



Australian Government
Inspector-General of Taxation

Review into the Australian Taxation Office's compliance approach to individual taxpayers – income tax refund integrity program

A report to the Assistant Treasurer

Inspector-General of Taxation

September 2013

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ISBN 978-0-642-74927-7

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18 September 2013

Senator the Hon Arthur Sinodinos AO
Assistant Treasurer
Parliament House
Canberra ACT 2600

Dear Minister

**Review into the Australian Taxation Office's Compliance Approach to Individual Taxpayers –
Income Tax Refund Integrity Program**

I am pleased to present you with my report of the above review which is one of three concurrent reviews examining aspects of the ATO's compliance approach to individual taxpayers.

This review arose out of taxpayer and tax agent concerns regarding extended ATO delays in processing income tax returns held for review under the ITRIP. The ATO has acknowledged that difficulties were experienced in the 2011-12 year but it has since embarked on a significant program of work to improve the ITRIP.

Stakeholder submissions to my review have confirmed the improved experience in 2012-13. However, these submissions also raised a number of concerns, which stakeholders believe have not yet been addressed, including the need for clearer reasons why returns are held and the possibility of early intervention to expedite processing in appropriate circumstances.

In this review, I have made a total of thirteen recommendations some of which are aimed at enhancing the ATO's communication and engagement with taxpayers and tax agents including better differentiation of potentially fraudulent taxpayers from those who may have merely overstated refund claims by mistake. The ATO has agreed in full with twelve recommendations and agreed in principle with the other. The effective implementation of these recommendations should ensure that the ITRIP is further improved for taxpayers, their advisers and the ATO.

I offer my thanks for the support and contribution of professional bodies, tax practitioners and individual taxpayers to this review. The willingness of many to provide their time, expertise and experience in preparing submissions and discussing issues with myself and my staff is greatly appreciated. I also thank the relevant ATO officers for their professional cooperation and assistance in this review as well as officers of other Government agencies which were consulted, such as the Commonwealth Ombudsman.

Yours faithfully

Ali Noroozi
Inspector-General of Taxation

CONTENTS

EXECUTIVE SUMMARY	VII
CHAPTER 1 — BACKGROUND	1
Conduct of the review	1
Individual income tax returns and associated risks.....	2
Pre-issue vs post-issue compliance activities.....	3
What is the Income Tax Refund Integrity Program (ITRIP)?.....	5
What is the High Risk Refund (HRR) program?	9
Management and budget structures in the ITRIP	12
Stakeholder concerns regarding the ITRIP.....	16
Structure of the report	16
CHAPTER 2 — THE ITRIP MODELS	19
The ITRIP models.....	19
Effectiveness of the ITRIP models	21
CHAPTER 3 — THE ITRIP EXPERIENCE.....	29
Causes of delays and the ATO's response	29
Impact on taxpayers.....	35
Impact on tax agents.....	37
Improvements made by the ATO in 2012–13 and planned for future years.....	38
CHAPTER 4 — TIMELINESS AND DELAYED REFUNDS	43
Minimum twelve week delay on processing of returns.....	43
Actual ITRIP timeframes	47
Tax agent visits	50
Opportunities to expedite processing	53
CHAPTER 5 — ATO COMMUNICATION AND ENGAGEMENT	59
Initial communications with taxpayers and their advisers	59
Communicating reasons for holding returns and delays	59
Requesting taxpayer information and related timeframes.....	67
Communicating reasons for adjustments	71

Contacting taxpayers directly 74

CHAPTER 6 — ADJUSTMENTS AND DISPUTATION..... 77

Proportionality of adjustments made 77

Objection and litigation..... 79

Reversals pilot 82

ATO use of default assessments 84

APPENDIX 1 — TERMS OF REFERENCE AND SUBMISSION GUIDELINES..... 89

Background..... 89

Terms of Reference 90

Submission Guidelines..... 91

APPENDIX 2 — ATO RESPONSE 95

EXECUTIVE SUMMARY

The Inspector-General of Taxation's (IGT) review into the ATO's income tax refund integrity program (ITRIP) is one of three concurrent reviews examining aspects of the ATO's compliance approach to individual taxpayers. The ITRIP comprises a series of analytical models designed to detect instances of overclaimed deductions, offsets or other credits in income tax returns. The ATO stops these returns for manual review before any refunds are issued to the taxpayer.

The review arose out of taxpayer and tax agent concerns regarding extended ATO delays in processing income tax returns held for review under the ITRIP. Significant complaints were raised with the Commonwealth Ombudsman, the ATO's Complaints section and the IGT in 2011-12 when higher than expected numbers of tax returns were held (109,000 returns were held when only 33,000 had been expected) leading to extended delays in the processing of those returns. This was exacerbated by the inability of taxpayers or tax agents to ascertain specific reasons for such delays or to have their returns expedited. Moreover, it was contended that the ATO's communication led to the perception that the ATO considered these taxpayers to be dishonest or fraudulent.

Following the experience in 2011-12, the ATO embarked on a significant program of work to refine the ITRIP models and processes to stop fewer tax returns and reduce timeframes. This review confirms that through user-testing of its correspondence, the ATO has improved its communications to affected taxpayers by providing greater clarity of timeframes for release of their refunds. Moreover, through its public communications, the ATO has placed less emphasis on potential fraud as a reason for returns being held to allay taxpayer concerns and anxiety. In relation to concerns that the ITRIP only stopped and adjusted tax returns with small refund amounts, the IGT found that statistics over a three year period indicated that of the stopped returns 5.29 per cent in 2010-11, 1.85 per cent in 2011-12 and 2.87 per cent in 2012-13 contained refunds of \$1,000 or less.

Stakeholder submissions to the review acknowledged the improved experience with ITRIP in the 2012-13 financial year. However, they have raised concerns regarding delays that have persisted, the inadequacy of the ATO's communication and the inability of taxpayers and their agents to intervene early and request their returns be expedited.

The IGT has identified a number of areas for improvement and has made a total of thirteen recommendations aimed at:

- continuously improving the time taken to review cases held under the ITRIP by increasing staff levels at appropriate times and exploring strategies to make use of third party data to verify taxpayer claims;
- adopting a differentiated approach to prioritising and expediting the processing of tax returns in appropriate cases;
- improving the specificity of reasons given for tax returns held and reasons for any adjustments made as a result of the ITRIP;
- continuing to engage with tax agents through site visits and other communications to alert tax agents to ITRIP processes and correspondence which may be sent to their clients;
- adopting behavioural economic concepts and utilising randomised controlled trials to test the effectiveness of correspondence used in the ITRIP;

- raising awareness of cost-effective and efficient dispute resolution strategies to address challenges to ITRIP decisions and monitoring the use of default assessments to limit instances of such assessments issuing to compliant taxpayers;
- maintaining robust and streamlined governance processes to avoid uncertainties, duplication and inefficiencies; and
- developing and maintaining comprehensive reporting systems to measure the effectiveness of fraud detection and treatment strategies.

The ATO has agreed in full to twelve recommendations and agreed in principle with one. In respect of the latter (Recommendation 5.2), the ATO has noted that implementation of the recommendation will require information technology systems and business process changes. Owing to the complexity of some of the proposed changes, the ATO has advised that this will be subject to prioritisation on its Enterprise Solutions and Technology Forward Program of Work.

CHAPTER 1 — BACKGROUND

CONDUCT OF THE REVIEW

1.1 This is the report of the Inspector-General of Taxation's (IGT) review into the Australian Taxation Office's (ATO) Income Tax Refund Integrity Program (ITRIP). It is one of three concurrent reviews examining aspects of the ATO's compliance approaches to individual taxpayers. The other reviews look at the ATO's use of data matching and its administration of the superannuation excess contributions tax. The IGT is also undertaking a related review into the ATO's use of compliance risk assessment tools. The ITRIP is one such tool.

1.2 The report is produced pursuant to section 10 of the *Inspector-General of Taxation Act 2003* (IGT Act 2003).

1.3 This review was commenced pursuant to subsection 8(1) of the IGT Act 2003, following complaints made to the IGT in 2011 and during the IGT's consultation to develop the 2012-13 forward work program. General community dissatisfaction was expressed with the level of delay in the ATO's processing of returns and issuing of refunds that were held under the ITRIP for manual review to investigate identified risks of potentially incorrect or fraudulent claims being made. Stakeholder submissions also expressed concerns about the lack of sufficient communication by the ATO and that the impact of the ITRIP on taxpayers and their agents was disproportionate to the risk that the ATO was seeking to address.

1.4 Notwithstanding acknowledgments by some stakeholders that 2012-13 has seen considerable improvement in income tax return processing times over the previous year, some concerns continue to be raised. Moreover, stakeholders have submitted that an examination of the learnings and improvements made since 2011-12 could provide a strong basis upon which the ATO manages the ITRIP and similar programs in future years.

1.5 Terms of reference for this review were announced on 20 November 2012. A copy of the terms and the submission guidelines are reproduced in Appendix 1.

1.6 The IGT received submissions from a diverse stakeholder group including taxpayers, tax practitioners and their respective representative bodies. The IGT met with interested stakeholders to better understand their experience and those of their clients in dealing with the ATO on this matter.

1.7 The IGT review team also liaised with ATO staff in the Individuals Compliance and Data Management (ICDM) stream of the Micro Enterprises and Individuals (MEI) business line who have primary responsibility for managing the operation of the ITRIP. In addition, the IGT examined case documents from the ATO's enterprise case management system, Siebel, to better understand taxpayer complaints in this area and analysed ATO statistics relating to performance and impact of the ITRIP.

1.8 The IGT also worked progressively with ATO senior management to distil potential areas for examination and to agree on specific improvements.

1.9 In accordance with section 25 of the IGT Act 2003, the Commissioner of Taxation was provided with an opportunity to make submissions on any implied or actual criticisms in this report.

INDIVIDUAL INCOME TAX RETURNS AND ASSOCIATED RISKS

1.10 The ATO currently holds 19.3 million active tax file numbers (TFNs) for individual taxpayers.¹ Under Australia's self assessment system, individual taxpayers are responsible for lodging annual income tax returns in which all assessable income is to be declared and only deductions, offsets and credits to which that taxpayer is entitled are to be claimed. From this information, the ATO processes and determines the net amount of tax payable or refundable to the taxpayer.

1.11 Each year, the ATO receives approximately 12.4 million individual income tax returns, over 10 million of which contain claims for deductions, offsets or credits totalling \$54.1 billion.²

1.12 The ATO acknowledges that within this system there is an endemic risk of taxpayers and tax return preparers lodging incorrect or fraudulent returns. Left untreated, the ATO considers that such risks may result in reduced community confidence, an erosion of voluntary compliance and significant revenue leakage.³

1.13 Given the high volumes of lodgements within this market segment, the ATO employs complex analytical models to risk assess and select certain returns for manual checking. These analytical models are generally contained in the ITRIP⁴ and its predecessor the High Risk Refunds (HRR) program.

1.14 The use of analytical models to detect instances of overclaimed or fraudulent deductions is not ordinarily problematic. However, problems emerge where systems-based issues give rise to extended delays as a result of a misalignment between increased workflows and ATO resourcing and responsiveness. Such delays were experienced by taxpayers and tax agents in relation to the ITRIP in 2011–12.

1.15 It is worth noting that refund and other assessment processing delays are not confined to the ITRIP. As the IGT observed in his *Review into the Australian Taxation Office's Change Program* (Change Program review),⁵ significant delays and associated issues were also identified in relation to the ATO's HRR program.⁶ In that review, the IGT noted the large numbers of income tax returns received by the ATO and not processed within the ATO's 14 day service standard.⁷ The IGT also noted that one of the causes of this delay was the high numbers of income tax returns stopped by the ATO's HRR program which required review

1 Commissioner of Taxation, *Annual Report 2011–12* (2012) p. 39.

2 Australian Taxation Office (ATO), *Compliance Program 2012–13* (2012) p. 10; ATO, *Taxation Statistics 2009–10* (2012), p. 10.

3 ATO, Risk Treatment Plan Income Tax Return Integrity (December 2011), internal ATO document, p. 5.

4 Ibid, p. 7.

5 Inspector-General of Taxation (IGT), *Review into the Australian Taxation Office's Change Program* (2011).

6 Ibid, pp. 70–73.

7 Ibid, pp. 69 and 70.

by ATO officers. The delays in finalising these HRR reviews resulted in notices of assessment being issued late.⁸

1.16 Relevantly, the Change Program review observed the contingencies put in place by the ATO to resolve the delays in HRR reviews, including a redeployment of staff to manually process and release delayed income tax returns.⁹ Notwithstanding this, the IGT noted the ATO's acknowledgement that many of the delayed returns were not as a result of pending taxpayer information or awaiting review by ATO officers. Instead, the ATO conceded that the delays were as a result of other systems-based problems, including the resolution of amendment cases or processing of other return types.¹⁰

PRE-ISSUE VS POST-ISSUE COMPLIANCE ACTIVITIES

1.17 In relation to the endemic risks of incorrect or potentially fraudulent individual income tax returns, the ATO notes:¹¹

Incorrect or fraudulent refunds

Our efforts to tackle incorrect and fraudulent refund claims include both pre-emptive action — warning taxpayers about the risk of potentially incorrect claims before they lodge their returns — and checking all returns for potentially incorrect claims before we issue a refund. We identify potentially incorrect claims through data mining and other analytical tools.

Incorrect claims may involve:

- basic errors and oversights or misunderstanding of entitlements
- a lack of documentation to support claims as required by the law
- lodgment of deliberately false claims
- identity crime.

Where a taxpayer makes incorrect claims as a result of an oversight or error we will work with the taxpayer and their tax agent to reduce the level of errors in the future.

Where it is apparent that deliberate fraud has occurred or the taxpayer has acted recklessly in making a claim, they may be prosecuted and penalties may be imposed.

1.18 Given the different behaviours which may lead to an incorrect return being lodged, the ATO has a number of risk treatment options available to it. These include activities to address accounting or system keying errors as well as compliance activity to verify taxpayers' claims. These activities may be classed as either pre-issue or post-issue.

8 Above n 5, pp. 72 and 73.

9 Above n 5, p. 74.

10 Above n 5, p. 73.

11 ATO, Compliance Program 2012–13, above n 2, p 19.

1.19 Pre-issue activity involves the ATO taking action to correct errors or to verify the details and amounts reported in an income tax return *before* a notice of assessment (and any associated refund) issues to the taxpayer. Post-issue activity is action taken *after* a notice of assessment (and any associated refund) has issued to the taxpayer.

1.20 Under the self assessment system, the vast majority of income tax returns are accepted by the ATO without adjustment and, as such, most compliance verification occurs post-issue.¹² However, post-issue compliance activity brings with it a number of inherent risks including the ATO not being able to properly identify the correct person for audit or review (such as where there has been identity fraud) or incorrectly paid refunds being irrecoverable where assets have been dissipated.

1.21 Accordingly, the ATO takes the view that certain risks should be addressed prior to issuing the notice of assessment and before any refunds are paid to the taxpayer. The ATO's approach in this regard is outlined in Table 1 below.

Table 1: Planned pre/post-issue risk treatment for the ITRIP

Risk behaviour	Preparer/ channel	Tax agent ELS [electronic lodgement service]	Self e-tax	Self Paper	Self IVR [interactive voice response]	Guiding mind (all channels)
	Fraud	Pre-issue	Pre-issue	Pre-issue	Pre-issue	Pre-issue
	Over- claiming	Post	Pre/post	Pre/post	Pre/post	Pre-issue
	Error	Pre-issue	Pre-issue	Pre-issue	Pre-issue	Pre-issue

Source: Pre/post-issue treatment risk management criteria 29 May 2012, ATO Enterprise Risk Manager.

