



## **Submission by the Commonwealth Ombudsman**

### **HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON TAX AND REVENUE: INQUIRY INTO TAX DISPUTES**

Submission by the Commonwealth Ombudsman, Colin Neave

**July 2014**

## INTRODUCTION AND SUMMARY

On 2 June 2014, the Minister for Finance and Acting Assistant Treasurer, Senator the Hon Mathias Cormann, referred a tax disputes inquiry (the Inquiry) to the House of Representatives Standing Committee on Tax and Revenue (the Committee). On 4 June 2014, the Committee adopted the Inquiry and called for submissions addressing the Terms of Reference.

This submission by the Commonwealth Ombudsman (the Ombudsman) provides an overview of the Ombudsman's perspective on disputes between taxpayers and the Australian Taxation Office (the ATO), based primarily on information gathered from complaints made to our office by individual taxpayers and small businesses.

We have identified specific areas of concern in relation to the ATO's management of disputes, including:

- the ATO's engagement with taxpayers prior to the litigation stage
- perceptions of a power imbalance between the ATO and individual taxpayers and small businesses during litigation and the settlement process;
- unnecessary and/or unclear terms of settlement
- poor communication from the ATO to individual taxpayers and small businesses during the dispute resolution process, and
- delays by the ATO contributing to a protracted dispute resolution and/or debt recovery process.

We have recently raised a number of these concerns with the ATO in the context of individual complaints, and we are pleased to note that the ATO has made some improvements, including:

- introducing new initiatives to increase the use of Alternative Dispute Resolution (ADR)
- agreeing to clarify the scope of the Deed of Release which often forms part of a settlement agreement, in particular, agreeing that it will not require taxpayers to withdraw a complaint which they have made with the Ombudsman's office as a condition of settlement, nor place any restrictions on taxpayers discussing the terms of settlement with the Ombudsman's office, and
- taking steps to ensure that communication with taxpayers remains open once a matter had progressed to litigation, such as by providing clear points of contact for taxpayers to utilise in relation to any queries about their tax affairs and/or offers to negotiate once the case has proceeded to a court/tribunal.

The ATO's management of disputes could be further improved by more effective engagement with taxpayers, particularly individuals and small businesses, during the critical time immediately prior to lodging a case with a court/tribunal. An increased focus in this area could reduce the need for litigation and also work to address perceptions that a power imbalance exists between the ATO and individual taxpayers and small businesses during litigation.

The ATO could also generally improve its communication with taxpayers and ensure that undue delays on its part do not contribute to a protracted resolution process.

## BACKGROUND

The Commonwealth Ombudsman safeguards the community in its dealings with Australian Government agencies by:

- correcting administrative deficiencies through independent review of complaints about Australian Government administrative action
- fostering good public administration that is accountable, lawful, fair, transparent and responsive
- assisting people to resolve complaints about government administrative action
- developing policies and principles for accountability, and
- reviewing statutory compliance by law enforcement agencies with record keeping requirements applying to telephone interception, electronic surveillance and like powers.

## RESPONSE TO TERMS OF REFERENCE

The Committee will inquire into and report on disputes between taxpayers and the ATO, with particular regard to:

- collecting revenues due
- fair treatment and respect of taxpayers
- efficiency, effectiveness and transparency, from the perspective of both taxpayers and the ATO, and
- how the ATO supports the outcomes of efficiency, effectiveness and transparency through the use and publication of performance information.

The Committee has indicated that it will examine these issues through the following themes:

- small business
- large business
- high wealth individuals
- individuals generally
- the legal framework for disputes, including:
  - the model litigant rules
  - real time compliance initiatives, including annual compliance arrangements, pre-lodgment compliance reviews, and the reportable tax position schedule, and
  - alternative dispute resolution, and
- the governance framework for disputes, including:
  - the arrangements for and appropriate level of separation between the compliance, investigation, objection and litigation functions, and
  - comparisons with tax administration bodies overseas.

