

# CHAPTER 1

## REFERENCE, ORIGINS AND THEMES

### Reference and conduct of the inquiry

1.1 On 24 June 1998, the Senate referred to the Senate Economics References Committee the matter of the operation of the Australian Taxation Office (ATO) with particular reference to:

- a) the equitable treatment of taxpayers;
- b) the performance of the Large Business and International Division, including, in particular, the High Wealth Individual Project;
- c) compliance by the ATO with the Client Settlement Guidelines; and
- d) allegations of infiltration of the ATO by organised crime.

1.2 The Senate originally set the reporting date for this inquiry as the last sitting day in August 1998 (20 August 1998). The inquiry was subsequently delayed significantly by a number of factors including the 1998 federal election and the major Senate inquiry into the re-elected Government's proposal to introduce a new taxation system (ANTS). Consequently, the inquiry made slow progress until mid 1999, apart from receiving submissions and conducting an initial public hearing prior to the election. On 17 July 1999, the Committee re-advertised the inquiry in the national press and wrote to all who had previously made submissions.

1.3 The Committee recommenced its public hearing program for the inquiry on 14 September 1999. The Committee conducted nine hearings in total, including the first hearing held in 1998. These hearings included a significant proportion of *in camera* evidence, reflecting the sensitivity of the subject matter of the inquiry.

1.4 The Committee's hearings included four in Sydney, Melbourne and Canberra at which thirteen individuals and eight organisations gave oral evidence. Five hearings with the ATO were also held in Canberra. Witnesses comprised a relatively broad cross section of the community and included 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.

### Range of submissions

1.5 The Committee received 141 submissions in total. Close to half of the submissions focussed on two investment schemes known as 'Budplan' and 'Sentinel'. Submissions also included 17 from current and former ATO officers. While this number was considerably less

than might have been expected,<sup>1</sup> several nonetheless provided the Committee with useful insights.

1.6 The Committee discusses these schemes in more detail in Chapter 4 of this report.

### **Constraints on the inquiry**

1.7 The Committee's inquiry and subsequent report has been somewhat constrained by three factors. These are:

- several witnesses were reluctant to give evidence other than on an *in camera* basis;
- some prospective witnesses expressed concern about possible consequences that might result from giving evidence to the Committee; and
- an awareness on the part of the Committee that some of the evidence received was historical and would not necessarily be relevant to future ATO operations under the new tax system and business tax reforms. While submissions and evidence received by the Committee were based on the ATO as it operated at the time the inquiry commenced, the changes to the tax system will deal with some of the issues and concerns raised.

#### *In camera evidence*

1.8 Of the 21 separate witnesses (including organisations but excluding the ATO) who gave evidence to the Committee, 11 gave their evidence *in camera*. A proportion of the ATO's evidence was also taken *in camera*.

1.9 The Committee subsequently wrote to the *in camera* witnesses with a view to publishing some of their evidence in such a way as to avoid identifying individuals. Three of these witnesses agreed with the Committee's request and the Committee has published their evidence in a separate volume.

1.10 While appreciating the co-operation of those witnesses who agreed that their evidence be published and respecting the decision of those who declined, the Committee nonetheless observes that the taking of extensive *in camera* evidence hindered the inquiry and made corroboration of evidence difficult.

#### *Reluctance to give evidence*

1.11 A small number of other potential witnesses who contacted the Committee's staff expressed a reluctance to give evidence either in public or *in camera* because they held concerns about the possible consequences that might flow from the giving of evidence. This

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1 One of the allegations made on the *Sunday* program was that "literally hundreds of former and serving Tax Office staff helped SUNDAY to investigate what they see as a crisis inside the administration..." (see subsequent section on origin of the inquiry.) If this claim had any veracity, it seems surprising that so few of these people were prepared to contribute to the inquiry.

concern persisted despite the protection offered to prospective witnesses by parliamentary privilege.

1.12 In the absence of an opportunity to hear and question these potential witnesses, the Committee was unable to establish whether their concerns were unwarranted or well based. However, the Committee regards the comments that have been made to Committee members and staff by prospective witnesses as disturbing. It also notes that the former Special Taxation Adviser to the Ombudsman, Mr Peter Haggstrom, encountered similar concerns in some of the cases referred to the Ombudsman's office. When told of the Committee's experience with witnesses who feared possible retribution from the ATO, Mr Haggstrom stated:

I can understand why. We investigated a couple of cases where that was an issue in terms of allegations of improper interest. It is a real concern; it is not a fanciful concern. With some cases it is hard to find specific concrete evidence, but you have an uneasy feeling about why they are interested in a person.<sup>2</sup>

... I do not say that they [some ATO officers] are doing this on a massive scale, but it happens.<sup>3</sup>

1.13 The Committee emphasises that Mr Haggstrom's evidence related to the actions of a relatively small number of individual ATO officers. It is clear from the evidence that ATO management does not sanction the actions of these individuals. Nonetheless, the actions of these individuals reflect on the rest of the organisation and represent an ongoing challenge for senior ATO managers.