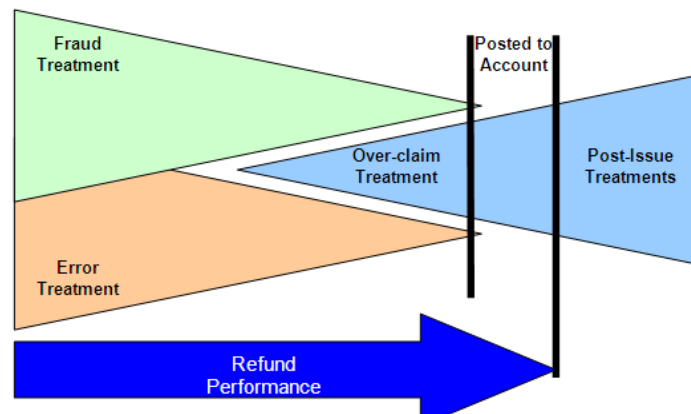
1.22 Table 1 indicates that the ATO will take pre-issue compliance action against clear cases of fraudulent income tax return lodgements, regardless of the channel through which it is received. The ATO further considers that cases in which taxpayers or the ATO clearly made errors, such as entering incorrect data against designated labels in the tax return or other simple keying errors, should also be treated in the pre-issue environment.

1.23 However, in relation to over claiming, the ATO recognises that there is a spectrum of behaviours which may lead to this outcome. In seeking to address this risk, the ATO considers that both pre-issue and post-issue compliance activities may be appropriate depending on, amongst other things, the person who prepared the income tax return, the

12 ATO, Self-Assessment and the Taxpayer webpage (7 March 2013)
<<http://www.ato.gov.au/Individuals/Ind/Self-assessment-and-the-taxpayer/>>.

channel through which the return was received and the quantum of the claims made. The ATO illustrates this differentiation in Figure 1 below:¹³

Figure 1: Differentiated pre/post-issue treatments



Source: Pre/post-issue treatment risk management criteria 29 May 2012, ATO Enterprise Risk Register.

1.24 To facilitate this differentiated risk approach, the ATO utilises the ITRIP and, until its recent integration into the ITRIP, the HRR program to identify which cases should be reviewed pre-issue and those which may be released.¹⁴

1.25 The ATO has advised that the ITRIP does not directly select any cases for post-issue compliance activity. However, post-issue compliance activity can occur indirectly where:

- an auditor expands the scope of a pre-issue audit to include prior year cases if there is evidence of compliance risk in prior years is detected;
- the ATO uses past cases to test new or revised expert business rules prior to implementing these rules in the pre-issue environment;
- reviews are undertaken of cases which were incorrectly released owing to system errors; and
- reviews are undertaken of returns which were released but would otherwise have been selected under expert business rules implemented part way through the financial year.

WHAT IS THE INCOME TAX REFUND INTEGRITY PROGRAM (ITRIP)?

1.26 The ITRIP was developed and introduced in the 2008–09 financial year and commenced operation from 1 July 2009. It comprises a series of analytical models designed to detect errors and potentially fraudulent claims in income tax returns.

¹³ ATO, 'Pre/post-issue treatment risk management criteria' (29 May 2012), internal ATO document, page 4.

¹⁴ ATO, communication with the IGT, 30 May 2013, p. 6.

1.27 As the ATO explains:¹⁵

The Income Tax Return Integrity program detects potentially fraudulent or over claimed refunds through a suite of analytical models that run independently of, but complementary to, the Integrated Core Processing system. The analytical models run in the ATO data warehouse environment and refunds detected by the models for review are then suspended from further processing in the Integrated Core Processing system pending a review as part of the Income Tax Return Integrity program.

1.28 When it was first introduced, the program focused solely on detecting identity crime perpetrated by individuals and networks through the ATO's electronic income tax lodgement system, *e-tax*. In the years which followed, the ATO expanded the ITRIP to examine returns lodged through other channels in addition to *e-tax* and developed systems-based 'expert business rules' to detect risks within specific labels of lodged returns.¹⁶

1.29 A more detailed discussion of the ITRIP models is contained in Chapter 2.

The ITRIP process

1.30 The end-to-end ITRIP process ensures that all individual income tax returns lodged are checked against the ITRIP risk models. This process occurs over a 48 hour period following lodgement. Given that the return is assessed against a range of models and expert business rules, it is possible that one return may trigger a number of different risks.¹⁷ Where a particular return triggers more than one model or expert business rule, the ATO attributes the risk to a single model for checking, based upon a risk hierarchy.¹⁸

1.31 Any return which triggers a risk item in any of the ITRIP models is stopped. System suppressions are put in place to stop these returns from being processed further pending manual ATO review. At the same time that a system suppression is put in place, a work item is created in the ATO's enterprise case management system, Siebel.

1.32 It should also be noted that there is a range of in-built monitoring auto-release rules to minimise returns being incorrectly stopped.

1.33 This end-to-end ITRIP process from lodgement of a tax return to the notice of assessment issuing is illustrated in Figure 2.¹⁹

1.34 Figure 3 is a diagrammatic representation of the current actioning timeline for ITRIP cases, with the ATO's expected timeframes for commencement and completion of each of the steps within the process, including steps for any objections or litigation in relation to the ITRIP adjustment.

15 ATO, Communication with the IGT, 13 March 2012.

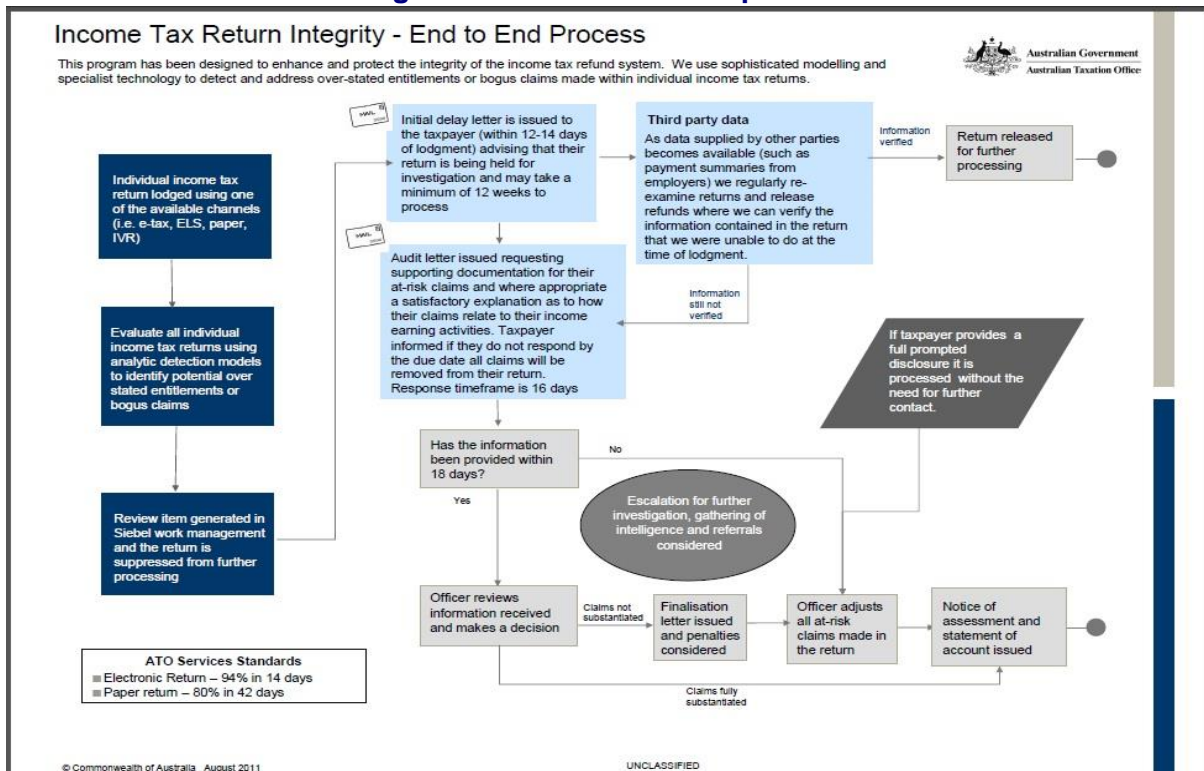
16 ATO, Evolution of the Income Tax Refund Integrity Program – 2009-2013, Presentation to the Inspector-General of Taxation (18 February 2013).

17 Above n 7, p. 8.

18 Ibid.

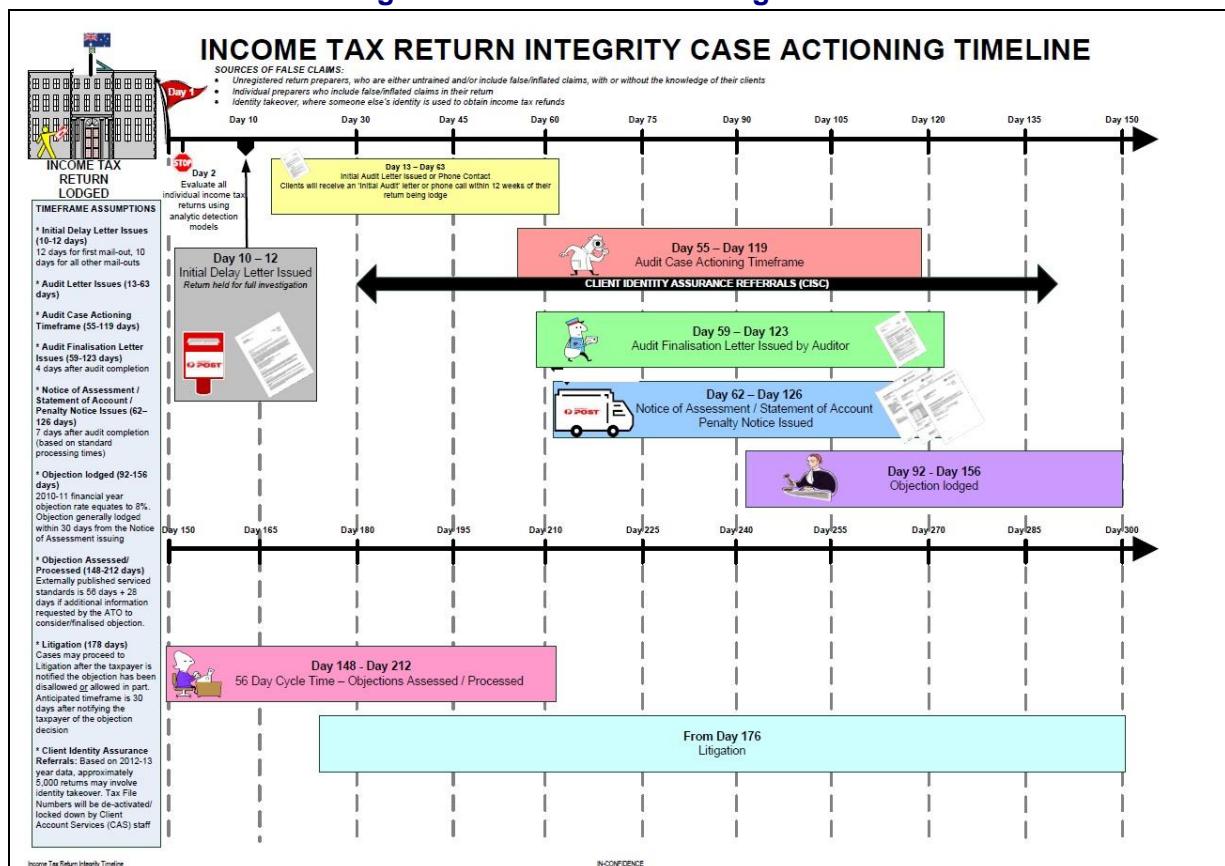
19 ATO, 'Income Tax Return Integrity – End to End Process' (August 2011), internal ATO document.

Figure 2: ITRIP end-to-end process



Source: ATO

Figure 3: ITRIP case actioning timeline



Source: ATO

1.35 As illustrated in Figure 2, after the return has been suppressed, a letter is issued to the taxpayer or their tax agent to advise them that the return has been stopped for further

checking. Figure 3 indicates that in 2012–13, the ATO expected these letters to be sent to taxpayers or agents within 10 to 12 days following lodgement of a tax return.

1.36 Between 13 and 63 days after lodgement, the ATO expects to commence its review of tax returns which have been held. These reviews can involve matching information reported in a tax return with third party data or it can involve an audit of the tax return.

1.37 If the relevant risk is matched and verified against third party data subsequently lodged, for example employers' pay-as-you-go withholding summaries, the return may be processed and the tax refund issued without further action. In such cases, no further interaction occurs between the ATO and the taxpayer or their agent.

1.38 However, where the identified risk cannot be checked against third party data, the ATO will issue an audit letter inviting taxpayers to submit further information or explanations to support their claims with the consequence that claims, which are not sufficiently substantiated, are disallowed.

1.39 Where the taxpayer provides sufficient evidence in support of their claim, the return is released for processing and the refund is issued in due course. However, where evidence is not provided or evidence provided is not sufficient to address the ATO's concerns, the actioning case officer disallows all unsubstantiated items by making adjustments to the tax return before processing.

1.40 The ATO expects that notices of assessment will issue to taxpayers within seven days following completion of the audit. In addition, taxpayers, whose income tax return has been adjusted following an audit, receive a finalisation letter usually within four days of audit completion to outline the reasons for any adjustments made. Taxpayers whose returns are released without adjustment also receive a finalisation letter, and may request further explanation as to why the return was held.²⁰

1.41 As the notices of assessment and audit finalisation letters are issued separately, there is a slight time difference between when each is sent to the taxpayer. The ATO expects that audit finalisation letters would issue between 59 and 123 days after lodgement and notices of assessment would issue between 62 and 126 days after lodgement.

1.42 The ATO has advised that where a return has been checked and adjusted by an officer, an audit indicator is placed against the return to ensure that taxpayers are not able to later reverse the adjustment through lodgement of an amended tax return.²¹ The audit indicator operates to divert such amendments for manual review and verification by an ATO officer before processing is completed.

1.43 It is important to note that ATO officers reviewing returns are required to ensure that the returns are 'correct'. In some cases, the ATO notes that this may lead to a 'negative adjustment'. A negative adjustment is an adjustment which is made in favour of the

20 Above n 15; ATO, 'Income Tax Refund Integrity case actioning timeline' (2013), internal ATO document.

21 Above n 7, p. 6; Above n 15.

taxpayer.²² The rates of adjustments, including negative adjustments, are discussed in Chapter 6.

IGT observations

1.44 The IGT notes that the ATO's case actioning timeline and associated timeframes for 2012–13 are an improvement on those in 2011–12. Outlined in Table 2 below is a comparison between the ATO's expected timeframes in 2011–12 and 2012–13.

Table 2: ATO expected case actioning time frame comparison 2011–12 and 2012–13

Task	Timeframes (number of days following lodgement)					
	2011–12		2012–13		Difference	
	Shortest	Longest	Shortest	Longest	Shortest	Longest
Initial delay letter issued	12	14	10	12	2	2
Initial audit letter issued or ATO phone contact	15	99	13	63	2	36
ATO audit action	57	141	55	119	2	22
Audit finalisation letter issues	61	145	59	123	2	22
Notice of assessment issues	64	148	62	126	2	22
Objection lodged	94	178	92	156	2	22
Objection determined	150	262	148	212	2	50
Litigation commences	180	-	176	-	4	-

Source: ATO

1.45 The IGT further notes from the data contained in Table 2, that in respect of its shortest expected timeframe, the ATO has consistently applied a reduction of two days at each stage of its ITRIP process. The changes to the ATO's timeframe expectations are most pronounced in relation to its longest expected timeframes where it has reduced its expectations by more than three weeks at each stage. Specifically, the IGT notes the 36 day difference in issuing initial audit letters or telephoning the taxpayer and a consistent 22 day reduction in undertaking and finalising audits.

