

CHAPTER TWO

EQUITABLE TREATMENT OF TAXPAYERS

Fairness and professionalism are important because the literature of the social psychology of procedural justice shows that when people believe they are treated fairly, they are more likely to comply with the law. *Professor John Braithwaite*¹

2.1 This chapter focuses on the equitable treatment of mainly ‘small’ taxpayers, that is, individual and small business taxpayers. It provides a general view of the issues to emerge in evidence to the inquiry, while Chapter Three focuses on particular areas of concern. It also serves as a basis for comparison with the ATO’s treatment of large business and high wealth individuals, examined in chapters 5 and 6.

2.2 The chapter starts by looking at the challenges facing the ATO in delivering equitable treatment and the key measures it has developed to address equity concerns. The chapter then surveys issues raised in evidence, examining contrasting views of the ATO and the impact of its organisational culture on taxpayer treatment.

Complexity, compliance and equity

2.3 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’² which stipulates the philosophy and standards of treatment taxpayers can expect to receive from the ATO.

2.4 One challenge facing the ATO is to strike a balance between revenue collection and compliance on one hand, and the interests of individual taxpayers on the other.³ For any organisation of approximately 14,000 that handles over 10 million public inquiries annually in a highly complex legal and financial area, striking that balance is not an easy task.⁴

2.5 Providing equitable treatment is an added challenge. The principle of equity does not provide for the trade-offs involved in balancing compliance and individual interests. In principle it is straightforward: all taxpayers should be treated equally in accordance with the tax law. In practice, however, it is not so clear cut. Providing equitable treatment is difficult in a society with economic divisions. For the ATO, this difficulty is compounded by the complexity of the tax system.

1 ‘Through the eyes of the advisers: A fresh look at tax compliance of High Wealth Individuals’, Contract Paper prepared for the Interim Review of the HWI Taskforce, p. 14.

2 Submission No. 83, p. 8.

3 See the quote from the Ombudsman cited by the ATO in Submission No. 83, p. 14.

4 Ibid, p. 8.

2.6 The hurdles that the tax laws pose for the ATO and taxpayers alike are commonly recognised, and are seen as fundamental to any examination of the ATO's operations, notwithstanding the impending reforms under the new tax systems.⁵ As the ATO stated:

The law is now acknowledged as a patchwork of amendments, too complex and too difficult for most in the community to understand. This complexity has spawned its own industry, thirsty for exploitable opportunity, leading to a spiral of further litigation and legislation.⁶

2.7 This statement points to part of the problem. Complexity increases opportunities for tax minimisation and avoidance; these in turn require the ATO to adopt counter measures, creating an ongoing tension in the tax system. It provides the environment for aggressive tax planning, leading to disputes over what is legitimate as opposed to schemes that the ATO sees as tax avoidance and a threat to revenue. The Committee notes that in line with the Ralph Committee review, the intention of the business tax reforms is to introduce a principles based approach that substantially simplifies tax law. Under the reformed business tax system, opportunities for avoidance should be greatly reduced. The Committee sees this as a positive step.

2.8 The other side of the problem is that tax law complexity compounds the inequity between those who can afford professional tax advice and those who cannot. It also causes misunderstanding and inadvertent errors – by both taxpayers and the ATO. It can lead to inconsistent decisions and therefore inequitable treatment by the ATO.

2.9 As this report shows, these issues underlie or affect many of the equity concerns raised in evidence to the inquiry. Before examining those concerns it is necessary to outline the ATO's main measures for addressing equity issues.

ATO equity measures

2.10 The ATO has established a range of measures to address equity issues. These measures are intended to complement the ATO's shift away from treating taxpayers uniformly (ie, 'broad brushing' taxpayers) towards taking individual circumstances more into account. Obviously it is impossible with finite resources to provide individualised treatment to every taxpayer, just as it is accepted that to collect every tax dollar is not feasible. To deal with these restrictions the ATO adopts a risk management approach to collecting tax.