We note that the Committee has requested that the Inspector-General of Taxation (the IGT) undertake a formal review under section 8(3)(d) of the *Inspector-General of Taxation Act 2003* in relation to tax disputes for two of the Inquiry's themes: large businesses and high wealth individuals.

The Ombudsman's perspective on disputes between taxpayers and the ATO is primarily based on information gathered from complaints taxpayers (for the most part, individuals and small business owners) make to our office about the ATO. As well as investigating individual complaints, we objectively analyse complaint issues and outcomes to form a broader view about the ATO's administration. This submission provides an overview of the Ombudsman's unique perspective, with particular regard to the ATO's management of disputes with individual taxpayers and small businesses.

## **COMPLAINTS TO THE OMBUDSMAN REGARDING THE ATO**

In 2013-14, the Ombudsman received 1,369 complaints about the ATO, which represents a decrease of almost 24% on complaints received in 2012-13.

The complaints received by our office about the ATO are most commonly from individual taxpayers and small business owners and relate to:

- delays in receiving income tax refunds
- the ATO's debt collection activities
- audits and reviews conducted by the ATO, and
- superannuation.

Of these, the two key areas of interest in relation to the current Inquiry are complaints about the ATO's debt collection activities, and audits and reviews conducted by the ATO.

### **Complaints about the ATO's debt collection activities**

Debt collection remains a persistent cause of complaints to the Ombudsman about the ATO. During 2013-14, around 21% of complaints we received about the ATO related to debt collection activities.

Individual taxpayers and small business owners with a complaint about debt collection typically explain to us that they are dissatisfied that the ATO has garnisheed their bank account to pay a debt and/or that the ATO would not agree to the payment arrangement they proposed.

The Ombudsman recognises that the ATO has an obligation to ensure that taxpayers pay the correct amount of tax under the law, and we acknowledge that the decision to use garnishee action as a means of collection is one that is open to the ATO to make.

We do not usually investigate the ATO's decision regarding debt payment arrangements. However, where the complaint involves exceptional or unusual

circumstances relating to hardship, the Ombudsman may transfer the matter back to the ATO for reconsideration (under the Second Chance Transfer program)<sup>1</sup>.

## **Complaints about audits and reviews conducted by the ATO**

In 2013-14, around 10% of ATO complaints received by the Ombudsman related to ATO audit activity. This is a slight increase on the previous year (9%), suggesting it is becoming a more common source of complaints to our office.

Individual taxpayers and small businesses typically contact the Ombudsman to complain when they:

- do not understand why they or their business have been selected for an audit
- are concerned at the amount of documentation the ATO has asked them to provide to substantiate their claims
- believe the audit is taking too long to finalise, and/or
- disagree with the ATO's decision to extend the audit beyond the terms initially advised.

Generally, the Ombudsman does not investigate complaints regarding the ATO's case selection decisions and compliance check processes unless there are exceptional or unusual circumstances. The Ombudsman recognises the ATO's responsibility to ensure that taxpayers pay the correct amount of tax under the law and considers that case selection and compliance check processes are consistent with the ATO's role and responsibilities.

The law provides taxpayers with the explicit right to object and to seek a review of the ATO's decisions, including a review by the Administrative Appeals Tribunal (AAT). We encourage taxpayers, particularly individual taxpayers and small business owners who may be unaware of their rights, to exercise their objection and review rights in cases where they disagree with an assessment made by the ATO.

In some circumstances, it is also open for complainants to apply for compensation under the Scheme for Compensation for Detriment caused by Defective Administration (the CDDA Scheme) if they believe they have suffered loss or damage as a result of defective administration by the ATO. We are aware that a number of individuals who have approached our office have successfully applied for compensation under the CDDA Scheme in relation to decisions and actions of ATO audit and objection officers.

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<sup>1</sup> The Ombudsman and the ATO entered into an agreement in July 2013 which involves the Ombudsman referring complaints which had previously been considered finalised by the ATO back to the ATO for reconsideration, where the Ombudsman considers it contains an issue that can be easily resolved by the ATO. The transfer of a complaint under this agreement is called a Second Chance Transfer.