1.46 It should be noted that the above table and associated discussion relate only to expected timeframes. Actual timeframes are discussed in Chapter 4 with some concerns persisting.

WHAT IS THE HIGH RISK REFUND (HRR) PROGRAM?

1.47 The HRR program, which preceded the ITRIP, was established in 2002 and was jointly managed by the MEI and the Client Account Services (CAS) business lines. The aim of the program was to detect refunds classified as 'high risk' based on certain risk criteria. At the time, the ATO defined a high risk income tax refund as a 'potentially incorrect refund

22 ATO, 'IGT Review – Delayed Refunds definitions' (12 April 2013), p. 7.

claimed through an income tax return, that could result in a significant risk to revenue, or that could undermine the community's confidence'.²³

1.48 The risk-based criteria underlying the HRR program were hard-coded into the ATO's National Taxpayer System (NTS). Where a particular tax return triggered these risk-based criteria, the return would be held for pre-issue review by an ATO officer before the return was processed and the refund released to the taxpayer.

1.49 On 1 November 2007, the Australian National Audit Office (ANAO) released its report into the ATO's administration of high risk income tax refunds in the individuals and micro enterprises market segments.²⁴ The ANAO's report made a number of findings including that the ATO had historically only adjusted 3 to 6 per cent of returns held by the HRR program.²⁵

1.50 The ATO also recognised the issues associated with the HRR program. In particular, it observed the tension between estimated and actual risk, the high rate of 'false positives'²⁶ detected by the program and the similar nature of the work undertaken by MEI and CAS, leading to inconsistent work practices across these business lines.²⁷

1.51 Further, the ATO noted that the risk-based criteria underlying the HRR program were difficult to modify, having been hard-coded first into the NTS and then later into the Integrated Core Processing (ICP) system as part of the ATO's Change Program.²⁸ An internal ATO project document also noted that:²⁹

An internal audit conducted late in 2011 by Internal Fraud Prevention and Control identified that the current High Risk Rules were at risk of not reflecting current and emerging risks due to the lack of regular reviews of the rules and have recommended that Client Account Services undertake this review on an annual basis.

1.52 The ATO has advised that in the 2011-12 financial year it commenced a project to consolidate aspects of the HRR program concerning individual income tax compliance and the ITRIP. It notes that the project was initially approached in a piecemeal fashion with a more formal review commencing in earnest in November 2011.³⁰

1.53 Through this program of work, the ATO aimed to deliver, amongst other things, a 'pre-issue environment managed consistently and effectively for the individual market' and 'an end-to-end risk differentiated treatment strategy based on risk and client behaviour

23 Australian National Audit Office (ANAO), *Administration of High Risk Income Tax Refunds in the Individuals and Micro Enterprises Market Segments*, Report No. 12 (2007-08) p. 12.

24 Ibid.

25 Ibid, p. 13.

26 Where the HRR program incorrectly detected a risk against certain tax returns when in fact no risk existed; see Manish Gupta and Vishnuprasad Nagadevara, 'Audit selection strategy for improving tax compliance – application of data mining techniques' in Ashok. Agarwal and V. Venkata Ramana (eds), *Foundations of E-government* (2007) p. 378.

27 Above n 16.

28 Above n 5, p. 6.

29 ATO, 'Project Outline: Individuals Pre Issue Re Design,' (9 February 2012), internal ATO document, p. 4.

30 Ibid.

which delivers an optimum client experience to the community, including meeting service standards.³¹

1.54 The ATO has advised the IGT that as at 1 July 2013 those aspects of the HRR program which concerned individual taxpayer compliance have been fully integrated into the ITRIP. As a result, the HRR rules which focused on individual taxpayer compliance risks have been replaced with expert business rules as part of the ITRIP.³² As this would only impact 2013–14 and subsequent years, it was not possible to comment on the effectiveness of these measures during this review.

1.55 Other aspects of the HRR program, such as those rules relating to accounting errors which do not present a compliance risk, or those relating to non-individual income tax returns, have not been integrated and will continue to be managed by the CAS business line.

1.56 Prior to 1 July 2013 and during the period of time relevant to the IGT's current review, the ITRIP and HRR program operated in tandem. All returns lodged in a particular year were run first through the ITRIP risk models prior to being processed through the ATO's ICP system. Where a return triggered risks in an ITRIP model, that return was suspended and routed to a relevant ITRIP team (or a Tax Agent Strategy team, in certain cases) for manual review before further processing.³³

1.57 Any returns which had not triggered the ITRIP and which required a refund to be made were then run through the HRR program. If a HRR risk was identified then the relevant tax return is routed to either a CAS or MEI HRR team for review and processing. The ATO had advised that returns which triggered the HRR program were allocated to CAS and MEI on a 50/50 basis rather than on the basis of the identified risk needing to be addressed.³⁴

1.58 Once a tax return was examined and cleared by the ITRIP, it is also run through the HRR program before processing was finalised and a notice of assessment issued to the taxpayer. This interaction between the ITRIP and the HRR program is illustrated in Figure 4 below.

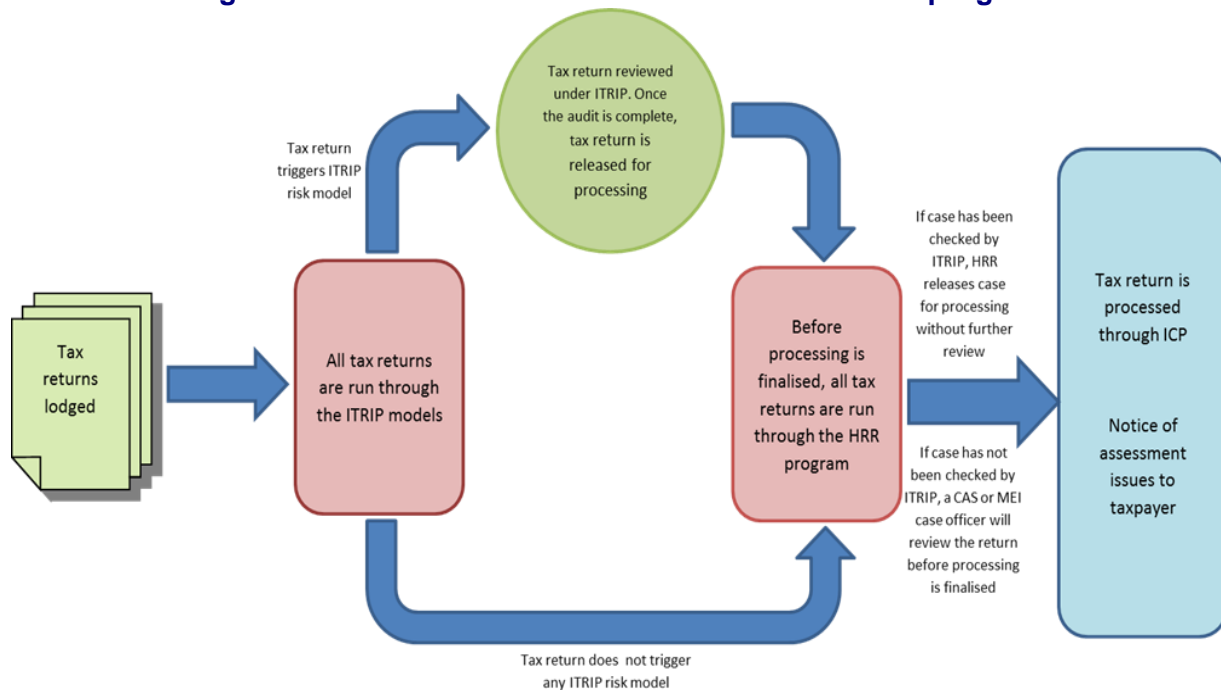
31 ATO, 'HRR and ITRI Current State and Issues' (December 2011), internal ATO document.

32 ATO, Office Minute to Deputy Commissioner, MEI (21 June 2013); ATO, Accounting Integrity Business Management Group, Minutes (27 June 2013); ATO, Credit Refund Business Management Group, Minutes (September 2012); ATO, Office Minute to Assistant Deputy Commissioner, MEI (August 2012).

33 Above n 31.

34 Above n 31.

Figure 4: Interaction between the ITRIP and the HRR program



Source: Adapted from ATO information.

1.59 The ATO has advised the IGT that the rules for the HRR program and the ITRIP were designed to detect different risks. The IGT has also been advised that the potential for a return to trigger both the ITRIP and the HRR program were small. Where there was such a double trigger, the HRR processes required the relevant officer to investigate whether the return had been the subject of review under the ITRIP. If so, the return would be processed and the tax refund issued to the taxpayer without further HRR action.

1.60 As there were different processes and risk treatment strategies used by each of the areas administering the ITRIP and the HRR program, taxpayers would have been subject to different approaches, correspondence and expected completion times.

MANAGEMENT AND BUDGET STRUCTURES IN THE ITRIP

ITRIP management and governance

1.61 There are three broad levels of management oversight and governance for the ITRIP. Generally, these are placed at the ATO-wide, sub-plan and business line levels. The different forums at each of these levels are outlined below:³⁵

- ATO-wide level — the ITRIP is overseen by the ATO Executive which is headed by the Commissioner of Taxation, the Tax Crime Steering Committee, the Income Tax Steering Committee and the Service Improvement Steering Committee;

35 ATO, 'Micro Enterprises – Individual Income Refund Integrity Program – Governance Structure' (December 2012), internal ATO document.

- Sub-plan level — there is the Compliance Executive headed by the Second Commissioner, Compliance, the Active Compliance Steering Committee, the Tax Time Steering Committee, the Tax Time Nerve Centre, the Account Integrity Steering Committee, the Account Integrity Senior Business Management Group and the Tax Practitioner Steering Committee; and
- Business line level — the primary oversight forum is the MEI Executive which is headed by the Deputy Commissioner MEI, the MEI Risk Management Committee, the Active Compliance Forum and the Refund Integrity Project Stakeholders Meeting.

1.62 The ATO has advised that, with the exception of the Account Integrity Steering Committee and the Account Integrity Senior Business Management Group, the other committees and forums at the ATO-wide and Sub-plan levels have no direct decision-making role in the ITRIP. It notes that all functional and operational decisions relating to the ITRIP are made at the business line level by the relevant Assistant Commissioners within the MEI business line, with ultimate decision-making responsibilities residing with the Deputy Commissioner of the MEI business line.

1.63 The IGT acknowledges that a large scale compliance initiative such as the ITRIP requires robust oversight and governance. However, there does seem to be a large number of committees involved at each of the above three levels even if not all of them have decision-making powers. There is a risk of over-governance resulting in duplication, inefficiencies and uncertainty relating to ownership of issues needing resolution.

ITRIP budgeting and staff allocation

1.64 The ATO allocates a certain portion of its general funding to the ICDM stream for the purposes of administering the ITRIP and the associated reviews and audits. The ATO refers to this as ‘business as usual’ funding

1.65 Table 3 below outlines the funding which the ATO has allocated and proposes to allocate to the ICDM stream between 2011–12 to 2014–15.

Table 3: ICDM budget and staffing

	2010–11	2011–12	2012–13	2013–14	2014–15
Budget Allocation	-	10,748,505	13,684,548	14,891,000	13,114,000
Full time equivalent staff	-	121.54	144.60	124	105

Source: 2011–12 and 2012–13 are based on information provided by the ATO to the IGT. 2013–14 and 2014–15 projection figures are sourced from an internal ATO staffing request document.

1.66 In addition to the ATO’s existing budget funding, the ITRIP has also received substantial financial support from government. In 2011, the-then Assistant Treasurer announced that the government would provide additional funding to the ATO to address ‘a substantial increase in fraudulent tax refund claims.’³⁶

1.67 In the 2011–12 Federal Budget, the government committed to provide \$54.6 million over four years to the ATO for the purposes of addressing fraudulent tax refund claims.

36 Bill Shorten MP, Assistant Treasurer, *Improving Tax Fairness and Compliance*, Media Release, 10 May 2011.

Specifically, the additional funding and expected revenue in fiscal balance terms over the four financial years 2011–12 to 2014–15 are as follows:³⁷

Table 4: Government budget funding

Revenue (\$m)	2010–11	2011–12	2012–13	2013–14	2014–15
Australian Taxation Office	-	63.9	67.2	59.3	42.2
Related expense (\$m)					
Australian Taxation Office	-	14.4	15.1	14.3	12.6

Source: Budget Measures 2011–12, Budget Paper No. 2

1.68 The government expected that, in underlying cash terms, there would be an estimated increase in receipts of \$225.6 million over four years.³⁸

1.69 The ATO has provided information from its Revenue Analysis Branch (RAB) to outline the levels of revenue raised or protected and the level of cash collection which it has achieved as well as its forecasts for meeting its commitment to government. These are outlined in Table 5 below.

Table 5: Liabilities and cash collection as a result of the Budget measure

Year	2011–12	2012–13	2013–14	2014–15
Expected liabilities raised or revenue protected (\$m)	67.2	70.8	62.4	44.4
Actual liabilities raised or revenue protected (\$m)	67.23	68.4539	-	-
Expected cash collections (\$m)	60.4	64.7	58.1	42.4
Actual cash collections (\$m)	60.4	-	-	-

Source: ATO, Revenue Analysis Branch

1.70 Table 5 indicates that in relation to the levels of revenue expected to be raised or protected (that is, refunds prevented from issuing where the taxpayer is unable to substantiate the claims), the ATO exceeded its forecasts in 2011–12 and in the year to date (to April 2013) has achieved revenue levels of \$68.45m, which is 96.7 per cent of its expected level, for 2012–13.

1.71 The ATO further notes that it achieved its expected cash collection levels in 2011–12. As the 2012–13 financial year had not ended when the RAB provided the above information, the level of cash collections for that year are not presented in this report.

1.72 The ATO has advised that based on the levels of revenue raised to April 2013, and the level of cash collections achieved in 2011–12, it is confident that it will be able to meet its commitments to government.⁴⁰

37 Treasury, Budget Measures 2011–12, Budget Paper No. 2, p. 46.

38 Ibid.

39 This figure represents revenue raised or protected by the ATO in the year to date as at April 2013.

40 ATO, Communication with the IGT, 16 May 2013.

How the ATO measures its commitments to government

1.73 In discussions with the ATO, the IGT was advised that the additional ITRIP funding was added to the existing funding already allocated by the ATO. As such, the ATO does not measure and report its ITRIP commitments to government under a separate project.

1.74 Instead, when calculating ITRIP revenue which could be generated by the extra funding, the ATO undertakes these calculations by reference to an expected base revenue amount. The base revenue amount is calculated from past data and represents the amount of revenue the ATO expects to have protected or raised without the government funding. The ATO then revises its expected base amount in accordance with the additional government funding. For example, if the additional funding represented a 20 per cent increase over the 'business as usual' funding then the ATO would increase its expected revenue by 20 per cent.