2.11 The risk management approach aims to target resources and tailor compliance strategies according to levels of risk. Higher risk taxpayers are subject to closer checks and audit attention than lower risk taxpayers.⁷ Complementing this strategy is the Taxpayers' Charter and Compliance Model, both of which attempt to avoid the one-size-fits-all approach and apply more individualised measures towards taxpayers.

5 See for example Submission No. 85, p. 5.

6 Note that this statement was prior to the legislation to introduce the Goods and Services Tax and new business tax system. Submission No. 83, p. 1.

7 For discussions of risk management in relation to the ATO, see the following ANAO reports, *Risk Management in ATO Small Business Income*, Audit Report No. 19, December 1997 and *Risk Management of Individual Taxpayer Refunds*, Audit Report No. 27, January 2000, pp. 25, 29.

Taxpayers' Charter

2.12 The ATO's key tool for its treatment of all taxpayers is the Taxpayers' Charter. According to the ATO, 'at the heart of the Charter is the notion that we will treat people fairly and reasonably under the law'.⁸ It outlines the rights and obligations of taxpayers and the service and standards that can be expected from the ATO. The core of the Charter comprises a number of guarantees, the most important of which include the ATO's commitment to:

- treating taxpayers fairly and reasonably; and
- treating taxpayers as being honest in their tax affairs:

The Tax Office presumes that you are trying to deal honestly with your tax affairs and supports you in doing this.... We differentiate between taxpayers who make honest mistakes and those who intentionally disregard their tax obligations.⁹

2.13 The ATO extends the presumption of honesty with the 'Commissioner's Guarantee' in the TaxPack that taxpayers who self-prepare their returns will not be penalised if they make an honest mistake.

Compliance model

2.14 Introduced in 1997, the Compliance Model reflects the ATO's intention to avoid 'broad brushing' taxpayers by taking account of their taxpaying history and current circumstances and treating them accordingly. It aims to match ATO treatment (ie, compliance strategies) with the taxpayer's assessed level of risk (ie, their attitude towards compliance). For instance, a taxpayer whose record demonstrates a willingness to comply with the law requires little attention from the ATO and is left to 'self regulate'. In contrast, taxpayers with a history of resistance or avoidance are subject to firmer measures, including litigation as a last resort. (See the diagram in Appendix 3 illustrating the Compliance Model). The ATO applies the model to both individual taxpayers and industry groups.¹⁰

Targeted equity and access measures

2.15 In addition to the Charter, the ATO has particular measures to assist taxpayers who face barriers (eg, financial constraints) in meeting their tax obligations. These include measures with general application and others that are targeted towards particular community groups, for example:

- hardship relief for taxpayers facing financial difficulties – during 1997-98 the ATO received 3200 applications, of which more than 50 per cent were granted in full; from 1 July 1999 to 1 February 2000 1160 applications were received. Of these, 665 were granted full or partial relief;

8 Submission No. 83, p. 10.

9 The Taxpayers Charter, p. 8.

10 See the ATO's paper on 'The Evolution of Compliance Strategies' to the Committee in ATO Response to Question on Notice 6 August 1998 – E21 to E24, pp. 4-10.

- negotiated arrangements for taxpayers to repay tax debts – of over 550,000 debt cases, currently 114,596 are under arrangement. Put in revenue terms, out of a total debt of \$7.8 billion, there is \$709.5 million under negotiated arrangement;
- free private rulings;
- differential standards in the application of tax penalties – that is, ‘the law requires that a standard of “reasonable care” be taken on amounts [of tax] up to \$20,000, over that, a tougher legal standard applies’;
- Tax Help – a network of community volunteers trained to assist low-income earners, pensioners and those with disabilities to complete their tax returns;
- multilingual staff and publications to support people from non-English speaking backgrounds; and
- the National Aboriginal and Torres Strait Islander Resource Centre in Alice Springs.¹¹

Problem Resolution Service

2.16 The Problem Resolution Service (PRS) is the ATO’s client complaint service. It involves three levels of complaint handling. In the more severe cases known as ‘Level 3’ complaints, cases are at the taxpayer’s request handled independently of the business area concerned. From 1 July 1997 to 31 January 2000 1546 Level 3 complaints were received. Of these, 695 were upheld, 267 partially upheld and 451 not upheld; the balance is in progress. From May 1999 to 31 January 2000, 2386 other complaints were received and handled by the business lines concerned.¹²

2.17 The ATO characterised the above measures in the following terms: ‘the ATO has *ensured* equity for all taxpayers through its systematic policies and practices’ [emphasis added].¹³ However, it is one thing to have equity measures in place, it is another to see that those measures are applied consistently and have their intended effect. The Committee explores the extent to which these measures have been put into practice and staff have complied with them in Chapter Three.