1.14 The Committee reminds all concerned that all persons who made submissions to the inquiry and all witnesses are protected by parliamentary privilege both in respect of the act of giving evidence or making a submission and in respect of the contents of that submission or evidence. Any person who is found to have breached the privilege resolutions can expect serious consequences.

### *Tax reform and the inquiry*

1.15 The consideration and passage of the Government's legislation to introduce a new tax system occurred during the course of the inquiry. Further, the Ralph review on business tax reform also presented its report late in the inquiry process, the Government indicating that it intended to implement the majority of the proposed reforms. The Committee is conscious that both of these initiatives will have a profound impact on ATO operations.

1.16 Further, the ATO has already moved to address some of the issues that were apparent early in the inquiry. For example, the ATO introduced the product rulings system, which is intended to minimise the risk of investors being trapped in aggressive tax planning schemes. The ATO has also introduced a number of other initiatives such as client settlement guidelines, which, if adhered to, should address some of the issues placed before the Committee.

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2 See Evidence p. 261, pp 254-255 ('tax officers making threats over the phone') and the case cited by Mr Haggstrom where the actions of some ATO officers could have been construed as an example of retribution.

3 Evidence p.262.

## Origins of the inquiry

1.17 This inquiry had its origins in the *Sunday* television program screened by the Nine network in mid-1998. That program made a number of serious allegations, including the following:

- that the ATO treats small taxpayers unfairly and inequitably compared to large corporations;
- that ATO staff disregarded hardship provisions within the Income Tax Assessment Act designed to assist small taxpayers in financial difficulty and did not inform individuals of their rights to this hardship relief;
- that the ATO was soft on the "big end of town";
- that a tax officer had threatened a disabled pensioner with gaol over a tax debt of \$300;
- that some senior ATO managers had improperly and corruptly influenced audit activity and the imposition of tax penalties;
- that the High Wealth Individuals taxforce had recovered only a tiny proportion of revenue lost to "ports";
- that the ATO had failed to address significant losses to revenue under the self assessment process; and
- that "organised crime" had targeted and infiltrated the ATO.

## ATO response to the *Sunday* program

1.18 At the Committee's first public hearing, the Commissioner for Taxation, Mr Michael Carmody, responded to the allegations of the *Sunday* program in some detail. The ATO also addressed many of the allegations in its submission to the inquiry.

1.19 The Committee examines the wider issues raised by these allegations in the following chapters of this report. However, a number of the allegations were of a quite specific nature and the Committee considers it appropriate that the ATO's response to them be presented at this point in the report.

### *Disregard of hardship provisions, failure to advise taxpayers about them*

1.20 The ATO's evidence demonstrated that the *Sunday* program allegation in relation to a particular case was incorrect. The Commissioner of Taxation, Mr Michael Carmody, advised the Committee that in court proceedings involving the case, the ATO agreed to an adjournment of hearings to allow a relief application by the person who appeared in the *Sunday* program to be heard by the Relief Board.<sup>4</sup> Clearly the applicant was aware that hardship relief was available.

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4 Evidence, p. 12.

1.21 The Commissioner also advised the Committee that training for debt collection staff within the office highlights the existence of the relief provisions. Further, all persons issued with a final notice to pay a tax debt are now informed about the debt relief provisions:

In further pursuance of our commitments in the charter, we have been preparing a brochure on people paying tax so that, whenever we send out a final notice in the future and the next coming months, they will receive, in pursuance of the charter, a brochure further explaining their rights, including the Relief Board.<sup>5</sup>

1.22 The ATO further noted that the Ombudsman's office had examined the matter and found the ATO's actions to have been both sound at law and administratively correct.<sup>6</sup>

*ATO is soft on the "big end of town"*

1.23 The Commissioner emphatically refuted the *Sunday* program allegation that the ATO was 'soft on the big end of town while being hard on ordinary taxpayers'. To support his proposition, he highlighted a wide range of initiatives that he considered demonstrated the ATO's commitment to ensuring all classes of Australian taxpayers receive equitable and fair treatment. These included, among other things:

- establishment of a 'rigorous program' to examine the tax arrangements of some high wealth individuals;
- introduction of the 'Commissioner's guarantee' for Tax Pack users; and
- establishment of a problem resolution service.

1.24 The Committee examines the ATO's equity measures in Chapter 2 of the report.

*Officer threatened taxpayer with gaol*

1.25 The *Sunday* program alleged that a tax officer had threatened a disabled pensioner with gaol over a tax debt of \$300. The ATO advised the Committee that they had been unable to identify the individual concerned, but made two pertinent points about persons with tax debts:

- the law would not permit such a person to be gaoled; and
- for small amounts, debtors are offered the opportunity to pay by instalments or if there is little or no hope of recovering a debt, the ATO ceases all recovery action.<sup>7</sup>

1.26 The Committee acknowledges that the threat, if it was made, was outside the ATO's established processes for recovering debt, which the Committee further examines later in this report.

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5 Evidence, p. 12.