1.75 The ATO allocates and reports the total revenue raised or protected on a pro-rata basis as against its 'business as usual' funding and the government funding. As such, where the ATO meets or exceeds its revenue expectations, it can report that it has met its commitments both in terms of 'business as usual' and to government. Conversely, where the ATO does not meet its revenue expectations, it will report a shortfall in relation to its 'business as usual' and government commitments.

1.76 The ATO indicates that where appropriate, it will look to first allocate revenue to its 'business as usual' before accounting for government commitments. Where government funding does not result in a separate project being commenced, the ATO advises that there are no circumstances in which it would account for government commitments first. In the ATO's view, this minimises the risk of perception that it is 'cherry picking' reported revenue figures to demonstrate that it has delivered on expected returns from a particular funding measure.

1.77 The IGT notes that the ATO's approach essentially measures the difference between expected revenue without government funding and actual revenue with government funding. Such an approach may provide an indication of the effectiveness of additional government funding in these areas. However, it is important to note that changes in the level of revenue raised or protected in any given year may be influenced by a range of extraneous environmental factors not related to funding and resources.

1.78 The ATO recognises this and indicates that in its revenue estimates and forecasts, it seeks to account for market drivers and other factors which may impact the level of revenue protected under the ITRIP. As outlined in its 2011-12 Annual Report, these extraneous factors include global economic conditions, the strength of the Australian dollar, legislative change and judicial pronouncements, all of which have a bearing on the level of collections.⁴¹

1.79 The ATO has further advised that impacts which are not accounted for when revenue estimates are generated are taken into account by the ATO when finalising its reporting. However, notwithstanding this, it is unclear to the IGT how the ATO specifically accounts for these factors in finalising its reports in relation to certain Federal Budget measures.

41 Above n 1, pp. 57, 68, 72.

STAKEHOLDER CONCERNS REGARDING THE ITRIP

1.80 In 2011–12, the ITRIP stopped more returns than was previously estimated by the ATO, resulting in significant delays in processing. These delays and general community dissatisfaction gave rise to significant media attention as well as complaints made to the ATO itself,⁴² the Commonwealth Ombudsman⁴³ and the IGT.

1.81 Flowing from this experience, the ATO undertook work to improve the ITRIP and the overall taxpayer and tax agent experience when dealing with ITRIP matters.

1.82 Consultations and submissions from stakeholders conveyed to the IGT have welcomed the improvements made by the ATO but some concerns remained. These may be broadly summarised as follows:

- a perception that the ITRIP is not accurately detecting cases of incorrect or fraudulent claims;
- the ATO's processes for reviewing returns stopped by the ITRIP could be more timely and there is still no mechanism for early intervention to expedite processing;
- the actions taken under the ITRIP are perceived to be disproportionate to the risks posed;
- the ATO is not clearly communicating with taxpayers and their advisers in a timely manner, particularly in providing reasons for certain returns being stopped or for adjustments being made with sufficient specificity;
- the ATO is not affording taxpayers sufficient time to address its concerns before making adjustments; and
- the ITRIP is adversely impacting both taxpayers and their tax agents through increased anxiety, cash flow problems and agents undertaking work which is not billable.

STRUCTURE OF THE REPORT

1.83 The remainder of the report examines the ITRIP in detail, seeking to address the concerns and identify opportunities for improvement. It is structured as follows:

- Chapter 2 discusses the ITRIP processes, the models which comprise the ITRIP and the effectiveness of the ITRIP in identifying at-risk income tax returns requiring manual review; and
- Chapter 3 examines the taxpayer and tax agent experience, relating to ITRIP delays in 2011–12, which gave rise to much of the concerns underpinning this report and the general improvements made by the ATO in 2012–13.

⁴² The ATO received 7,381 unique complaints in 2011–12 for the ITRIP compared with 1,269 complaints in 2010–11.

⁴³ Commonwealth Ombudsman, Submission to the Joint Committee of Parliamentary Accounts and Audit Annual Hearing with the Commissioner of Taxation (September 2012), p. 4.

1.84 The following chapters explore further opportunities for improvement in the administration and management of the ITRIP:

- Chapter 4 outlines the delays experienced by taxpayers arising out of the ITRIP and looks to identify opportunities to minimise those delays and to mitigate the impact on taxpayers;
- Chapter 5 examines the ways in which the ATO communicates and engages with taxpayers and their agents throughout the ITRIP process; and
- Chapter 6 looks at the proportionality of adjustments made by the ATO as a result of the ITRIP and the level of disputation this has generated.

CHAPTER 2 — THE ITRIP MODELS

THE ITRIP MODELS

2.1 The ITRIP comprises a suite of income tax risk models which use ‘a series of known behavioural attributes and fraud indicators to build a risk profile for individual income tax returns’.⁴⁴ The current suite of models are the identity crime and network detection model, the ‘expert business rules’ model and the pattern detection model. Each of these is discussed below.

Identity crime and network detection model

2.2 The ATO has advised that the identity crime and network detection model ‘uses known attributes of identity fraud to detect high risk returns using pre-set thresholds. Networks linked to this high risk population are subsequently identified and their size, value and growth assessed’.⁴⁵

2.3 The identity crime and network detection model aims to detect cases of potential identity fraud, such as where a taxpayer’s details have been stolen and a tax return lodged in their name with any refund due being paid to another person or entity other than the taxpayer themselves. This model also utilises analytics to:

- identify commonalities between different returns;
- identify possible networks of perpetrators of fraud lodging such returns; and
- to seek to address this risk by attacking the networks rather than the individual preparers.

2.4 The ATO advises that this model is currently applied to lodgements received from all channels. It is owned and managed by the Serious Non-Compliance (SNC) business line. Due to the high risk and severity of identity crime, the inputs to this model are considered highly sensitive and the ATO quarantines access and authorisation to modify the model to a limited group of officers within that business line.

Expert business rules model

2.5 The ATO defines the expert business rules model as:

... a suite of rules constituting both label-based rules with risk-based criteria, and watch lists of suspect individual identifiers (tax file numbers, bank accounts, IP addresses and ESIDs

44 ATO, Senate Estimates Briefing, October 2012.

45 ATO, ‘Risk Treatment Plan – Income Tax Refund Integrity’ (September 2012), internal ATO document, p. 8.

(computer identifiers), ABNs). The structure is flexible to facilitate response to emerging fraud issues.⁴⁶

2.6 The expert business rules model seeks to identify abnormalities recorded at specific labels within the tax return, claims in risk areas identified by the ATO or income tax returns which bear suspicious indicators on the ATO's watch lists, such as TFNs or bank accounts the ATO considers to be compromised.

2.7 To illustrate certain risks the expert business rules seek to address, the following sample is provided:⁴⁷

- claims for spouse offset to which the taxpayer is not entitled;
- claims for education tax refund when the taxpayer appears to be too young to support a dependent school age child;
- inflated amounts of tax withheld or fabricated employer details in relation to payment summaries; or
- returns which contain references to TFNs or bank accounts which are currently on the ATO's watch lists as representing a risk to the revenue or the taxpayer.

2.8 The expert business rules model is generally responsible for stopping the majority of returns which are held for review under the ITRIP. In particular, the ATO notes that the rules relating to spouse offset, education tax refund and payment summary fraud (as outlined above) stopped the majority of returns which were reviewed under the ITRIP in 2011–12.⁴⁸ This may change from year to year as the mix of models applied to the ITRIP changes depending on the risks needing to be addressed.

Pattern detection model

2.9 The pattern detection model uses data mining to identify organised tax evasion patterns or groups. Such patterns may include multiple returns which share abnormal commonality suggesting that the returns may have been prepared by one person or a group of people. The ATO refers to this person or group as the 'guiding mind'.⁴⁹ A particular focus of the pattern detection model is identifying income tax returns which are prepared by a single or groups of unregistered tax agents.

2.10 The ATO has advised that as at 1 July 2012, the pattern detection model was only applied to returns lodged through its *e-tax* system. However, the ATO is currently undertaking a project to expand the application of this model to other lodgement channels such as mail lodgements and lodgements made by telephone.⁵⁰ Some expansion of the model had occurred by the end of August 2012.

46 Above n 45.

47 ATO, '2011–12 Expert Business Rules Quick Reference Guide' (2012), internal ATO document.

48 Above n 13, page 5.

49 ATO, 'Risk Assessment – Income Tax Refund Integrity' (January 2012), internal ATO document, p. 11.

50 Above n 45.

Updating the ITRIP models

2.11 The ATO has advised that the ITRIP models are dynamic and changes to them may be effected within a period of between 48 hours to two weeks. It notes that this is a significant improvement from the hard-coded approach adopted in the HRR program.⁵¹

2.12 The ATO formally reviews the ITRIP models and expert business rules on an annual basis, incorporating observations regarding adjustment rates from different models and rules, intelligence on areas of potential fraud and changes to legislation (such as an increase in the tax free threshold). The formal review may lead to a refinement of existing models and business rules, or new business rules being developed and implemented with the approval of the Assistant Deputy Commissioner, MEI Active Compliance.⁵²

2.13 The ATO notes that prior to implementing any new business rules, ‘a sample of post-issue audit cases is undertaken to ensure the intended risk is being targeted appropriately’.⁵³

EFFECTIVENESS OF THE ITRIP MODELS

ITRIP strike rates

2.14 A strike rate is one means of assessing the effectiveness of a particular approach or strategy. A strike rate may generally be defined as the proportion of selected taxpayer cases, in which the relevant risk was confirmed resulting in a positive outcome or action, measured against the total population. Those taxpayers incorrectly selected or whose tax returns were released without action are not included and are considered to be false positives in the risk identification process.⁵⁴

2.15 As the ITRIP incorporates a number of different models which are aimed at detecting and addressing different risks (for example, overstated claims, identity crime and fraud), a positive outcome may include a reduction of refunds claimed, a referral for prosecutorial action or an increase in taxpayers’ returns to reflect claims to which the taxpayer may be entitled but not otherwise claimed.

Overall ITRIP strike rates

2.16 The ATO’s strike rates for the ITRIP in aggregate for all risk models used are outlined in Table 6.

2.17 In the ITRIP’s first full year of operation, 2009–10, it was only applied to *e-tax* lodgements for the purposes of identifying unregistered preparers and fraudulent returns through the pattern detection and identity crime and network detection models. Limiting the ITRIP to *e-tax* and only applying selected models resulted in a high strike rate of 93 per cent.⁵⁵

51 ATO, Communication with the IGT, 18 February 2013.

52 ATO, Communication with the IGT, 12 April 2013.

53 Ibid.

54 Above n 26.

55 Above n 16.

2.18 However, with the expansion of the ITRIP to lodgements through all other channels and the inclusion of expert business rules to identify errors or incorrect claims within specific labels, a general decline in its overall strike rate has resulted. Between 2009–10 and 2012–13, the overall strike rate reduced from 93 per cent to 68 per cent, as shown in Table 6. However, the average adjustment from ITRIP returns increased between 2011–12 and 2012–13 from \$2500 to \$4098.⁵⁶

Table 6: ITRIP strike rates

	2009–10	2010–11	2011–12	2012–13 YTD
Strike Rate (%)	93	71	76	68
Average adjustments (\$)	N/A	3,323	2,500	4,098

Source: ATO, Evolution of Income Tax Refund Program 2009–13; ATO, 2011 ITRI Final Treatment Evaluation; Senate Estimates Briefing October 2012; ATO information dated 5 June 2013.

2.19 The ATO acknowledges the decline in the ITRIP's overall strike rate and has undertaken work to specifically address the models and expert business rules which it considers to have contributed to this overall decline. As part of this program of work, the ATO has more actively monitored and refined the outputs of the affected models and adjusted low risk parameters in a more timely manner to ensure that cases are not unnecessarily held up for review.⁵⁷

Identity crime and network detection model strike rate

2.20 In addition to the overall strike rate, the ATO's data also captures the strike rates in relation to returns which are stopped by its identity crime and network detection model. This particular strike rate is a subset of the overall ITRIP strike rates outlined in Table 6.

2.21 The identity crime model strike rates for the years 2010–11 and 2011–12 as reported to the Senate are outlined in Table 7.

Table 7: Identity crime and network detection model (ICM) adjustments 2010–11 and 2011–12

Year	Total income tax returns reviewed by ATO	Revenue protected by review (approx. \$m)	Returns stopped by the ICM	Returns adjusted from ICM cases	Percentage of returns adjusted in ICM cases	Revenue protected by ICM review (approx. \$m)	Average revenue protected by ICM cases (\$)
2010–11	34,600	115	7,269	6,427	88.4%	15.1	2,349
2011–12	79,000	200	7,924	4,894	61.8%	21.6	4,413

Source: ATO, Senate Estimates Briefing October 2012

2.22 Table 7, above, shows that of all the returns stopped by the ITRIP, only a fraction were as a result of risks identified by the identity crime and network detection model. In 2010–11, this accounted for 7,269 cases (being 21 per cent of total returns reviewed by the ATO). In 2011–12, 7,924 cases were stopped by the identity crime and network detection model, accounting for about 10 per cent of total returns reviewed by the ATO.

⁵⁶ Above n 16.

⁵⁷ ATO, communication with the IGT, 17 May 2013, p. 2.

2.23 Of those returns which were stopped by the identity crime model, the ATO reports that it made adjustments in 6,427 cases (or 88 per cent) in 2010–11 and 4,894 cases (or 62 per cent) in 2011–12. The average adjustment rate, however, has increased between the two years from an average of \$2,349 to \$4,413 per case.

Expert business rules and pattern detection strike rates

2.24 The ATO's data in relation to the strike rates for its expert business rules and pattern detection model are not reported publicly. These are collated and analysed by the ATO for internal evaluation purposes. Like the identity crime model statistics above, strike rates in relation to the expert business rules and pattern detection models are also subsets of the overall ITRIP strike rates outlined in Table 6, above.

Table 8: 2010–11 expert business rules and pattern detection model strike rates as at 30 June 2011

Channel	Model	Returns completed	Total returns adjusted	Strike rate (%)	Total adjusted (\$)	Average adjusted amount (\$)
Agent	Expert business rules	7,573	5,174	68	14,928,127	2,885
	Identity crime	12	8	67	32,862	4,108
	Other source	744	311	42	1,166,260	3,750
	Sub-total	8,329	5,493	66	16,127,249	2,936
E-tax	Expert business rules	4,449	3,283	74	8,946,432	2,725
	Identity crime	6,338	4,947	78	14,623,126	2,956
	Pattern detection	3,425	2,952	86	9,099,143	3,082
	Other source	1,471	1,112	76	4,829,072	4,343
	Sub-total	15,683	12,294	78	37,497,773	3,050
Other self	Expert business rules	2,995	2,690	90	19,783,862	7,355
	Identity crime	76	66	87	435,245	6,595
	Other source	447	339	76	1,677,612	4,949
	Sub-total	3,518	3,095	88	21,896,719	7,075
Unknown	Expert business rules	239	192	80	1,426,935	7,432
	Identity crime	1	1	100	9,900	9,900
	Other source	4,213	1,616	38	11,553,663	7,150
	Sub-total	4,453	1,809	41	12,990,498	7,181
Total		31,983	22,691	71	88,512,238	3,901

Source: ATO, 2011 ITRI Final Treatment Evaluation

2.25 As outlined in Table 8, above, in 2010–11, the ATO reported that the pattern detection and expert business rules models had a strike rate of 86 per cent and 74 per cent

respectively when applied to tax returns lodged through *e-tax*.⁵⁸ The strike rates for expert business rules applied to tax agent lodgements and lodgements by taxpayers through channels other than *e-tax* were 66 per cent and 88 per cent, respectively.⁵⁹

2.26 At the IGT's request, the ATO has constructed a three year comparison of the strike rates achieved by the expert business rules and pattern detection models for 2010–11 (based on the table above), 2011–12 and 2012–13 (sourced from other internal evaluation documents). This comparison is outlined in Table 9 below.