Two views of the ATO

2.18 A striking dichotomy emerged in the evidence on the ATO’s approach towards handling of taxpayers. On one hand, the ATO is viewed as an organisation that strives in the main to provide both effective service and equitable treatment to a large scale client base. This view is summed up in the comment that ‘the ATO carries out a thankless task fairly well’.¹⁴ Particular note is made of the ATO’s concerted efforts to improve its operations across the board and in relation to all taxpayer groups. According to a highly experienced

11 Submission No. 83, passim and ATO update to Committee, 4 February 2000.

12 ATO update to Committee, 4 February 2000.

13 Submission No. 83, p. 15.

14 Submission No. 17A, p. 2.

senior tax lawyer, ‘the ATO has done a great deal to lift its game in terms of achieving consistency ... and] much has been achieved in improving accountability within the ATO’.¹⁵

2.19 Nevertheless, this view also indicates areas where further improvements are needed and problems persist. For instance, while consistency in decision making and treatment has improved, disparities still occur. While the ATO’s senior management has had a positive influence in raising the overall level of professionalism, outmoded attitudes and aggressive behaviour persist with some ‘frontline’ officers. Other factors impact on the treatment of taxpayers. The Taxation Institute of Australia believed administrative inefficiencies, as opposed to unprofessional conduct, are at the root of taxpayer complaints.¹⁶ Arthur Andersen pointed to funding cuts hampering service.¹⁷

2.20 A notable point about this generally positive view is that it reflects the perspective of organisations with extensive experience of the ATO and is based on a range of cases.

2.21 Individual and small business taxpayers presented a contrasting view. This group depicted the ATO as an organisation that is prone to adopting a narrow, process-driven and at times doctrinaire approach towards taxpayers. Based on the cases presented to the Committee, the ATO can appear intractable and bureaucratic, particularly over the imposition of penalties. Communication can be slow, the tone impersonal, and taxpayers sometimes experience difficulties in getting responses to their inquiries. This is in contrast to the efficiency with which the ATO issues recovery notices and the deadlines it imposes on taxpayers to settle matters with the ATO.

2.22 This view of the ATO stems largely from individual taxpayers and involves single cases, some of them long running, rather than reflecting a wide range of experience of ATO operations.¹⁸ However, it should also be noted that, while based on single cases, this viewpoint reflects patterns of treatment which suggest that the cases have common causes and are not random.

2.23 The two views are not mutually exclusive. Indeed, the next section reflects criticisms of the ATO found in both views. Taken together both views present a composite picture of the ATO. The first view offers qualified praise of the ATO’s operations and treatment of taxpayers, noting in particular that inconsistencies occur and that not all officers appear to have embraced the spirit embodied in the Taxpayers’ Charter. This would account, to some degree, for the negative view presented by witnesses critical of the treatment they personally received. But since this second view reflects single cases it is an insufficient basis on which to draw reliable conclusions or make comparisons about the ATO’s treatment of other taxpayers.