# DISPUTES REGARDING TAXPAYERS AND THE ATO

## Availability of ADR

The ATO has made a commitment to participate in ADR where appropriate in order to resolve matters in dispute (either wholly or partly) as soon as possible without the need for litigation and at minimal cost to the parties.<sup>2</sup>

Consistent with this commitment, we have seen a recent improvement in the ATO's use of ADR. For example, we have been pleased to see the following recent initiatives by the ATO:

- a pilot of in-house facilitators to help negotiations between taxpayers and tax officers in less complex GST objections
- a new independent review process for income tax disputes for large businesses, and
- extended mediation by experts (such as former judges) for resolving complex disputes.<sup>3</sup>

However, we continue to receive complaints, mostly from individual taxpayers and small businesses, about the ATO's conduct during the dispute resolution and/or debt recovery process. Past complaints to our office indicate that the key concerns are:

- the ATO's engagement with taxpayers prior to the litigation stage
- individual taxpayers and small businesses feeling intimidated by the ATO during litigation and the settlement process
- unnecessary and/or unclear terms of settlement
- poor communication from the ATO to individual taxpayers and small businesses during the dispute resolution process, and
- undue delays by the ATO which contribute to a protracted dispute resolution and/or debt recovery process.

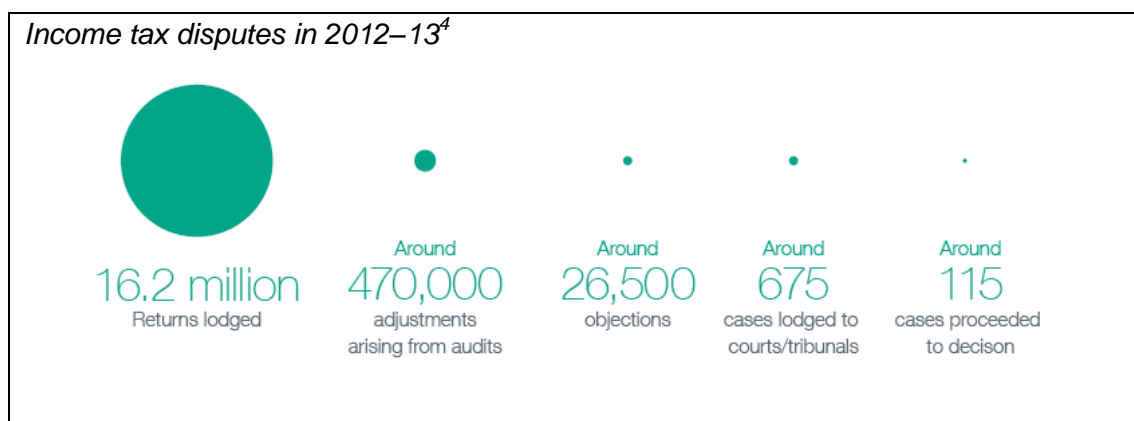
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<sup>2</sup> ATO Practice Statement, PS LA 2013/3, "Alternative Dispute Resolution (ADR) in ATO disputes":  
<http://law.ato.gov.au/atolaw/view.htm?docid=%22PSR%2FPS20133%2FNAT%2FATO%2F0001%22>

<sup>3</sup> ATO Annual Report: <http://annualreport.ato.gov.au/Part-02-Performance-reporting/Resolving-disputes/>

## Reaching an agreement to settle a dispute

Figures provided by the ATO in relation to income tax disputes indicate that only a very small number of disputes proceed to a court/tribunal decision:



The majority of the cases which do not proceed to decision are resolved when the parties agree to settle (with other reasons including that the ATO conceded the case, or the taxpayer conceded the case).<sup>5</sup> The ATO reports that the number of cases settled in 2012–13 increased by 32.4%.<sup>6</sup>

While, on the face of it, these figures are pleasing, they also identify an opportunity for the ATO to work further with taxpayers immediately prior to lodging a case with a court/tribunal. Given that approximately 83% of cases lodged with a court/tribunal are resolved before proceeding to a decision, it appears that resolution of the dispute is possible without a court/tribunal decision in the majority of cases. We also note that some individual taxpayers and small businesses who contact our office state that they initially found it difficult to engage the ATO in negotiations to resolve their dispute, but then suddenly felt pressured to agree to an offer of settlement during court/tribunal proceedings.