Table 9: Three year comparison of expert business rules and pattern detection model strike rates

Channel	Model	Strike rate 2010–11	Strike rate 2011–12	Strike rate 2012–13 (YTD)
E-tax	Identity crime (IDC)	78%	68%	66%
	Pattern detection	86%	89%	81%
	Expert business rules	74%	83%	74%
	All e-tax	78%	81%	71%
Tax agent	Expert business rules	66%	69%	57%
Non e-tax or other self preparer	Expert business rules	88%	89%	72%
All channels and models		71%	76%	68%

Source: ATO

2.27 The IGT notes that, like the overall strike rates and those for the identity crime and network detection model above, there is a general declining trend in the strike rates for the expert business rules and pattern detection models across all channels. The IGT notes that the declining trend is most pronounced in relation to the expert business rules applied to tax agent lodgements and lodgements by unrepresented taxpayers through channels other than *e-tax*.

2.28 This declining trend could suggest a need for the ATO to more closely monitor the performance of the expert business rules model and to undertake more stringent sample testing before applying these rules broadly. There may be valid reasons for this decline. However, the complete 2012–13 year return data is not yet available and the ATO has not yet undertaken a full evaluation. Accordingly, the IGT is of the view that it would be premature to draw any final conclusions.

IGT observations

2.29 While the statistics in Tables 6, 7 and 9 show some decline in strike rates, both for the ITRIP overall and the models individually, the ATO notes these strike rates continue to exceed its own expectations of achieving a 55 per cent strike rate.⁶⁰ It is unclear to the IGT how the ATO arrived at this expectation. The IGT has requested details of the ATO's

58 ATO, 'Micro Enterprises and Individuals Final Treatment Evaluation - Income Tax Refund Integrity Project (2010–11),' (17 February 2012), internal ATO document, p. 14.

59 Ibid.

60 ATO, 'Individuals Pre-Issue Overarching Strategy' (13 March 2012), internal ATO document, p. 11.

considerations in developing this 55 per cent benchmark but as at the date of this report, has not been provided with those details.

2.30 The IGT also notes that when compared with other compliance verification strategies, such as the ATO's use of benchmarks in the cash economy,⁶¹ the strike rates in the ITRIP are considerably higher. The comparison of the strike rates between different compliance initiatives is indicative only. This is necessarily so as these programs adopt different methodologies and target different risks and taxpayer populations.

2.31 As a general observation, the IGT believes that it is difficult to assess whether a particular strike rate accurately indicates the effectiveness of a risk assessment tool when the rate of non-compliance within the relevant population is unknown.

2.32 It is also important to point out that while examining strike rates can provide a broad overview of the general effectiveness of certain projects or strategies, caution must be exercised as these are not necessarily conclusive. This is because a number of other factors can also directly affect strike rates. In the case of the ITRIP, strike rates and average adjustment figures may be attributable to factors such as changes to underlying legislation,⁶² improved taxpayer compliance with fewer errors in lodgements, more sophisticated methodologies for identifying fraudulent returns or changes made to relevant risk models between the years.⁶³

2.33 Notwithstanding the comparatively high strike rates above, the impact of holding a return that is later confirmed to be of lower or no risk can be significant. As discussed later in this report, delayed processing of income tax returns generates a considerable level of taxpayer and tax agent complaints. The IGT notes that as part of the ATO's intended improvement work, the ATO should focus on reducing the numbers of these types of returns from being stopped.

Level of fraud detection from the ITRIP

2.34 One of the key aims of the ITRIP is to identify and stop claims which are potentially fraudulent.⁶⁴ Where a return is stopped by the ITRIP on the basis of suspected fraud and the ATO reviewing officer cannot substantiate the claim or satisfy themselves of the absence of the fraud risk, there are three options available to ATO officers to escalate the potentially fraudulent case. These options are:⁶⁵

- comprehensive referrals for investigation and prosecution by the SNC business line under a joint funding agreement. The ATO notes that these referrals involve the most egregious cases of non-complying taxpayers, repeat offenders and taxpayers who fail to comply with the ATO's notices to give information under section 264 of the *Income Tax Assessment Act 1936* (ITAA 1936). The ATO acknowledges that these referrals, when compared with other approaches to dealing with fraud, are comparatively low. The ATO estimates that, between 2011-12 and 2014-15, 25 matters will be referred by

61 IGT, *Review into the ATO's use of benchmarking to target the cash economy*, 4 October 2012, p. 62.

62 For example, *Tax Laws Amendment (2012 Measures No. 1) Act 2012* which phased out the Dependent Spouse Offset.

63 Above n 58, p. 5.

64 Above n 13, page 4.

65 Above n 57.

the SNC business line to the Commonwealth Director of Public Prosecutions for action. In addition, the ATO expects to complete 150 in-house prosecution matters;⁶⁶

- identity fraud cases which are reported to the SNC business line by the CAS business line but in which prosecution activity is generally not suitable because of difficulties in identifying those suspected to have committed the fraud. Information from the ATO indicates that, in 2011–12, there were 1,915 such cases reported while, in 2012–13 (as at 3 June 2013), 3,240 cases have been reported;⁶⁷ and
- fraudulent and dishonest behaviour cases which are reported to the SNC business line in accordance with the ATO's internal corporate management practice statement on fraud control.⁶⁸ The ATO notes that all cases in which a penalty of more than 50 per cent (for recklessness) is imposed are reported to the SNC business line under this category. Where the ATO considers a case may be appropriate for prosecution, this is referred to the SNC business line as a comprehensive referral. In 2011–12, the ATO reported 1,645 such cases, while in the current year; it has reported 660 cases (as at February 2013).⁶⁹

2.35 The ATO notes that, in 2010–11, there were difficulties in specifically identifying the number of comprehensive referrals to SNC from the ITRIP.⁷⁰ The recorded information for 2010–11 shows that the MEI business line comprehensively referred 356 cases to the SNC business line, of which the ATO can only identify two being as a result of the ITRIP.⁷¹ This accounts for approximately two per cent of all tax returns in which there was an adjustment in favour of the revenue.

2.36 In 2011–12 and 2012–13, the MEI business line undertook more comprehensive recording of its referrals and their progress and outcomes through the use of a manual spreadsheet. These records indicate that 170 and 112 cases were referred to the SNC business line in 2011–12 and 2012–13, respectively.⁷² In 2011–12 and 2012–13, the level of referrals to the SNC business line was less than one per cent of cases adjusted in favour of the revenue. As a fraction of total returns stopped by the ITRIP, the levels of referrals across all years represent an even smaller fraction.

2.37 The ATO acknowledges the low levels of comprehensive referrals to the SNC business line for investigation. The ATO notes that this level of referral is directly related to a joint funding agreement between the SNC business line and the MEI business line for the investigation and prosecution of fraud cases arising out of the ITRIP between 2011–12 and 2014–15.

2.38 However, the ATO also notes that in addition to comprehensive referrals to the SNC business line, it also takes action to treat cases in which fraud is identified but which are not suitable for prosecution. Such cases include instances of identity crime. In these cases, TFNs are stolen and fraudulent income tax returns are lodged claiming refunds.

66 Above n 57, p. 7.

67 ATO, Communication with the IGT, 5 June 2013.

68 Corporate Management Practice Statement PS CM 2007/02 *Fraud Control and the Prosecution Process*.

69 Above n 57, p. 8.

70 ATO, Communication with the IGT, 21 March 2013, p. 5.

71 Ibid.

72 ATO, Communication with the IGT, 18 July 2013.

2.39 The ATO has advised that prosecution action may be frustrated in cases of identity crime due to difficulties associated with identifying the perpetrators. However, the ATO has also advised that it takes a number of other remedial actions such as requiring proof of identity for issuing refunds and cancelling compromised TFNs and reissuing new ones. Accordingly, the ATO considers that a measure of comprehensive referrals to the SNC business line alone is not an accurate measure of the effectiveness of the ITRIP as a fraud detection and treatment mechanism.

IGT observations

2.40 The IGT notes the ATO's advice that the low levels of fraud referrals and prosecution action undertaken by the ATO is limited by internal funding decisions and also by difficulties associated with identifying the perpetrators of fraud. The IGT also notes the treatments applied by the ATO to cases in which prosecution is not suitable. This is reflected in the relatively high quantity of cases identified and adjusted on the basis of identity crime and pattern detection. As illustrated in Tables 7, 8 and 9, a total of 9,379 and 10,028⁷³ cases were adjusted as a result of identity crime and pattern detection in 2010–11 and 2011–12, respectively.

2.41 Notwithstanding the above, the IGT is of the view that prosecutorial action and specific court rulings in fraud cases serve as the most visible and public outcomes of the ATO's action against fraud. Absent these, there is a risk of a general public perception that the ATO is ineffective or that its program of work in relation to refund integrity is disproportionate to the risks identified.

2.42 It is also worth noting that in addition to the above reasons, the low levels of referrals may be due to the vast majority of individual taxpayers voluntarily complying with their taxation obligations and that discrepancies may be the result of errors ranging from simple mistakes through to negligent statements, rather than dishonest or fraudulent behaviour.

2.43 Having already examined the overall ITRIP strike rates as a general measure of effectiveness, the levels of referrals to the SNC business line raise two further questions:

1. should the ATO continue to group incorrect or potentially fraudulent claims together when publicly referring to the ITRIP; and
2. is the pre-issue compliance action taken by the ATO proportional to the materiality of the risk posed by these income tax returns?

2.44 These questions are examined in Chapters 5 and 6, respectively.

2.45 At this point, it is important to note the ATO's current limitations on capturing and reporting data in relation to SNC referrals from the ITRIP. As noted earlier, since 2011–12, the MEI business line has utilised a manual spreadsheet to track those ITRIP cases which have been referred to the SNC business line. The spreadsheet also records the nature of the

73 This figure comprises 4,894 identity crime cases as outlined in Table 7 and 5,134 pattern detection cases (extrapolated from 5,769 total returns stopped as a result of pattern detection and an 89 per cent strike rate as indicated in Table 9); ATO, 'Income Tax Return Integrity – 2011–12' (22 April 2013), draft internal ATO document.

risk, the reasons for referral and the outcomes of any investigation or prosecution action taken against the taxpayer.⁷⁴

2.46 The ATO advises that this spreadsheet is maintained by the MEI business line for its own purposes and does not interface with reporting by the SNC business line. Moreover, as the spreadsheet is manually maintained, any reporting must also be manually generated through a review of the cases recorded and notes made in relation to the progress of those matters.

2.47 While the IGT acknowledges that the spreadsheet represents an improvement on the more generic records of the earlier year, there is a risk that a manually maintained document may be inadvertently corrupted, data lost or information being inaccurate or not up to date. As the referrals are tied closely to the SNC business line's own work and investigations, the absence of cohesion between the reporting mechanisms also creates some concern.

2.48 Given a key outcome from the ITRIP is the prevention of fraudulent claims, the IGT considers it imperative that there is appropriate record-keeping and reporting to enable the ATO to identify and assess the level of accuracy with which the ITRIP detects cases of potential fraud and the effectiveness of the related strategies. Such data would not only assist the ATO to continually update and refine its fraud detection parameters and strategies but, when publicly reported, would also enhance community confidence in the ATO's efforts to address fraud more accurately with minimal compliance costs.

RECOMMENDATION 2.1

The IGT recommends that the ATO:

(a) ensures that the MEI, CAS and SNC business lines collaborate to develop a comprehensive record-keeping system to identify and report on:

(i) the number of cases referred from the ITRIP to the SNC business line for fraud investigation and the number of these cases where actual fraud was established;

(ii) the number of cases in which identity crime was observed and those in which the ATO suspects that false tax returns were lodged by perpetrators of crime; and

(iii) the actions taken by the ATO to address the fraud and the outcomes of such action.

(b) distils common factors in cases where fraud activity has been identified and use such findings in its annual review process of the ITRIP models to improve their ability to detect potential fraud.

ATO Response

Agree.

74 Above n 72.

CHAPTER 3 — THE ITRIP EXPERIENCE

3.1 During the 2011–12 financial year, substantial numbers of taxpayers and tax agents expressed dissatisfaction with the delay in processing income tax refunds, the related impacts and the ATO's handling of their concerns. This was highlighted by the Commonwealth Ombudsman, the IGT and the ATO itself receiving increased taxpayer complaints relating to the amount of time that cases within the ITRIP were taking to be finalised.

3.2 In her submission to the Joint Committee of Public Accounts and Audit, the Acting Commonwealth Ombudsman observed that in 2011–12, the average completion time for ITRIP cases was five months, with about 30 per cent taking between six and nine months to complete.⁷⁵ The submission noted that this delay resulted in a large number of complaints both to the Commonwealth Ombudsman's office as well as the ATO's own complaint section.

3.3 Indeed, the ATO reported that between 2010–11 and 2011–12, there was an increase in the number of ITRIP-related complaints from 1,269 to 7,381.⁷⁶ The ATO recognises this significant increase in complaints, and notes that 'the primary cause of these complaints is client dissatisfaction with the time taken for the review to be completed'.⁷⁷

3.4 As discussed in Chapter 4, since 2011–12, the ATO has markedly improved its audit finalisation times for ITRIP cases. In order to understand the improvements the ATO has made to the ITRIP since that year, and the remaining areas for improvement, it is important to understand the causes for the delays in 2011–12 and their impacts.

CAUSES OF DELAYS AND THE ATO'S RESPONSE

3.5 In the 2011–12 year, the ITRIP risk models were expanded to detect a wider range of risks across a number of different lodgement channels. It is generally accepted that the delays were due to the difficulties experienced by the ATO in managing the unexpected high volume of cases being stopped by the ITRIP as a result of this expansion.

3.6 The ATO had planned its resources on the basis that it expected to complete 32,658 cases in 2011–12.⁷⁸ The expected number of cases in 2011–12 appears consistent with the number of income tax returns stopped in previous years. However, the number that was actually stopped was more than three times the expected amount. The numbers of returns stopped by the ITRIP in the three years from 2010–11, 2011–12 and 2012–13 year to date are outlined in Table 10 below.

75 Above n 43, p. 4.

76 ATO, Communication with the IGT, 14 December 2012.

77 ATO, 'Income Tax Refund Compliance – High Level Summary' (4 May 2012), internal ATO document.

78 ATO, 'Individuals Compliance and Data Management, Stream Plan 2011–12' (September 2011), p. 10.

Table 10: Number of ATO stopped returns for the lodgement years ending 30 June 2011 to 2013 (YTD)

	Financial year in which returns were stopped		
	2010–11	2011–12	2012–13 YTD
Expected returns	36,400	32,658	50,000
Stopped returns	34,600	106,067	47,429

Source: Data warehouse: 2011 year as at 6/2/2013, 2012 year as at 5/2/2013 and 2013 year to date as at 4/2/2013; Active Compliance Individuals Stream Plan 2010–11; ICDM Stream Plan 2011–12; ICDM Stream Plan 2012–13.

3.7 The ATO attributed the increased volume of stopped returns to the enhancements and modifications made to the ITRIP models. It summarised the changes to the models as follows:⁷⁹

- A change to the expert business rules model to take into account extended lodgment periods for analysis. (Expanded to include all current, future and prior year returns back to 2009).
- The Serious Non-Compliance models (network detection and identity crime) commenced operating across all channels (including tax agent lodgment channels) for the full financial year.
- Expert business rules — there were fifteen rules and twenty six watch lists in operation including the introduction of new rules to include:
 - Spouse Tax Offset.
 - Education Tax Refund.
- Expansion of expert business rules across all channels in addition to e-tax (including tax agent channels).

