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JOINT COMMITTEE OF  
17 OCT 2006  
PUBLIC ACCOUNTS & AUDIT

Our ref: A/2006-103363

10 October 2006

Mr Russell Chafer  
Committee Secretary  
Joint Committee of Public Accounts and Audit  
Parliament house  
CANBERRA ACT 2600

Dear Mr Chafer

**OMBUDSMAN'S SUPPLEMENTARY SUBMISSION TO THE JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT INQUIRY INTO TAXATION ADMINISTRATION IN AUSTRALIA**

Thank you for the opportunity to provide a supplementary submission to the Joint Committee of Public Accounts and Audit (the JCPAA) inquiry into taxation administration in Australia.

At our appearance before the JCPAA on Friday, 28 July 2006, a number of important issues were canvassed. Unfortunately, time did not permit me to fully elaborate my views on these matters on the day. Therefore, I am delighted to be able to provide the JCPAA with additional commentary, in the form of a supplementary submission.

I hope that you will find the submission to be balanced and considered, and that it provides additional useful information on my office's general approach to, perspectives on, and work in the area of Australian tax administration.

I would welcome the opportunity to discuss the submission directly with members, as necessary or appropriate. If you or your staff have any queries about any of the above matters, please do not hesitate to contact Mr Damien Browne on (02) 6276 0156.

Yours sincerely,



Prof. John McMillan  
Commonwealth and Taxation Ombudsman

## **Commonwealth and Taxation Ombudsman**

### **Supplementary Submission to the Joint Committee of Public Accounts and Audit**

#### **Inquiry into Taxation Matters**

At our appearance before the Joint Committee of Public Accounts and Audit ('the Committee') on Friday, 28 July 2006, a number of important issues were canvassed by Committee members.

Unfortunately, time did not permit me to fully elaborate my views on many of these matters on the day. Therefore, I am pleased to be able to provide the Committee with additional commentary, in the form of a supplementary submission. It is best read with reference to both my original submission and the Committee Hansard recording of my appearance on Friday, 28 July 2006.

My primary submission noted key issues relating to the inevitable complexity of tax legislation in today's world; the need for administrative systems and review processes to curb the consequences of that legislative complexity; and the need for continuing improvement in ATO processes, particularly in relation to its educational and information strategies and programs. The comments and observations outlined in my supplementary submission build upon these issues and themes, and as with my primary submission, are based on the experience of my office in dealing with tax complaints and the results of our Own Motion investigations into broader areas of tax administration.

#### *Reform, Change and Certainty*

A recurring issue before the Committee related to the complexity of current tax legislation and administration. Some suggestions for reform were advanced. My office supports ongoing reform to improve and enhance the ATO's administration of tax legislation and policy. However, as a result of our experience in dealing with tax complaints, we are also mindful of the complexities and difficulties that reform can entail.

It is important to emphasise that reform towards simplification can be a double-edged sword. Simplification is not a simple process of itself. Depending on its scope and context, simplification can give rise to what might be described as "downstream" problems. For this reason it is important that simplification, even if it is a desirable outcome, should not be treated as a universal panacea. The experience of our office is that complaints about administration occur in respect of both simple and complex systems.

In November 2003 the Treasurer initiated the Review of Aspects of Income Self-Assessment (ROSA) to examine aspects of Australia's self assessment system for income tax to determine whether the right balance has been struck between protecting the rights of individual taxpayers and protecting the revenue for the benefit of the whole Australian community. ROSA made 54 legislative and administrative recommendations to the current self-assessment system.

In December 2004 the Treasurer indicated that Government would adopt the legislative recommendations with amendments to take effect from 1 July 2005, and that the Commissioner of Taxation would adopt the administrative changes as soon as practicable.

A peak tax body, Taxpayers Australia, expressed the view that the recommendations are a series of realistic, positive and practical measures, which should benefit taxpayers through a reduction of anomalies in the system, greater certainty for taxpayers, and increased transparency and accountability for the ATO<sup>1</sup>.

If effectively implemented, the ROSA recommendations should facilitate significant improvements to structural aspects of the self-assessment framework and provide for a more equitable management of the ATO's relationships with taxpayers. My office anticipates there may well be some reduction in the number of tax complaints overall, or perhaps increased clarity in the content of complaints.

Overall, given the scope and breadth of the ROSA recommendations, there may be benefits in government allowing the changes to 'settle' before embarking on another round of reform. That is, ongoing change is not always conducive to certainty and consistency.

### *Reform and "Downstream" Problems*

Our experience in dealing with complex systems is that change proposals can give rise to unanticipated problems in other areas of administration. There is rarely such a thing as a problem-free solution.

We have observed these difficulties in many reform proposals. For example, the General Interest Charge (GIC) was introduced in part to simplify the previous penalty regime, but was itself seen as creating issues not necessarily foreseen by its original proponents. One such issue was the date at which the GIC should "equitably" apply - the date of an original ATO assessment or the date of any amended assessment. The Shortfall Interest Charge (SIC) has now been introduced to address some of these issues, but has also "re-introduced" a degree of complexity into the penalty interest system. Taxpayers may now have two different rates and periods of interest to contend with, where previously there was one.

Reform proposals invariably envisage tangible benefits to taxpayers. They may well do so, and to this extent may have merit. However, it is also our experience that they invariably have some drawbacks. They can entail significant additional processing and administrative costs. In some instances, they can add to system complexity. In others, they might mandate the introduction of additional accountability mechanisms or processes. Further, they can provide potential for an increase in complaints because there are more stages at which things can go wrong, and more scope for delays.