If the ATO was able to better engage with taxpayers, particularly individual taxpayers and small businesses, during the critical time immediately prior to lodging a case with a court/tribunal, the need for litigation might be avoided in a larger number of cases. A greater focus on this point in disputes should improve the effectiveness of the ATO's dispute resolution process, as well as address other areas of concern, such as the power imbalance between the ATO and individual taxpayers and small businesses which can become apparent once a dispute reaches the litigation stage.

<sup>4</sup> ATO Annual Report: <http://annualreport.ato.gov.au/Part-02-Performance-reporting/Resolving-disputes/Our-approach/>

<sup>5</sup> ATO, 'Your case matters: Tax and superannuation litigation trends, 3<sup>rd</sup> edition', March 2013, p 5: <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/General-statistics/Your-case-matters---3rd-edition/>

<sup>6</sup> ATO Annual Report: <http://annualreport.ato.gov.au/Part-02-Performance-reporting/Resolving-disputes/Settlements/>

## Perceptions of a power imbalance with individual taxpayers and small businesses

Despite the ATO's increased focus on ADR in recent times, we have heard from some individual taxpayers and small businesses that they initially find it difficult to have meaningful discussions with the ATO when attempting to resolve their dispute (often due to a lack of response or delay), but then suddenly feel pressured to agree to an offer of settlement either immediately before or during court/tribunal proceedings.

Some statements made by these complainants suggest a perceived power imbalance, particularly once a dispute reaches the litigation stage. For example, we have been told that some individual taxpayers and small business owners felt pressured or "bullied" to agree to a settlement with the ATO, felt that the ATO was being heavy-handed in its approach, and/or that the ATO had reneged on informally agreed aspects of their terms of settlement agreement and they now felt powerless to enforce these agreements.

### ***Case study: Mr Y***

Mr Y, a small business owner, complained about the ATO's conduct following an audit of his tax affairs.

Following unsuccessful mediation sessions, the matter was to appear before the AAT. Mr Y complained that half an hour before the hearing was to begin he was presented with new evidence by the ATO (which Mr Y disputed).

Mr Y stated that this new evidence, the presence of several ATO lawyers at the hearing, as well as what Mr Y believed were inappropriate opening comments from the Tribunal Member, combined to make him feel that he had been "caught off guard". Mr Y told us that he felt that he had been presented with an "all or nothing situation" and he reluctantly accepted an offer of settlement.

Mr Y explained that he was aware that he could pursue this matter further through the courts, but the legal options were too expensive for him to pursue.

Following an assessment of Mr Y's complaint, it became apparent that he had not made a formal complaint to the ATO. Consistent with our policy that a complainant must firstly provide an agency with an opportunity to resolve the matter before we become involved, we explained to Mr Y that he would need to make a formal complaint to the ATO. We transferred Mr Y's complaint to the ATO and also explained to Mr Y that he could reapproach our office if he was unsatisfied with the response that he received from the ATO.

The perception of a power imbalance between the ATO and individual taxpayers and small business owners could be alleviated if the ATO increased its focus on engaging with these taxpayers as early as possible, particularly before disputes reach the litigation stage.



## Terms of settlement

One particular aspect of the settlement process which has led to complaints to the Ombudsman relates to Deeds of Release which the ATO often asks taxpayers to sign as part of an offer of settlement. Common areas of concern are that the Deed restricts the taxpayer from making any future claims, as well as confidentiality requirements.