3.8 The ATO has advised that it became aware of the increased volume of returns stopped by the ITRIP sometime over the period from the end of July to the middle of August 2011. During this time, it became apparent that the numbers of returns requiring review under the ITRIP would likely, or had already, exceeded the estimated numbers for that year.⁸⁰

3.9 In response, a group of senior ATO officers from across a number of different business lines convened in August 2011 to discuss possible strategies to manage the increased workload and to mitigate the adverse impacts on taxpayers. The group considered a number of mitigation options, including:⁸¹

- re-assessing the risk and identifying any low-risk candidates suitable for early release, which would involve the development of automated processes for checking held returns against third party data and developing a low-risk threshold to determine which returns should be released without further compliance activity;

⁷⁹ Above n 70; Above n 14, p. 5.

⁸⁰ Ibid.

⁸¹ Ibid.

- increasing the level of resourcing applied to this workload, including increasing staff numbers, increasing overtime hours and making use of staff in other areas of the ATO such as the call centre and complaints sections to streamline processes related to the ITRIP;
- seeking opportunities to improve case actioning efficiency, including the use of bulk letters to tax agents seeking information on a number of cases and the reliance on the notice of assessment to inform taxpayers of adjustments rather than specific correspondence. (The ATO notes that both options created some difficulties for tax agents and taxpayers);⁸² and
- seeking opportunities to communicate with taxpayers and their intermediaries on the expected delays and related issues, including at external consultation forums, through publications such as media releases⁸³ and weekly progress reports⁸⁴ and liaising with the Commonwealth Ombudsman on complaints received from taxpayers and tax agents.

3.10 In its Risk Treatment Plan for the ITRIP, dated December 2011, the ATO also gave some consideration to contingencies and possible strategies where the ITRIP yielded more cases than expected. Relevantly, the Risk Treatment Plan noted:⁸⁵

If the number of cases stopped is significantly higher than expected it may exceed the capacity for Individuals Compliance and Data Matching [ICDM] to action.

This can be addressed by reassessing the low-risk thresholds applied to all cases and releasing cases that would otherwise be held, or increasing ICDM capacity. Ongoing review is required to identify this circumstance early.

3.11 The above-mentioned plan is dated four to five months after the ATO was first aware of the increased numbers of stopped income tax returns. The ATO advises that the document is a later formalisation of matters considered by the previously mentioned group of senior ATO officers in August 2011, when the higher than expected case numbers first emerged.⁸⁶

3.12 In addition, the group of ATO senior officers also delivered updates and briefings to the relevant ATO Second Commissioners on progress of the ITRIP and to outline a number of strategies being implemented, including bulk mail out letters to tax agents and compliance manager contact and site visits with agents who had a high number of clients with returns held.⁸⁷

82 Above n 70.

83 See for example: ATO, 'ATO warns: honesty is best policy when claiming your tax refund this year', Media Release, 3 August 2011.

84 ATO, Tax time processing reports 2011, <<http://www.ato.gov.au/Media-centre/Tax-time-processing-reports/Tax-time-processing-reports/>>.

85 Above n 3, p. 9.

86 ATO, communication with the IGT, 31 May 2013.

87 ATO, Briefing to Second Commissioners on the ITRIP (14 September 2011), internal ATO office minute.

IGT observations

3.13 The IGT's observations in relation to the specific initiatives implemented by the ATO are outlined in the sections below.

Community and tax agent communication

3.14 The ATO sought to manage taxpayer and tax agent expectations through communication of its progress during Tax Time. It used a number of different channels, including weekly Tax Time progress reports which commenced early July, discussions at consultation forums such as the ATO Tax Practitioner Forum which occurred in October 2011 and the publication of an article on its E-Link service in December 2011 to provide an update for tax agents.⁸⁸

3.15 In relation to the ATO's weekly Tax Time progress reports, the IGT notes that only the first report provided taxpayers with any indication as to when they may expect their refunds. Specifically, that update provided:⁸⁹

We commenced processing income tax returns for the 2011 year on Wednesday 6 July. Refunds for these returns will start being received from Thursday 14 July.

3.16 In subsequent updates, the ATO did not outline any expected refund timeframes. Instead, the ATO adopted standardised phrasing to assure taxpayers that 'we are processing according to schedule and will continue to keep you informed as we progress'.⁹⁰ This statement was later changed to 'processing is continuing in accordance with our plans and schedules with no major impacts on processing timeframes'.⁹¹

3.17 The IGT appreciates that these weekly updates may relate to processing of all tax returns rather than those held by the ITRIP and that in relation to general processing, the ATO may have largely been operating to schedule. However, the IGT also notes that taxpayers whose returns are not held under the ITRIP would have little need to seek updates as to the ATO's progress during Tax Time. For taxpayers impacted by the ITRIP seeking updates, it would appear inaccurate and misleading to make statements such as there being no major impacts on processing timeframes. Such statements have the potential to create unnecessary confusion and anxiety for affected taxpayers and tax agents.

3.18 The ATO considers that the risk of confusion and anxiety for taxpayers affected by the ITRIP should have been minimal. The ATO considers this to be so as ITRIP cases account for less than one per cent of the total population of taxpayers lodging income tax returns. Moreover, it advises that under new arrangements in 2012-13 and later years, affected taxpayers are contacted within seven to 14 days in relation to their returns being held for review, an estimated timeframe and a contact point is provided for further queries.

88 Above n 14.

89 ATO, Tax time progress report 1, 2011 <<http://www.ato.gov.au/Media-centre/Tax-time-processing-reports/Progress-report---2011-returns/>> (16 May 2012).

90 ATO, Tax time progress report 2, 2011 <<http://www.ato.gov.au/Media-centre/Tax-time-processing-reports/Progress-report-2---income-tax-returns-since-1-July-2011/>> (16 May 2012).

91 ATO, Tax time progress report 15, 2011 <<http://www.ato.gov.au/Media-centre/Tax-time-processing-reports/Progress-report-15---Latest-figures-as-at-close-of-business-12-October-2011/>> (16 May 2012).

3.19 While it may be true that only a small proportion of taxpayers are impacted by the ITRIP, the actual numbers of affected taxpayers are high. Moreover, while the IGT acknowledges that in 2012–13 the need to rely on general communications decreased as a result of improved ATO timeframes and communications, in the prior years with high numbers of stopped returns and extended delays, the risk of confusion for affected taxpayers was higher.

Lowering risk thresholds and early release

3.20 The ATO has a number of thresholds and systems-based rules to automatically review and release returns deemed to be lower risk or which can be verified against third party data. These rules examine a number of aspects of a particular return to determine whether manual review is required before processing may continue. These include matters such as whether:

- a return from the same taxpayer was stopped in a prior year and released without further action;
- returns reported nil or debit balances (that is, where the taxpayer is required to pay an amount of tax upon the tax return being processed); and
- in light of new data received during Tax Time, the tax returns continued to meet the risk-based criteria for examination under the ITRIP.⁹²

3.21 The ATO has advised that a number of these rules were operational from 1 July 2011 but awaited appropriate third party data before they could be applied against the tax returns held under the ITRIP.⁹³

3.22 In addition to the rules already in existence, the ATO has developed new or updated existing expert business rules and implemented low risk threshold tests to re-assess and release certain lower risk cases without review as early as 9 August 2011.⁹⁴

3.23 However, in relation to the expert business rules dealing with the education tax refund and spouse offset, both of which the ATO considered were the primary causes of the increased cases, the risk thresholds were not lowered. The ATO notes that an assessment of the cases in question revealed ‘a high element of fraudulent and/or dishonest behaviour’ and therefore, lowering the threshold to release such cases would have been inappropriate.⁹⁵ In support of this view, the ATO notes that it adjusted 90 per cent of education tax refund cases and 76 per cent of spouse offset cases.⁹⁶

3.24 The IGT notes that while the rates of adjustments may be high in relation to these cases, it does not necessarily follow that they represented fraudulent or dishonest behaviour. It is unclear to the IGT how the ATO arrived at this assessment and not the possibility of taxpayers having made errors resulting in overclaiming.

92 ATO, communication with the IGT, 12 July 2013.

93 Ibid.

94 Above n 14, p. 2.

95 Above n 86.

96 Ibid.

Increasing staff and utilising overtime

3.25 The ATO also considered options to increase staff and the use of overtime to clear backlog cases. However, this did not appear to take place until March 2012, notwithstanding that the ATO intended to apply these measures to immediately to address the risks posed by an increased workload.⁹⁷

3.26 The number of actual staff engaged against budgeted staffing (in full-time equivalents (FTE)) and overtime hours is set out in Table 11, below.

Table 11: 2011–12 monthly income tax return receipts and staff resources⁹⁸

	Income tax returns stopped by the ITRIP	Budget FTE/month	Actual FTE/month	Overtime hours
July	24,565	109.65	109.59	0
August	44,683	119.05	119.50	0
September	16,217	124.23	123.83	0
October	9,056	124.73	120.09	0
November	7,339	111.23	116.18	0
December	2,450	139.81	104.19	0
January	1,280	125.82	113.98	0
February	1,115	124.12	124.27	0
March	1,078	122.52	136.83	1,265.71
April	480	120.92	157.29	2,032.88
May	675	119.42	158.85	2,670.51
June	62	117.02	159.93	1,524.02
Total returns stopped	109,000			

Source: ATO

3.27 The above Table 11 shows that between July and December 2011, only August and November saw an increase in staff over and above the numbers for which the ATO had budgeted. The data shows that the clearest increases in staffing occurred between March and June 2012 when the ATO worked to clear the backlog of returns prior to the commencement of the new financial year. Similarly, the IGT notes that no overtime was utilised until March 2012. The staffing numbers were also below budget in December and January although this may be a result of the Christmas and New Year period.

3.28 The ATO has advised that the staffing figures in Table 11 do not incorporate an unquantified number of staff from other areas of the ATO which were brought in to assist in dealing with the matters.⁹⁹ These included staff from the:

⁹⁷ Above n 70; Above n 14.

⁹⁸ ATO, Communication with the IGT, 28 February 2013.

- ICDM stream, including HRR staff, who were redirected to assist in compliance verification work;
- call centre in August 2011 developing strategies for enquiries and complaints management, including the establishment of a dedicated team for ITRIP complaints;
- Client Support and Assistance section of the ATO contacting affected stakeholders by phone between September to December 2011; and
- Tax Agent Compliance Strategy section contacting and visiting tax agents, with high numbers of client tax returns held under the ITRIP, to assist with reviewing and finalising returns.¹⁰⁰ The ATO's tax agent visits initiative is discussed in more detail in Chapter 4.

Other improvement initiatives

3.29 In mid-August 2011, the ATO also implemented a number of other initiatives to improve the management of ITRIP cases. These initiatives included:

- implementation of a process enabling tax agents to respond in bulk to ATO enquiries on multiple cases resulting in increased volumes of correspondence to which the ATO was unable to respond in a timely manner which in turn led to tax agent complaints;¹⁰¹
- updating of ATO procedures to limit the instances of ATO officer-generated correspondence only to those cases in which a response had been received from the taxpayer, however, the absence of finalisation letters and reliance on notices of assessments alone generated some concern for tax agents;¹⁰² and
- the use of default assessments for cases in which the ATO identified a high likelihood of non-response from taxpayers (the ATO's use of default assessments is discussed further in Chapter 6).¹⁰³

3.30 As a result of the above events and delayed ATO response, taxpayers and tax agents were subject to a number of adverse impacts.

IMPACT ON TAXPAYERS

3.31 Submissions to the IGT outlined a number of impacts on taxpayers arising from the ITRIP, the most significant of which is the anxiety for taxpayers caused by the belief that the ATO considers them fraudulent, dishonest or negligent as a result of their returns being held.

3.32 These concerns arose in part because of the uncertainty regarding reasons why tax returns were held for long periods of time. Moreover, they were exacerbated by the ATO's

99 Above n 70; Above n 14.

100 Above n 72.

101 These visits took place between August and October 2011 and again in March 2012. See above n 92.

102 Ibid.

103 Ibid.

public communications on the issue which emphasised fraud over inadvertence through the use of such phrases as 'fraudulent and overclaimed refunds.'

3.33 The 'fraudulent and overclaimed refunds' wording was used extensively in 2011–12 in the ATO's weekly progress reports for income tax lodgement processing¹⁰⁴ which were published online, in media releases¹⁰⁵ and provided in ATO consultative forums.¹⁰⁶

3.34 The ATO has also received informal feedback from tax agents about the negative connotations associated with the ATO's use of this phrasing and the impact this can have on both taxpayers and their agents.¹⁰⁷

3.35 The ATO has, since the publication of its *Compliance Program 2012–13* in July 2012, moved away from using the 'fraudulent and overclaimed refunds' phrase. Instead, the ATO has adopted terminology which shifted the focus from fraud to potentially incorrect.¹⁰⁸ The IGT observes, however, that in a weekly Tax Time processing report in late 2012, the 'fraudulent or overclaimed refund' terminology was still used.¹⁰⁹ The ATO advises that this usage was inadvertent and was not reflective of other publications at the time.

3.36 The ATO has advised the IGT that from 1 July 2013, it has adopted the phrase 'potentially overstated or possibly fraudulent claims' in relation to risks it seeks to identify and treat under the ITRIP. The use of new phrasing is intended to remove the emphasis on the fraud aspect of the ITRIP work and the ATO considers this will assist to minimise the anxiety for affected taxpayers.

3.37 In addition to the above, submissions to the IGT also raised a number of other impacts on taxpayers arising out of the ITRIP. These include:

- the creation of cash flow problems for taxpayers who have earmarked refunds for a specific intended purpose and the associated lost opportunity which is not always appropriately compensated by payment of interest;
- increased compliance costs may be incurred where, owing to a lack of clarity in the ATO's communications, taxpayers have engaged in gathering significant documentation to address perceived ATO concerns which were not otherwise required (the clarity and sufficiency of the ATO's communication and guidance to taxpayers and tax agents is discussed in Chapter 5);
- taxpayers opting to pay the ATO's adjusted amounts even though they considered them to be incorrect because taxpayers felt that the time and cost of challenging the adjustment would be excessive; and

104 Above n 84.

105 Above n 83; ATO, 'ATO continues to shine spotlight on tax cheats', Media Release, 1 September 2011.

106 ATO, ATO Tax Practitioners Forum, Minutes (August 2011), item 6.

107 Above n 57, p. 5.

108 ATO, *Compliance Program 2012–13*, above n 2, p. 19; ATO, 'Take care what you declare, Media release', 19 September 2012; ATO, ATO Tax Practitioners Forum, Minutes (November 2012), item 4.

109 ATO, Tax Time Progress Report 21, <<http://www.ato.gov.au/Media-centre/Tax-time-processing-reports/Progress-report-21/>> (16 May 2012).

- ongoing concern of a re-occurrence of extended delays experienced in 2011-12 in future iterations of ITRIP.

IMPACT ON TAX AGENTS

3.38 The ITRIP also had adverse impacts on tax agents. According to submissions received by the IGT these included:

- time and lost billable hours in following up with the ATO, lodging complaints and taking action to have returns processed;
- professional impacts such as damage to the tax agent's personal reputation and brand or, where relevant, the brand of their firm. Where the delay is inadequately explained and the ATO has not officially communicated the reasons for delay, this can be corrosive to tax agent and taxpayer client relationships and clients abandoning agents due to the creation of an unfair perception; and
- personal embarrassment, stress and frustration in dealing with the ATO and addressing taxpayers' concerns that the agent has acted improperly or fraudulently.