A case in point is the proposal to allow taxpayers to elect to be fully assessed by the ATO rather than to self-assess. The ATO would be required to administer two different systems, one for self-assessment and one for full assessment. This would add to the overall complexity of the ATO's processes and systems. Full assessment might also duplicate, in part, some of the features of other existing provisions and processes - such as audits and private binding rulings. If the proposal does in fact replicate other tax processes, we must query whether a full assessment process is likely to be any more successful for taxpayers than the current system. If a taxpayer seeks certainty, currently he or she may seek a ruling. If there is a problem with the ruling system providing certainty, it is not immediately obvious how a full assessment system will facilitate greater assurance.

Further, because the proposal adds new steps and processes, it introduces more potential complaint points. For example, taxpayers seeking a full assessment might be required to provide more information to the ATO than would normally be expected. This increases the

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<sup>1</sup> Taxpayers Australia, *Taxpayer*, (Issue 15 2004/05, 14 February 2005, pp.238-247)

scope for dispute about how much information is required, and raises the possibility of downstream compliance action if insufficient or misleading information is provided, even in good faith. While there may be a basis to say that the ATO should carry that burden, the reality is that the ultimate burden will be shifted onto all other taxpayers.

The implementation of an 'election' option could also give rise to problems of a new kind. The ATO would have to find additional funding to cover the costs of:

- conducting a public communications strategy to advise taxpayers of their option;
- developing appropriate policy settings and an adequate procedural framework to give effect to elections and assessments, including perhaps a prescribed form;
- providing for remedial options in the event of disputes as to election and assessment outcomes;
- engaging, training and locating staff to discharge the new function; and
- additional compliance activity, including verification of taxpayer option decisions.

My observations above are intended to highlight that reform proposals need to be carefully analysed and considered, and may benefit from appropriate consultation processes. This leads to my next point - the ATO's willingness to engage in liaison and consultation on new initiatives and proposals.

#### *Reform, Consultation and Cultural Change*

Our experience is that the ATO has made some significant advances in embracing cultural change. The establishment of consultation and liaison groups and oversight bodies reflects an openness to change, a willingness to accept advice and recommendations, and recognition that co-operative collaboration provides tangible administrative benefits.

By way of illustration, my office has worked closely with the ATO to identify a regular project schedule that identifies specific areas of ATO administration for analysis and consideration. Our project schedule has included topics like the ATO's administration of the superannuation co-contribution and the superannuation guarantee, and ATO decision-making in relation to compromise of tax debts, garnishee, release due to serious hardship, and remission of the General Interest Charge (GIC). The ATO has demonstrated a willingness to engage with us on these matters, providing my office with sufficient information to allow us to form considered judgments. One benefit is that we are able to complete measured reports on aspects of tax administration. We see this as providing an important quality assurance mechanism for both taxpayers and the ATO.

The ATO also regularly consults with us, seeking our input during the development of new practices. For example, my office has communicated with the ATO about settlement issues over the last 10 years, both generally and in regard to specific matters such as mass marketed schemes and employer benefit arrangements. In general, we have taken the view that settlement is an appropriate option for parties to resolve disputes. On occasion, we have found it necessary to criticise the ATO's performance and to suggest improvements to the settlement process. Some years ago, our submission to the Senate Economics Committee Inquiry into the Operation of the ATO raised issues regarding absence of settlement procedures, inadequate supervision of settlements, lack of systems to monitor settlement across business lines, the need for taping of settlement negotiations, and broader perceptions about the fairness or otherwise of tax settlements. Chapter 7 of the Committee's 2000 Report dealing with settlement guidelines refers to these matters.

More recently, in July 2005, the Special Tax Adviser in my office wrote to the ATO providing comments on its draft Practice Statement regarding widely-based tax disputes. We believed the draft Practice Statement to be balanced and considered, but made some suggestions

regarding facilitating taxpayer submissions to the Widely-based Settlement Panel and review rights. Subsequently, in August this year the ATO sought our feedback on its latest draft Code of Settlement Practice ('the Code').

In our view, the prime objective of any settlement code is that settlements occur in appropriate cases. For this to happen, we consider that there needs to be an effective Code which provides guidance on when and how to settle; adequate training of staff to administer settlement in accordance with the Code; and appropriate quality assurance mechanisms to check that the settlements are in accordance with the Code. Our concluded view was that the Code appears to provide suitable guidance for the settlement of tax disputes, but further consideration could be given to making provision for some external scrutiny of the settlement register as well as including general statistics about settlements in the ATO Annual Report.

Generally speaking, our suggestions over the years have been accepted and implemented by the ATO, and we believe they have gone some way to improving the ATO's administration of its settlement processes, particularly as they relate to avoidance schemes. The ATO has been responsive and diligent in improving its settlements processes. Of course, if we receive complaints that suggest there are matters which need to be addressed, we will continue to raise them with the ATO.

Importantly, we felt that the ATO's efforts to engage with my office on the efficacy of the Code at an early stage of its development is a substantive illustration of a cultural commitment within the ATO towards open, accountable and responsible administration. We believe that the ATO's collaborative consultative approach enables it to better identify priorities, craft appropriate responses and undertake more focussed reviews of different aspects of its administration. In turn this facilitates salient and targeted improvements.

### **Summation**

Our general experience is that, by and large, the ATO is an effective manager and administrator in the majority of cases. There are instances where its performance does not meet relevant standards, and there are areas where its administration can be improved.

My office supports considered and structured, practical and effective reforms. Importantly, to realise such goals, my office supports continued engagement and consultation by the ATO with external stakeholders and peak bodies.