6 Submission No. 83, p. 5.

7 Submission No. 83, p. 7.

*Improper and corrupt influence of audit and penalties*

1.27 The *Sunday* program cited two examples of what they argued was improper influence on audit activity and tax penalties:

- the case of a "prominent politician" whose tax audit was allegedly improperly terminated; and
- the Lion Nathan case.

1.28 The Committee received information from the ATO that convincingly demonstrated that the first case was based on innuendo and was without foundation.<sup>8</sup>

1.29 The Lion Nathan case was more complex and raised wider issues. The Committee was unable to verify the *Sunday* program's allegations, although a departure from procedure by the audit team working on the case gave cause for concern.

The Lion Nathan case

1.30 In respect of the Lion Nathan case, the *Sunday* program alleged that ATO management interfered with the work of an ATO audit team that had assessed a substantial tax liability as being payable by Lion Nathan. The evidence provided by the ATO paints a different picture.

1.31 The controversy associated with the Lion Nathan case arose because of conflicting opinions among ATO staff as to how the case should be handled. The audit team who conducted the Lion Nathan investigation sought an outside opinion from a QC (apparently without authorisation) which was at variance with the ATO decision.

1.32 The Lion Nathan case was, as described by the Commissioner, 'large and complex'. In its submission, the ATO advised the Committee that the case raised complex issues on which there was no established ATO position and accordingly, under the ATO's escalation guidelines, '...these issues should have been referred to more senior officers for resolution'.<sup>9</sup>

1.33 In accordance with public guidelines and established practice, an internal ATO review panel reviewed the position reached by the audit team. The panel also sought advice on a key aspect of the case from the Commissioner's public rulings panel, which includes ATO and external tax experts. The public rulings panel agreed with the internal review panel.

1.34 The Commissioner also advised the Committee that he had asked a second commissioner to review the case. This senior officer also concurred with the panel's decision. Mr Carmody assured the Committee that the audit team had been involved in the review and the decision explained to them. Mr Carmody emphasised that in his view, the matter had been handled correctly and in fact exceeded requirements imposed by the guidelines.

1.35 On the basis of the Commissioner's evidence and the detailed material that the ATO provided to the Committee, it appears that, with the possible exception of the original audit

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8 See ATO submission No. 83, p. 6.

9 Submission No. 83, p. 4.

team itself, ATO officers followed established procedures and there was no improper interference with due process.

#### *Failure to address losses to revenue under self assessment*

1.36 The Committee discusses this matter in Chapter Eight of the report.

#### *Allegations of infiltration by organised crime*

1.37 The *Sunday* program raised a number of serious allegations about possible infiltration of the ATO by persons with criminal connections. The clear inferences of the program were that:

- the ATO's procedures for detecting criminal activity by staff are inadequate;
- there is scope for criminals within the ATO to systematically abuse the self-assessment system;
- access to ATO databases about investigations of individuals is relatively uncontrolled, permitting criminal activity; and
- the ATO failed to prosecute staff found to have engaged in criminal activity.

1.38 The ATO provided the Committee with a detailed response to the allegations. This response included comprehensive information about the ATO's strategies for dealing with the possibility of criminal infiltration, mis-use of information or possible fraudulent behaviour by staff. The Committee notes that the Commonwealth Ombudsman also commented on this matter in the 1998-99 annual report, expressing satisfaction with the Commissioner's initiatives to address the issue.

1.39 The Committee is of the view that the *Sunday* program did not deal with this matter in a responsible fashion and failed to report the issue accurately. For example, the program did not mention that allegations about the first individual, Mr Zagari, dated back to 1988 when he resigned from the ATO, or that the second individual, Mr Ngui, who pleaded guilty to 21 charges under the Crimes Act before resigning, was charged following an internal ATO investigation. The program also failed to mention the substantial changes that have been made within the ATO in the last decade to safeguard the integrity of taxpayer information and which attempts to prevent possible criminal activity by staff.

1.40 It is reasonable to expect that if the *Sunday* program's inferences had any substance, the Committee's inquiry would have been informed of other examples of criminal activity and infiltration of the ATO. The Committee received no credible evidence to suggest infiltration of the ATO by organised crime.

#### **Overall view of the *Sunday* program allegations**

1.41 On the balance of the evidence received, the Committee considers that the *Sunday* program allegations were largely without substance. The Committee notes advice from the

Commissioner that an independent review of the Sunday program, conducted by Stewart Littlemore QC, also concluded that the program was neither fair nor accurate.<sup>10</sup>

1.42 The Committee is particularly concerned that inaccurate reporting of this nature can undermine public confidence in the integrity of the ATO. There are few effective opportunities for redress. 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 opportunities for conveying the ATO's message.

### **Investigation of matter by the Auditor-General**

1.43 The Committee received in-camera evidence of a possible major fraud against the Commonwealth which it was unable to investigate. The Committee advises the Senate that it is in the process of requesting the Auditor-General to consider investigating this matter and reporting his findings to the Parliament.

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10 Evidence, p. 10.