3.39 The IGT observed a similar tax agent-taxpayer dynamic in his review into the ATO's Change Program. In that report, the IGT noted:¹¹⁰

Tax practitioners argued that a combination of the ATO's delays and communication had damaged their reputation with many of their clients. This was because they were of the view that the ATO communications appeared to imply that the tax practitioner was the cause of the delays and errors.

IGT observations

3.40 The efficient operation of the ITRIP, as with any large scale compliance project, involves a number of factors, including:

- planned resourcing based on appropriate pre-testing and pilots;
- the number of cases which those resources can complete within a reasonable timeframe; and
- the parameters for case selection.

3.41 Central to this paradigm is the ATO's responsiveness to changes in the three factors listed above.

3.42 In the case of 2011-12's Tax Time, the ATO made modifications and refinements to its ITRIP models which resulted in an unexpected increased case load. It could be argued that this increase in numbers may have been predicted if appropriate sample testing was carried out before the above modifications and refinements were widely implemented.

110 Above n 5, p. 76.

3.43 The IGT notes that the ATO did undertake sample testing of the new expert business rules, however, there were anomalies in the application of the results of this testing. These anomalies related to the education tax refund and spouse offset rules and led to the number of returns ultimately stopped by these business rules in 2011–12 being 153 per cent and 247 per cent of expected volumes, respectively.¹¹¹

3.44 In respect of the education tax refund, the ATO advised that the difference between estimated and actual numbers of returns held by the ITRIP is attributable to changed claim behaviour which was not anticipated during sample testing. The ATO attributes the spouse offset anomaly to human error regarding sample figure inputs.¹¹²

3.45 Notwithstanding this, the IGT recognises that the ATO's effective monitoring of case levels in 2011–12 enabled it to detect the increased workload early in August 2011. However, despite its early awareness of the increasing workload, there was considerable delay of a number of months before the ATO implemented some initiatives to mitigate the impact on taxpayers and their agents.

3.46 When faced with an unforeseen substantial increase in workload, prompt remedial action needs to be taken. This could be done by either reducing the case load, increasing resourcing or by conducting verification of lower risk cases after refunds are issued. Some of this delayed implementation may be symptomatic of the multiple levels of governance associated with the ITRIP which were discussed in Chapter 1. A streamlined and consolidated governance arrangement may have assisted in a more timely implementation of initiatives to mitigate the adverse impacts on taxpayers and tax agents.

RECOMMENDATION 3.1

The IGT recommends that, whilst maintaining robust governance processes with respect to initiatives such as the ITRIP, the ATO should consider more streamlined governance arrangements, particularly in the early stages of the initiative, to facilitate a timely resolution of issues that might arise and to minimise uncertainties, duplications and inefficiencies.

ATO Response

Agree.

IMPROVEMENTS MADE BY THE ATO IN 2012–13 AND PLANNED FOR FUTURE YEARS

3.47 One of the learnings from the 2011–12 ITRIP experience is the need for the ATO to better predict potential taxpayer and tax agent impacts when changing risk parameters, as well as ensuring quick and effective remedial action where unexpected events occur. The

111 Above n 86, p. 2.

112 Ibid.

IGT notes that as a result of this experience, the ATO is seeking to implement a number of changes to its management of the ITRIP.¹¹³

3.48 At its Individual Taxpayers Advisory Forum in May 2012, the ATO noted:¹¹⁴

Due to an increase in the number of held returns in 2011–12, there have been delays issuing some legitimate refunds. This led to concerns being raised by both taxpayers and tax agents. The ATO is consulting with the community and addressing these concerns through a range of consultation forums and intermediaries.

3.49 Furthermore, the ATO has indicated, in information provided to the IGT, that it is seeking to improve the management of the ITRIP through undertaking a comprehensive review and re-design of the pre-issue compliance environment. Some key improvements identified by the ATO include:¹¹⁵

- integrating the HRR program into the ITRIP, including implementing improvements to rules to reduce the number of low risk returns stopped and subsequently released without adjustment;
- revising and user-testing the suite of letters notifying taxpayers and tax agents that a refund is being held and providing more information as to why it is held;
- adopting a differentiated approach for tax agents with significant numbers of refunds held;
- making greater use of third party data to cross check claims prior to reviews commencing;
- more closely monitoring numbers of refunds stopped early in Tax Time and developing contingencies for timely implementation of strategies for dealing with higher than expected refunds detected;
- improving explanation of decisions made, including reasons for decision where an adjustment has been made;
- maintaining a flexible workforce to manage peak volumes;
- further automation of the ATO's use of the default assessment process. This process is discussed in detail in Chapter 6;
- improving strategies for dealing with audit/objection workloads in a more timely manner;
- improving information and communication to the community about income tax refund compliance activity and how it may affect the issue of assessments both proactively through regular Tax Time updates and through increased information on ato.gov.au and in call centre scripting;

113 Above n 70; Above n 14.

114 ATO, Individual Taxpayers Advisory Forum, Minutes, 22 May 2012, item 6.

115 Above n 70; Above n 14, p. 5.

- providing taxpayers with early and ongoing communication on the progress of their assessment.
- refining the approach to information requests and allowing taxpayers and tax agents a reasonable time to provide supporting documentation (including extensions of time where appropriate); and
- providing written reasons for decisions where an adjustment has been made and, when requested, providing more detailed information on any decision made to adjust the return lodged by a taxpayer.

3.50 The ATO has provided information to the IGT demonstrating its commencement or implementation of the above initiatives in 2012–13. The IGT notes that while these have been commenced, not all have been completed. Some improvements such as those relating to communication and information gathering are ongoing through ATO evaluation and stakeholder feedback.

3.51 In relation to initiatives rolled out during 2012–13, firstly, the ATO implemented the use of overtime and increased staff levels earlier in Tax Time to ensure that held cases were actioned and released efficiently. This is shown in Table 12, below, which illustrates the increasing staff levels in November, December and January as well as high levels of overtime use from as early as August. The lower case loads and increased staffing levels led to significantly improved timeframes and reduced ATO complaint levels from about 7,381 in 2011–12 to 1,369 in 2012–13 (year to date), representing a decrease of more than 80 per cent.

Table 12: 2012–13 Year to date monthly income tax return receipts and staff resources

	Income tax returns stopped by the ITRIP	Budget FTE/month	Actual FTE/month	Overtime hours	Labour hire FTE
July	11,604	167.51	167.67	19.16	-
August	20,381	203.87	203.64	920.64	-
September	6,832	220.42	214.71	2,158.93	22
October	4,374	218.46	212.38	2,816.99	15
November	4,195	177.56	203.62	2,537.44	15
December	892	182.52	190.86	1,743.02	12
January	836	130.37	169.63	236.15	-
Total receipts	49,114				

Source: ATO

3.52 Secondly, the ATO made greater use of public announcements to update the community about its weekly progress in processing income tax returns. It also engaged with tax agents directly through the use of monthly emails, site visits and a tailored approach for those tax agents with the highest numbers of clients with income tax returns held for review.

3.53 Thirdly, the ATO also updated its suite of ITRIP correspondence following user-testing and feedback to remove uncertainty and provide greater clarity of the ITRIP process and any actions the taxpayer needs to take and the specific reasons for adjustments being made to taxpayers' income tax returns.¹¹⁶

3.54 Fourthly, the ATO has also sought to improve and streamline the complaints process and is currently piloting the use of 'administrative reversals' to efficiently reverse any initial ATO tax return adjustments in a timely and cost-effective manner where taxpayers provide further information to support their claims. Such a process affords taxpayers, and the ATO as administrator, a cheaper and easier alternative to disputing ATO adjustments than the more formal objection and litigation processes. The administrative reversals pilot is discussed further in Chapter 6.

3.55 The IGT observes that many of the ATO's improvement initiatives are largely aimed at addressing concerns such as those raised in stakeholder submissions to this review. However, as acknowledged in Chapter 1, while submissions have noted a generally improved ITRIP experience in 2012-13, certain areas have been identified as requiring further improvements. The remainder of this report will examine these areas. In doing so, it will be important to discuss what has occurred historically to provide appropriate context and determine what further improvements are necessary.

116 Above n 76.

CHAPTER 4 — TIMELINESS AND DELAYED REFUNDS

4.1 Delay in the actioning and processing of held income tax returns under the ITRIP is a significant cause of concern for taxpayers and their advisers. Delay brings inherent uncertainty and anxiety. Moreover, delayed refunds may also result in lost opportunity for taxpayers who may have earmarked the expected monies for a specific purpose. These impacts are not necessarily able to be addressed through the ATO's payment of interest on delayed tax refunds.¹¹⁷

4.2 A high level overview of the nature of ITRIP complaints is provided in Table 13, below. These statistics clearly show that dissatisfaction with delays in finalising ITRIP audits and reviews was the primary cause of complaints across each of the years presented.¹¹⁸ In 2010–11, these account for almost two-thirds of all ITRIP complaints, approaching close to three quarters in 2011–12 and 2012–13 (73.9 per cent and 71 per cent, respectively).

Table 13: Numbers of complaints and main reason for complaint¹¹⁹

	2010–11	2011–12	2012–13
Total complaints received	1269	7381	1394
Reasons for complaints			
Time to finalise audit/review	64.50%	73.90%	71.00% ¹²⁰
Verification Procedures	14.20%	4.70%	4.20%
Dissatisfied with Process	10.20%	8.70%	8.50%
Dissatisfied with Outcome	4.40%	1.50%	10.70%
Other/not specified	6.70%	11.20%	5.60%

Source: ATO

MINIMUM TWELVE WEEK DELAY ON PROCESSING OF RETURNS

4.3 In early 2011–12, the IGT received correspondence and enquiries in relation to the ATO's initial 'delay' letters which issued to taxpayers and tax agents whose clients' returns were held for ITRIP reviews. One of the main concerns was that the ATO estimated that the checks would take a minimum of twelve weeks.¹²¹ It was not apparent on the face of the letter why a review of an income tax return should take that long. Some tax agents also reported that the ATO had informed them that they were unable to provide specific reasons for the twelve week delay.

4.4 The IGT reviewed copies of standardised correspondence which had been used historically by the ATO. The IGT notes that in 2009–10, the ATO took a very general

117 *Taxation (Interest on Overpayments and Early Payments) Act 1983.*

118 Above n 76; ATO, Communication with the IGT, 8 March 2013.

119 Ibid.

120 The IGT adjusted this figure on advice from the ATO that due to an error in reporting, some taxpayer's dissatisfaction with timeliness was incorrectly recorded as dissatisfaction with process.

121 Above n 76.

approach towards the length of time a return would be held. Specifically, the ATO's letter stated that:¹²²

As a result of this the Tax Office will hold your 2009 return until investigations are finalised.

4.5 In 2010–11, the ATO began adopting its 'minimum twelve week' statement which noted:¹²³

What we will do

We have a responsibility to the government and the community to ensure that everyone pays the correct amount of tax under the law. We will be undertaking further investigations and will compare the information in your return with data supplied by third parties, such as employers.

We anticipate your return is likely to be delayed for a minimum of twelve weeks while we conduct our investigations. If we require further information to verify particular details within your return we will contact you and request it. Credit interest is payable by the Australian Taxation Office (ATO) in certain circumstances. If you are due a refund you may be entitled to an amount of credit interest as a result of the delay in issuing your notice of assessment. Where applicable we will automatically calculate and credit your account with the interest amount payable.

4.6 The 'twelve week minimum' statement was used again in 2011–12:¹²⁴

What we will do

We have a responsibility to the government and the community to ensure that everyone pays the correct amount of tax under the law. We will be undertaking further investigations and will compare the information in your return with data supplied by other parties, such as employers.

We anticipate your return is likely to be delayed for a minimum of twelve weeks while we conduct our investigations. We will hold your <Year> return until our investigations are finalised.

4.7 The use of the 'minimum twelve week' period by the ATO created significant uncertainty and concern amongst taxpayers and tax agents. Moreover, the concern may also have been exacerbated by the inability of taxpayers and tax agents to understand the reasons for the ATO needing a minimum of twelve weeks to review a tax return, matters the ATO was seeking to test and what could be done to expedite processing.

4.8 Similar sentiments were echoed in submissions made to the IGT which considered that the period was excessive, especially when the ATO was unable to specifically explain why it needed such a long period of time to undertake and complete its reviews.

122 Ibid.

123 Above n 76.

124 Ibid.

4.9 The ATO has advised that when the delay letter was first issued, the ATO did not have any historical data in relation to the processing of the ITRIP cases and therefore provided the twelve week minimum period as a ‘guesstimate’.¹²⁵ This was based upon a number of factors including peak period resourcing, the number of cases held and expected case completion rate.¹²⁶

4.10 Following the feedback received from stakeholders and the Commonwealth Ombudsman, the ATO undertook some user-testing of its ITRIP correspondence for use in 2012–13. The feedback from external users of the letters noted that:¹²⁷

- the 12-week minimum was too open-ended;
- uncertainty around when the period started and finished;
- some thought something happened at the 12-week mark; and
- some questioned whether any work is performed by the ATO during the 12-week period.

4.11 Amongst the recommendations made following the user-testing of this letter was the removal of the ‘minimum twelve week’ reference and replacing it with a timeline of expected events within the twelve weeks. For example, when taxpayers may expect a letter requesting further information and when they can expect their tax return to be processed and tax refund issued.¹²⁸ To further reduce the likelihood of confusion, it was recommended that specific dates should be used rather than time periods.¹²⁹

4.12 The ATO adopted some of the recommendations (such as providing more specific timing information rather than just the 12 week period) and updated the letters which issued during the 2012–13 year. The ATO did not specifically provide a timeline of expected events, but it did provide greater detail of what it intends to do as part of the checking process. These changes are illustrated in relevant extracts below:¹³⁰

What we will do

We will check the information in your return with data supplied by other parties, for example, employers must lodge their pay as you go (PAYG) withholding payment summary annual report with us by 14 August each year. If we can match the information in your tax return with information provided by other parties, we will issue your notice of assessment without contacting you again.

If we cannot match the employment details in your return with other party data or require further information to verify particular details in your return we will contact you and request it.

125 Above n 57, p. 4.

126 Ibid, p. 4.

127 ATO, ‘Income Tax Refund Integrity fraud letters usability report’ (6 February 2012), internal ATO document, p. 5.

128 Ibid, p. 16.

129 Ibid.

130 Above n 76.

When can I expect my notice of assessment?

We will hold your <Year> return until we have verified your claims. It is likely your return will be delayed until <insert date> while we verify these details with other party data we are yet to receive. We will then:

- issue a notice of assessment, or
- contact you and request additional information to prove the claims listed in the table above.

4.13 Moreover, the ATO's 2012–13 ITRIP letters also include dates by which the ATO expects to have contacted the taxpayer, and a telephone contact number for the taxpayer to follow up where this has not occurred.

4.14 The ATO calculates these dates based on the numbers of returns, expected staffing levels and the rates at which the ATO expects that cases would be finalised. In addition to setting these new timeframes, the ATO also actively monitors and adjusts expected delays in accordance with work performance so that the ATO can update its communications accordingly.¹³¹ Information provided to the IGT indicates that the ATO updated its timeframes several times in 2012–13 to reflect changing workloads and resources. Specifically, these updates occurred in August 2012, September 2012, October 2012 and January 2013.¹³² In addition, in April 2013, the ATO ceased issuing delay letters, noting that its resources enabled lodged tax returns to be allocated and actioned within two weeks of lodgement.¹³³

4.15 The 2012–13 ITRIP letters also provided some guidance as to the action taxpayers may wish to take in the meantime. Namely:¹³⁴

What can you do

Review the claims outlined in the above table and make sure you have the written evidence to support these claims in case it is requested. For more information about written evidence — go to our website www.ato.gov.au and search for 'Income tax return integrity supporting documentation'.