2.24 The Ombudsman’s perspective on the ATO represents the overlap between both these views. The Ombudsman’s office receives around 2000 complaints from taxpayers per

15 Mr Mark Liebler AO, Submission No. 85, p. 9.

16 Submission No. 17A, p. 2.

17 Submission No. 6, p.1.

18 An exception is at Evidence, p. 202-208, which reflects the views of a tax partner with 20 years experience dealing with the ATO.

year.¹⁹ Although the number of complaints the Ombudsman receives is minor in absolute terms, it is notable that the ATO accounted for the second largest number of cases received by the Ombudsman's office in 1998-99.²⁰ More importantly, it is the *nature* of those complaints that gives rise for concern. The office is afforded a close insight into the ATO, including its procedures, operations and organisational culture. While the focus is primarily on issues of dispute between taxpayers and the ATO, the Ombudsman has also worked with the ATO to remedy administrative defects and improve procedures, for example, with debt collection practises and formulating the new code of settlement guidelines. On the basis of a major investigation into the ATO's debt handling, the Ombudsman concluded:

The picture we have gleaned is that while the ATO's handling of cases is less monolithic than is frequently alleged, there are nevertheless important cultural and supervisory problems that need to be addressed by ATO management. In some instances, the ATO appears to have taken the least line of resistance with its debtors and, far from being overly aggressive, has often been quite accommodating. Yet in other instances, we have been surprised by the lengths to which the ATO has gone to recover relatively small amounts. This suggests that individual officers, or branch office attitudes, can be decisive in the way a debt is handled.²¹

2.25 This picture is broadly consistent with not only some of the concerns raised in evidence to the inquiry but also community attitudes about the ATO's administration of the tax system, based on ATO surveys. In particular, the ATO's research indicates that:

- about 60 per cent of those surveyed see the ATO as doing a good job overall;²²
- about 50 per cent believe ATO staff are 'really helpful';
- 78 per cent believe that the ATO treats them as being honest unless they act otherwise; and
- 78 per cent believe that the ATO treats them fairly and reasonably.²³

2.26 These are impressive results for an organisation such as the ATO that has the 'thankless task' of collecting revenue and enforcing compliance. But they also indicate significant room for improvement. As the ATO states, 'while these results are encouraging, they are also fragile: we cannot assume they will continue'.²⁴

2.27 Community attitudes are important because perceptions of fairness influence compliance behaviour. Treating taxpayers fairly and taking into account individual

19 Complaints to the Ombudsman for the reporting year 1998-99 were close to 3000. Around 1,100 of those complaints related directly to one issue known as Budplan which is discussed in Chapter Four. See *Commonwealth Ombudsman Annual Report, 1998-99*, p. 37.

20 *Commonwealth Ombudsman Annual Report, 1998-99*, p. 16. Note also that the ATO's Problem Resolution Service also dealt with several thousand complaints in 1998-99.

21 Submission No. 80, p. 8.

22 Commissioner of Taxation, *Annual Report 1998-99*, 20 October 1999, p. 85. Note that this percentage was down from the 70 per cent stated in the ATO's June 1998 Submission to the inquiry.

23 Submission No. 83, p. 2.

24 Submission No. 83, p. 2.

circumstances have a positive effect on compliance. The attitude and conduct of ATO officers towards taxpayers can therefore be critical factors which influence the voluntary compliance nature of self-assessment. The next section examines the contention that ATO has an organisational culture that is biased towards treating taxpayers on the assumption that they are, by and large, tax cheats. It also looks at how ATO handles cases where tax officers are found to have acted improperly.

A ‘tough culture’? Addressing Improper Conduct

2.28 The view assembled by the Committee 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. It is a view encapsulated by the Ombudsman’s overall assessment of the ATO:

The ATO generally makes an honest attempt to balance the interests of revenue collection against the interests of citizens. That balance can be difficult given the nature of revenue collection and the passions it can excite in individuals. The ATO has a wide variety of internal guidelines which are designed to minimise the possibility of individual officers taking inappropriate action.²⁵

2.29 The Ombudsman also pointed out that the ATO faces a considerable challenge in exercising ‘some very intrusive powers’ in an efficient manner that protects revenue but also meets ‘community expectations of what is reasonable official behaviour’.²⁶

2.30 Most ATO staff have succeeded in managing this challenge. However the evidence shows that some individual officers and local work areas have concentrated solely on the goal of collecting the revenue and failed to take regard of other considerations, contravening clear ATO corporate guidelines. In some cases, the actions of individual officers have been upheld on technical grounds at more senior levels of the ATO which can convey the *impression* of an organisational or systemic bias. This impression is countered to some extent, however, by other cases where the ATO has supported taxpayer complaints as witnessed by, among other things, the performance of the Problem Resolution Service.

