATO as consistent with the “good management rule”, which has been upheld and encouraged by the courts.

However, the secrecy surrounding settlements has laid them open to the perception, both in the community and within some quarters of the ATO itself, that they are a device that can be used to provide favourable or “soft” treatment to certain taxpayers, mainly big business or high wealth individuals (HWIs).

On the face of it, settlements make good sense, providing the ATO with the flexibility to enter arrangements that on balance are in the overall interest of the tax system. The onus is on the Commissioner, however, to ensure that settlements are resorted to only when prescribed. If not managed and controlled the potential for settlements to be misapplied or abused is significant.

In September 1999 the ATO issued revised settlement guidelines, titled ‘Code of Settlement Practice’. In general, the revised code amounts to a tightening up of settlement procedures. To further strengthen the accountability and transparency of settlements, **the Committee recommends that the ATO consider formulating advice to the Government on legislative measures necessary to empower it to tape settlement negotiations, particularly in cases involving significant amounts of revenue and/or persistent tax avoiders, tax debtors and aggressive scheme promoters** (paragraph 7.45).

The Committee notes that the operation of the new Code will be audited one year after it came into effect. **The Committee recommends that, to promote transparency and provide assurance about the administration of tax settlements, the ATO report the findings of the forthcoming audit of the new Code of Settlement Practice in the Commissioner’s annual report to the Parliament** (paragraph 7.35).

The Committee also recommends that the Commissioner include in his annual report statistics that show: numbers of cases settled per annum; cases identified by business

line; the difference between tax assessed and paid (by business line); and an explanation of why there are differences between the tax assessed and paid (paragraph 7.32).

Self Assessment and Risk Management (chapter eight)

Self-assessment requires taxpayers to calculate their own liabilities using ATO guidelines, rulings and publications. The self-assessment system raises equity concerns if taxpayers do not consistently conform to self-assessment guidelines. Critics claim the system has weaknesses that encourage tax avoidance.

The Committee notes the concern that the ATO's reliance on risk management to target compliance leaves holes in audit coverage which tax evaders can slip through. The Committee did not pursue the issue of the ATO's management of risks within the self-assessment system to the extent that it is prepared to form conclusions about the matter. However, the Committee considers that further ATO investigation of possible threats to the revenue posed by abuses of the self-assessment system is warranted.

The Committee is also concerned about evidence indicating that local intelligence on revenue risks and leakages collected by field officers is overlooked. It is claimed that the experience and knowledge of long serving ATO operatives is discounted or not utilised fully. There is also a risk that the ATO may be losing invaluable corporate knowledge and field experience as "front line" auditors leave the organisation.

The Committee recommends that the ATO re-assess the effectiveness with which intelligence gathered by "front line" staff is integrated into targeting of compliance strategies (paragraph 8.25). The Committee further recommends that the ATO re-assess the effectiveness of retention and retraining programs for experienced officers and examine how their skills and experience might be better harnessed within the organisation (paragraph 8.26).

Infiltration of the ATO by organised crime (chapter nine)

The *Sunday* program raised a number of serious allegations about possible infiltration of the ATO by persons with criminal connections. The program inferred that the ATO's procedures for detecting criminal activity by staff are inadequate; that there is scope for criminals within the ATO to abuse the self-assessment system; that access to ATO databases about individual taxpayers is relatively uncontrolled and allows criminal elements to circumvent ATO action; and that the ATO has failed to prosecute staff found to have engaged in criminal activity.

The Committee is of the view that no organisation can be fully protected from individuals with criminal intent, and it would be unrealistic to suggest that future examples of criminal activity within the office will not arise. However, the Committee notes that the ATO has developed and implemented a comprehensive range of fraud prevention and control procedures and has subjected these procedures to external review.