The following case study relates to a Deed of Release presented to a small business owner as part of the settlement of a CDDA claim:

### ***Case study: Mr X***

Mr X, a small business owner, complained to the Ombudsman about a number of matters relating to a long-running and complicated dispute with the ATO which arose following an audit. In particular, Mr X complained about the ATO's response to his claim for compensation under the CDDA Scheme.

The ATO made a compensation offer to Mr X and Mr X was asked to sign a Deed of Release as part of this offer. Mr X was dissatisfied with the amount of compensation offered to him, as well as the terms of the Deed of Release (in particular, the clauses which stated that the release covered claims and liabilities that arose in the future, and that Mr X would be required to withdraw his complaint about the ATO from the Ombudsman's office without referring to the Deed of Release).

We did not investigate the quantum of compensation offered to Mr X by the ATO as that was the subject of ongoing legal proceedings, however, we investigated the terms of the ATO's offer of compensation.

In response to our investigation, the ATO explained that its overall objective was to resolve Mr X's claims and achieve finality in respect of the dispute. We accepted the explanations provided by the ATO regarding the intent behind the Deed of Release and also accepted that it was open to the ATO to make an offer of compensation on the basis of Mr X agreeing to a release in order to achieve finality in respect of the dispute.

However, we suggested to the ATO that it review the terms used in its Deed of Release agreements to ensure that there is greater clarity about the scope and intended coverage of the release (i.e. that it be made clear that the release did not prevent the taxpayer from making a claim in the future, provided that the claim was unrelated to the particular dispute which was the subject of the Deed of Release). We also suggested that the ATO re-evaluate its use of clauses requiring taxpayers to withdraw their complaint to the Ombudsman, including clauses requiring taxpayers to withhold information from the Ombudsman.

The ATO accepted the suggestions made by the Ombudsman and agreed to revise the clause regarding the scope of the release in relation to future claims, and also agreed that it will not require taxpayers to withdraw their complaint with the Ombudsman's office as a condition of settlement, nor place any restrictions on taxpayers discussing the terms of settlement with the Ombudsman's office.

We are satisfied with the ATO's response, and are pleased to report that we have not received any complaints of a similar nature about the terms of a Deed of Release since that ATO agreed to our recommendations.

## **Poor communication with individual taxpayers and small businesses**

One of the most persistent themes in complaints to the Ombudsman about the ATO's management of disputes is poor communication between the ATO and the taxpayer, particularly individual taxpayers and small businesses.

These complainants tell us that they have not received responses to letters regarding offers of settlement, are not given specific points of contact in the ATO to communicate with, and requests for meetings to discuss the matter further are not responded to. In general, the feeling among individual taxpayers and small businesses who complain to us is typically that as the dispute progresses towards the litigation stage, the lines of communication with the ATO close, which inhibits resolution of the matter and increases their feelings of anxiety.

We appreciate that the ATO has taken the view that, once a matter is before the courts, contact with ATO officers outside the legal area of the ATO creates the potential for misunderstandings. However, there is an opportunity here for the ATO to ensure its lines of communication remain open with a view to resolving more disputes without the need to pursue the matter to finality in a court/tribunal. Further, providing better communication to individual taxpayers and small businesses may relieve some of the anxiety experienced by these taxpayers when involved in long and complicated disputes, which could also serve to reduce complaints about the ATO during the dispute resolution process.

### ***Case Study: Ms C***

Ms C, a small business owner who had a long-standing dispute with the ATO, complained that she was finding it difficult to communicate with the ATO. A key source of concern for Ms C was that she was told by the ATO that she was unable to lodge a complaint to the ATO about the ATO's legal department.

We investigated Ms C's complaint. The ATO did not accept Ms C's claim that it had refused contact with her regarding clarification of her legal matters. The ATO explained that there was a period of time when it advised Ms C that it would not communicate directly with her in regards to the dispute as she was legally represented and, as per legal protocols, communication needed to be through her legal representatives. The ATO also explained that it had taken the view that Ms C was seeking to agitate issues that it believed it had explained to her previously and which it believed would be more appropriately dealt with as part of court proceedings.