2.31 A strong theme in the evidence to the Committee indicates that pockets remain among ATO staff that are resistant to the spirit and approach exemplified in the Taxpayers’ Charter. The push at the top of the ATO to adopt an approach sensitive to the special circumstances of individuals has not filtered through to all frontline officers. A mindset persists among some officers which assumes the worst of taxpayers, in contrast to the presumption of honesty contained in the Charter. While this group is seen to be in the minority, the impact of its actions on public perceptions of the ATO is disproportionate to its size.²⁷

25 Commonwealth Ombudsman Annual Report, 1996-97, p. 158.

26 Commonwealth Ombudsman Annual Report, 1996-97, p. 158.

27 See Arthur Andersen, Submission No. 6, p. 6; TIA, Submission No. 17A, pp. 2, 10; Mr Liebler, Submission No. 85, pp.6-7; Mr Haggstrom, Submission No. 141 and Evidence, pp. 246-248, 254-255, 261-262.

2.32 The former Special Taxation Adviser to the Ombudsman, Mr Peter Haggstrom, highlighted the role attitudinal or cultural factors play in the treatment of some taxpayers. In particular, he pointed to the effect the operational environment can have on some ATO officers who are exposed to cases involving unscrupulous taxpayers:

...the starting point for all this is understanding a little bit about tax culture. It is a pretty tough culture. You are sometimes dealing with taxpayers who really do not want to pay any tax at all. It seemed to me that that environment of dealing with people – some people – who really did not want to pay any tax hardened a lot of staff, particularly when they had been there a long time.

What we tended to see was a process whereby, when cases arose, some of the tax office staff were unable to discern the meritorious ones from the unmeritorious ones.²⁸

2.33 Reforming cultural attitudes, and re-aligning them with the philosophy that the ATO wishes to promote, requires strong training and educational programs, as well as adequate supervision and transparency processes. The ATO has invested considerable effort and resources in establishing these measures. The Commissioner advised the Committee that the ATO has engaged personnel recruitment consultants to assist it in selecting new staff with appropriate interpersonal and client liaison skills.²⁹ It has also, in the form of staff counselling, the Problem Resolution Service and funding for the Special Taxation Adviser to the Ombudsman, established mechanisms and avenues of redress to deal with instances where officers act in breach of the Charter and other guidelines.

2.34 The Committee accepts that no system of training, guidelines and supervision can be expected to be fail-proof and that instances will arise, and continue to arise, where officers will act in breach of expected levels of conduct towards taxpayers. As the Commissioner observed, the ATO operates in a complex environment with complex human interactions and it is inevitable that mistakes occur.³⁰ It is essential when mistakes do occur that the ATO takes responsibility for any breach of conduct and does not resile from pursuing the measures necessary to remedy inappropriate behaviour and prevent its likely recurrence.

2.35 It is in this regard that the Committee is disturbed by Mr Haggstrom's comments that, in his capacity as Special Taxation Adviser to the Ombudsman, the ATO was on occasion intractable and obstructive in redressing cases of improper conduct. Mr Haggstrom told the Committee that he encountered, in some cases, obstruction at not only lower levels of the ATO but also among the organisation's hierarchy, that the organisation closed ranks:

If there is a high level of commitment to taxpayers' legitimate interests then why is it that when I wrote to very senior ATO staff I met such resistance in getting what they assert are 'unusual' cases remedied? If the cases are so unusual there ought to be no problem in remedying them.³¹

28 Evidence, p. 246.

29 Evidence, p. 266.

30 Evidence, pp. 269, 285.

31 Submission No. 141, p. 2.

2.36 The matters Mr Haggstrom raises 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. As Mr Haggstrom notes, much depends on the principles and cultural attitudes of the officers entrusted with such powers:

In short the Parliament has invested the Commissioner and his staff with powers that, for practical purposes for most individuals except the very rich, are unassailable. This works reasonably well if the ATO staff concerned are not motivated by ill-will to someone. In this context I have to say that many of the ATO staff I came into contact with in 3 and half years were appalled by the behaviour of some of their colleagues. There is a real core of people in the ATO who have a good grasp of ethics, however, like all large organisations, pockets of resistance to the proper approach exist.³²

2.37 The importance of accountability measures, particularly independent scrutiny and investigation of improper conduct, necessary to safeguard the interests of individuals, cannot be overstated. The ATO possesses wide powers that, due to the nature of tax administration, are open to misuse unless adequate checks and balances are set in place. Those checks require more than internal systems. Independent external oversight is crucial as both an avenue of redress and as a means for ensuring that the organisation addresses inappropriate practices vigorously. By virtue of his experience, Mr Haggstrom's insight is instructive:

... checks and balances are highly dependent on the people who are chosen to protect the public interest. The ATO is not unique in not wanting people to criticise it and in many cases those criticising will have a personal interest in deflecting the ATO from its proper course. However the ATO does do things which are seriously prejudicial and it should be held accountable in such cases. I was uniquely placed to see the full range of ATO interactions with all sections of society and I can assure the Committee that it is dangerously naïve to believe that in all its interaction with people the ATO are objective.

... this is why it is necessary to ensure that while the ATO is allowed to pursue its legitimate ends of extracting the proper tax payable from those who actively don't want to pay, it is also sanctioned when it goes overboard in those cases when the person really can't pay (and hasn't constructed things to achieve that situation) or where its actions are, to use the police context, an exercise of excessive force.³³

2.38 The Committee takes Mr Haggstrom's evidence seriously. It 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 Ombudsman's power to report on the findings of his investigations is an important window of transparency that serves to discourage government agencies from closing ranks and failing to take breaches seriously.

2.39 The Committee considers that the Ombudsman should give consideration to reporting to the Parliament cases where ATO practices have been prejudicial and any

32 Submission No. 141, p. 3.

33 Submission No. 141, p. 4.

instances where it is the view of the Ombudsman that his investigations have encountered obstructions on the part of ATO staff. This would enable the Parliament and its committees to investigate these matters further if it warranted.

2.40 The current tax adviser to the Ombudsman, Ms Catherine McPherson, advised the Committee of areas of improvement in respect of the ATO's treatment of taxpayers. For example, Ms McPherson indicated that she was satisfied that the ATO had largely agreed to the changes to settlement guidelines sought by the Ombudsman and had put new guidelines in place, effective from September 1999. She also indicated that the ATO had agreed to the Ombudsman's proposed changes to debt collection practice.³⁴

2.41 The latest Ombudsman's annual report also indicated that the Commissioner has acknowledged the Ombudsman's concerns about 'the need for cultural change within the ATO as reflected in the tenor of its correspondence, general staff behaviour towards clients and the inconsistencies in practices between different ATO offices'. The Committee notes that the Ombudsman expresses satisfaction that 'the ATO is moving in the right direction'.³⁵

Recommendation

2.42 **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.**

2.43 The Committee signals its intention to encourage its sister committee, the Senate Economics Legislation Committee, to employ its powers under Standing Order 25 (2) (b) to inquire and report into the performance of agencies allocated to it, with the view to scrutinising the conduct of ATO officers, where improper and prejudicial actions are detected or the Ombudsman reports of obstructive conduct arising in the course of his investigations.

2.44 Finally, 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.

2.45 It is crucial that the Commissioner and his senior management address any instances of such misconduct seriously. While small in number, cases involving unfair and harsh treatment can have a disproportionate effect in undermining public confidence in the ATO's administration of the tax system. As noted at the outset of the chapter, community perceptions of fairness are linked to compliance. The confidence of the community's expectation that it will receive a fair deal from the ATO is therefore a key foundation on which voluntary compliance rests. It is a foundation that needs to be protected for the self assessment tax environment to function and be sustained.

34 Evidence, p. 217.

35 Commonwealth Ombudsman, Annual Report 1988-99, p. 38.