However, the ATO acknowledged that Ms C had requested advice about how she could complain to it about the conduct of the ATO's solicitor and it agreed that its response to her was inadequate as her concerns were poorly acknowledged and handled.

As a result of our investigation, the ATO wrote a letter of apology to Ms C and informed her about the process for lodging a complaint about the ATO's solicitor.

In cases where ATO investigations are ongoing, some individual taxpayers and small businesses have told us that they feel that resolution of the matter has stalled because of inadequate communication on the part of the ATO.

#### **Case Study: Mr A**

Mr A was involved in a long-running and complicated matter involving investigations by the ATO and the Australian Federal Police (AFP). Mr A complained that he had been unsuccessful in obtaining a satisfactory response to his letters of complaint to the ATO.

Mr A wrote letters of complaint to the Commissioner of Taxation, Deputy Commissioner of Taxation and other ATO officers about the conduct of the ATO during an audit of his tax affairs, however, Mr A believed that the response he received did not answer any of the questions he raised and amounted to obfuscation.

During our investigation of Mr A's complaint, we suggested to the ATO that it provide an additional written response to Mr A which better addressed the matters raised in his letters to the ATO. The ATO subsequently provided a thorough written response to Mr A.

Parallel to this investigation, we also raised more broadly with the ATO the common perception shared by a number of complainants that communication with the ATO was difficult in cases involving complicated and long-running disputes. We were therefore pleased to see that the ATO's additional response to Mr A provided clear points of contact for Mr A to utilise in relation to any further queries about his tax affairs, including direct contact details of a senior ATO officer.

We acknowledge that the ATO has taken steps to improve its communication with taxpayers and we commend the ATO for being receptive to the feedback we have provided to it in this area. However, we believe that there is still room for improvement, particularly in relation to communication between the ATO and individual taxpayers and small businesses immediately before and during the litigation stage.

### **Delay**

Another common area of concern for individual taxpayers and small businesses is delay by the ATO which seems to stall the dispute resolution process. Complaints of this nature generally involve delayed responses from the ATO about offers of settlements, proposals for payment arrangements, or requests for further information from the ATO about specific elements of the dispute.

**Case study: Mr S**

Mr S, a lawyer, complained on behalf of his client, Ms L, about the ATO's conduct during attempts to settle tax debts arising from Ms L's various business entities. Of particular concern to Mr S was unreasonable delay by the ATO, as well as a lack of communication in relation to the ATO's debt collection activities and Ms L's payment arrangement proposals.

Our investigation revealed that for a period of 6 years, an unpaid Director Penalty Notice (DPN) debt remained on Ms L's account but the ATO took no firm recovery action and an administrative oversight meant the debt was not included in a request for debt judgment made during this time. In addition to this, the ATO did not advise Ms L of its decision in relation to her application for General Interest Charge (GIC) remission until almost one year after the original request was made.

Our investigation led us to conclude that there were aspects of Mr S's complaint that could have been mitigated or avoided had either party acted in a more timely way, and had communication between the parties been more complete. We acknowledged that Ms L had a poor compliance history and contributed to the protracted nature of the debt recovery, but the unexplained delay in processing requests for GIC remission contributed to an already protracted debt recovery process.

We suggested to the ATO that this complaint provides a view of potential gaps in its processes concerning debt recovery and GIC remission, as well as gaps in its subsequent communication with taxpayers. We suggested to the ATO that improvements in this area would help to avoid unreasonable delay and protracted debt settlement negotiations.

We will continue to work with the ATO to ensure that it is addressing our concern regarding unreasonable delays in responding to individual taxpayers and small businesses involved in tax disputes. Improvements in this area should lead to a greater sense of clarity about the progress of disputes for these taxpayers, as well as a more efficient dispute resolution process for the ATO.