4.16 The ITRIP letters used in 2012–13 represented an improvement on those in prior years. The updated letters anchored taxpayer expectations as to dates by which they can expect to be contacted and any action they can take in the meantime. Such clarification helps to address the uncertainty and anxiety for taxpayers when returns are held for review by the ATO.

131 Above n 14, p. 1.

132 Ibid.

133 Ibid.

134 Above n 76.

ACTUAL ITRIP TIMEFRAMES

4.17 The ATO has extracted data in relation to the average timeframes for processing of returns held through the ITRIP. As a broad overview, the ATO has provided a three year comparison of completion timeframes within ranges of days. This is outlined in Table 14 below which records data from the date of lodgement to the notice of assessment being issued.

Table 14: Number and percentage of cases finalised within days specified for the lodgement years ending 30 June 2011 to 2013 (YTD)

Days	Year ending 30 June					
	2010–11		2011–12		2012–13 YTD	
	Number	Per cent	Number	Per cent	Number	Per cent
30 days	1,471	6%	14,334	14%	5,416	13%
60 days	3,966	15%	13,132	13%	15,945	39%
90 days	3,387	13%	10,384	10%	12,579	31%
120 days	4,688	18%	10,863	10%	4,644	11%
150 days	4,922	19%	9,908	10%	1,012	2%
200 days	5,366	20%	17,316	17%	179	<1%
250 days	1,769	7%	19,647	19%	1	<1%
300 days	375	1%	7,549	7%	1	<1%
300+ days	275	1%	658	1%	10 ¹³⁵	0%

Source: ATO data for 2011 and 2012 years extracted as at 11/2/2013 and 2013 YTD data extracted as at 4/2/2013.

4.18 The data shown above from the ATO largely reflects the previous taxpayer experience that large numbers of returns were delayed for processing and completion with two-thirds of cases requiring more than 90 days to complete. This can be compared with 83 per cent of cases being completed in 90 days or less in the 2012–13 year to date.

4.19 Moreover, these statistics are a useful point to determine whether the time actually taken to complete cases aligned with the ATO's expected shortest and longest timeframes prior to 2012–13, being 39 days and 148 days, respectively.¹³⁶ In 2010–11, 29 per cent were completed after 150 days had elapsed; exceeding the ATO's longest expected timeframe. In 2011–12, the number of cases requiring 150 days or more to complete increased to 44 per cent.

4.20 However, following the ATO's improvements in 2012–13, 96 per cent of cases were completed in 150 days or less and more than half (52 per cent) being completed in 60 days or less. This appears to better align with the ATO's expected shortest timeframe for completion of ITRIP cases for 2012–13.

¹³⁵ The ATO notes that these 10 cases are a result of a suppression having been placed on the taxpayer's file in the previous year and which was not lifted until 2013. It is therefore not an ITRIP case in 2012–13.

¹³⁶ ATO, 'Income Tax Return Integrity – End to End Process – Shortest Timeframe' (August 2011), internal ATO document; ATO, 'Income Tax Return Integrity – End to End Process – Longest Timeframe' (August 2011), internal ATO document.

4.21 To further illustrate differences in timeframes, the ATO has also provided two sets of average actual timeframes comparing three consecutive financial years of performance being 2010–11, 2011–12 and 2012–13 year to date. Table 15, below, shows the mean, mode and median of timeframes between the taxpayer lodging their income tax return and the refund being issued.

4.22 The ATO's data also examines differences in average timeframes depending on the specific outcomes resulting from action taken by the ATO. The ATO's definition of each of the outcome categories included in the Table 15 are:

- no adjustment — compliance action has resulted in no adjustment being made to the original return. This is sometimes referred to as no further action (or NFA);
- adjustment — compliance action has resulted in an adjustment being made to the original return. The adjustment could either be in favour of the taxpayer or in favour of the revenue;
- internal review — the return is matched and verified against internally held data or third party data (such as employers' returns) and is released without adjustment and without further contact with the taxpayer; and
- unknown — these cases cannot be categorised owing to missing data fields in the ATO's information.

Table 15: Days elapsed from lodgement to issue of notice of assessment for the lodgement years ending 30 June 2011 to 2013 YTD

Category	Financial year								
	2010–11			2011–12			2012–13 YTD		
	Mean	Median	Mode	Mean	Median	Mode	Mean	Median	Mode
No adjustment	120	119	125	168	177	9	67	64	64
Adjustment	143	143	127	172	176	232	83	81	85
Internal review	61	43	41	79	43	9	56	56	68
Unknown	93	72	50	120	104	9	65	63	79

Source: ATO data extracted as at 12/2/2013

4.23 The IGT notes, from the data in Table 15 above regarding days elapsed, that the ATO's average timeframes for cases resulting in adjustments in 2010–11 fell just under the ATO's expected longest timeframe for completion of ITRIP cases of 148 days. In 2011–12 this expected standard was exceeded on average by 24 days, with a median of 176 days and the most frequently occurring completion being around 232 days. It should be noted that the timeframes in both 2010–11 and 2011–12 were better in relation to cases in which no adjustment was made, or where the ATO could use other data to assist in its verification.

4.24 In the 2012–13 year to date, all average timeframes were markedly better than in the preceding two years, with average timeframes being under 90 days for adjusted returns, and around 60 days for other outcome categories.

4.25 There also appears to be a reasonably consistent difference between time taken in cases involving an adjustment and those involving no adjustment. This may be attributable

to the time taken for the ATO to initially contact the taxpayer, consider any taxpayer-provided information or to notify the taxpayer of the outcome of the review.

4.26 The ATO notes that while the days elapsed from lodgement to issuing of notices of assessment is one measure of the timing impact of ITRIP; it does not represent the most accurate picture. It considers that a better measure of the timing impact of ITRIP would be from the suppression start date, that is, when the return is suppressed from further processing in ICP, and the suppression end date when the return continues to be processed through ICP following completion of the ITRIP checks.

4.27 While the ATO may consider that suppression start and end dates provide a better measure of the timing impacts of the ITRIP process itself, it is important to appreciate that much of the machinations of the ITRIP are not visible to the taxpayer. The primary measure of timeliness of tax return processing for taxpayers is the date of lodgement and the date on which the refund is received. To an extent, the ATO also recognises this, having provided both sets of data for comparison.

4.28 Suppression start and end dates serve as a good ‘internal measure’ for the ATO to assess the timeliness of its ITRIP process. The average days elapsed from start to end of suppressions for the years 2010–11, 2011–12 and 2012–13 year to date are outlined in Table 16, below.

Table 16: Days elapsed from suppression start to end dates for the lodgement years ending 30 June 2011 to 2013 YTD

Category	Year ending 30 June								
	2010–11			2011–12			2012–13 YTD		
	Mean	Median	Mode	Mean	Median	Mode	Mean	Median	Mode
No adjustment	114	109	120	155	163	197	55	53	50
Adjustment	132	130	134	156	159	218	67	65	57
Internal review	64	39	34	76	37	16	48	47	63
Unknown	94	71	41	127	117	16	53	50	29

Source: ATO data extracted as at 12/2/2013.

4.29 The data in Table 16 largely aligns with that contained in Table 15. It shows that returns in the 2010–11 year largely comply with the ATO’s estimated longest timeframe for completion of ITRIP cases. In 2011–12, average timeframes for cases in which, following compliance activity, either an adjustment was made or no adjustment was made, exceeded the ATO’s estimated longest timeframe. In 2012–13, average timeframes were significantly improved from the previous two years with all timeframes averaging between 29 and 67 days.

IGT observations

4.30 From the information contained in both Tables 15 and 16, the IGT notes that the taxpayer experience in 2012–13 appears much improved from the previous two years in relation to the timeliness of processing of returns. In some cases, the 2012–13 experience represented an average improvement of about 100 days.

4.31 It is clear from the data in these tables that the review of ITRIP returns is significantly more efficient where the ATO is able to use third party data to verify its concerns. In all years presented for comparison, cases in which third party data is used to address the risks identified by the ATO, the average days elapsed to completion was lower — frequently by a wide margin from other cases.¹³⁷ The ATO has also indicated that it recognises the efficiency of utilising third party data to verify and release returns held by the ITRIP. Accordingly, it is currently trialling the use of third party data in relation to some returns held under the pattern detection and identity crime models.¹³⁸

4.32 The IGT acknowledges that not all cases can be verified through the use of third party data as it is dependent on the data available and the risk being addressed. However, the efficiency benefits of using third party data for this purpose are clear from the statistics. Accordingly, the IGT considers that, to the extent possible, the ATO should implement strategies to enhance its use of third party data to verify and release as many returns as possible without the need to contact the taxpayer or their agent. Such an approach would assist in minimising resource impacts on the ATO and taxpayers and their agents.

RECOMMENDATION 4.1

The IGT recommends that:

- (a) the ATO continuously improve the time period between a return being stopped and initiating inquiries with the taxpayer or their agent by increasing staff conducting ITRIP reviews during Tax Time and commencing audits sooner;*
- (b) the ATO continue to implement strategies to obtain data in a timely manner which may be applied to verify tax returns held by the ITRIP; and*
- (c) where any new risk or label rules are proposed to be incorporated into the ITRIP, or where any existing rules are proposed to be updated, the ATO build into the model available third party data that could be used for compliance verification.*

ATO Response

Agree.

TAX AGENT VISITS

4.33 The ATO has recognised that in 2011–12, about half of the returns stopped by the ITRIP (approximately 50,000) were lodged by tax agents. As a result of the extended delays experienced in that year, a number of tax agents were managing multiple individual tax returns which the ATO was reviewing.

137 With the exception of the mode in relation to internal reviews for the 2012–13 year to date which was six days more than the mode for adjusted returns.

138 Above n 14, p. 4.

4.34 The ATO had originally planned in July 2011 to send compliance managers to all tax agents identified as having 50 or more returns stopped to provide education on the ITRIP and to deliver key Tax Time messages.¹³⁹ However, following observations regarding the high numbers of returns stopped in 2011–12, the ATO decided to re-focus the purpose of these meetings to assist these tax agents in managing tax returns held by the ITRIP and to improve ITRIP processing efficiency.¹⁴⁰ Between the end of August and early October 2011, the ATO undertook approximately 90 such visits to tax agents who were dealing with a combined total of about 4,500 income tax returns which had been stopped by the ITRIP.¹⁴¹

4.35 A number of these visits were educational, while others focused on the risks identified in the returns. While the ATO notes the good feedback received from these visits, it did not keep any records of the numbers of returns which were processed as a result of this initiative.

4.36 As the high numbers of returns stopped by the ITRIP created a backlog into early 2012, the tax agent site visits initiative was undertaken again in February 2012. The initiative involved a re-allocation of compliance managers to make personal visits to tax agents who had more than 10 clients with returns held. As with the earlier visits, the purpose was to expedite information gathering, consideration of information provided and processing of returns.

4.37 Between February and June 2012, the ATO visited 100 tax agents and finalised 2,000 cases. While the ATO did not undertake any formal assessment of the effectiveness of the initiative, it has advised the IGT that informal feedback received from tax agents noted the following benefits:¹⁴²

- Opportunity to speak with someone face to face regarding the process, individual cases and answer any queries.
- A single contact point for cases, ongoing concerns and issues.
- Ability to better systematically manage their workloads resulting from the income tax return integrity process.
- A feeling of satisfaction that consideration was given to the effect of these workloads on their practices and clients.

4.38 The reduction in backlog cases coupled with the reduced numbers of tax agent-lodged returns which were stopped by the ITRIP in 2012–13 (approximately 15,000 in 2012–13), has resulted in fewer instances of tax agents being required to manage multiple cases subject to ATO review.¹⁴³ Accordingly, the ATO notes that the tax agent visits initiative will not be implemented in future years.¹⁴⁴

139 Above n 72.

140 Above n 92.

141 Above n 72.

142 Above n 98, pp. 6 and 7.

143 Ibid.

144 Ibid.

4.39 Notwithstanding this, the ATO notes that based on the informal feedback it received in 2011–12, it has implemented a communication strategy to assist tax agents with the highest number of returns held by the ITRIP, including:¹⁴⁵

The top 5 Tax Agents with the most number of client returns stopped were allocated to a Tax Agent Compliance Strategy Compliance Manager. The cases from these 5 Tax Agents were allocated to a specific team in Pre Issue Compliance. The Compliance Manager worked with these teams in terms of co-ordination of the work and discussion of key points. The Compliance Manager contacted the Tax Agent to explain the Income Tax Return Integrity process, discuss any issues and identify themselves as a central contact point.

The remaining top 30 Tax Agents with the most number of client returns stopped were also profiled by Compliance Managers. These Tax Agents were also contacted in order to explain the process and provide any relevant messaging.

4.40 During the course of this current review, the ATO has advised the IGT that, moving forward into future years, it intends to implement a more comprehensive engagement model with tax agents to assist them through Tax Time. The first of these initiatives was a series of 1,000 visits to tax agents by ATO compliance managers in the weeks leading up to 1 July 2013. The purpose of this was to deliver key messages regarding refund fraud to those tax agents considered at risk of being affected by fraud and who used online systems to communicate with their clients.¹⁴⁶

4.41 In addition to delivering key messages to assist tax agents to identify instances of potential fraud, the ATO also notes that through these visits, tax agents were provided with a single point of contact, being the visiting compliance manager. The ATO notes that it has received positive feedback from these visits though no formal evaluation of the initiative has been undertaken.

IGT observations

4.42 The IGT supports the ATO's ongoing engagement with tax agents and acknowledges the ATO's new initiatives to assist tax agents during Tax Time. Such engagement assists in developing a more effective and efficient working relationship between tax agents and the ATO and operates to mitigate potential adverse impacts which may otherwise arise from the ATO's compliance activities. Tax agents have raised with the IGT the benefits of having direct access to identified ATO officers to resolve and address issues as and when they emerge.

4.43 The IGT acknowledges that, historically, the ATO had provided tax agents with relationship managers to assist in resolving issues as and when they emerge. However, given the numbers of tax agents, such a program was resource intensive and the officers allocated to the roles were perceived to lack sufficient seniority and technical proficiency to effectively manage relationships with tax agents. As such, these roles were abandoned in favour of such initiatives as tax agent 'fast key codes' to provide more timely telephony support to direct tax agent enquiries to appropriate areas within the ATO.

145 Ibid.

146 ATO, communication with the IGT, p. 4.

4.44 However, given the positive feedback received by the ATO in relation to its tax agent visits campaign, the IGT considers that there may be some benefit in the ATO looking to identify further opportunities to engage and assist tax agents to meet their obligations and resolve any issues which may emerge, including undertaking site visits at the request of tax agents with larger numbers of tax returns stopped by the ITRIP.

RECOMMENDATION 4.2

The IGT recommends that the ATO, in addition to undertaking specific campaign visits to assist tax agents:

- (a) undertake site visits at the request of tax agents with larger numbers of delayed income tax returns held under the ITRIP to review and finalise these in an efficient and cost-effective manner; and*
- (b) provide a direct contact point within the ATO and clear lines of escalation to assist tax agents to raise and address areas of concern in relation to the ITRIP.*

ATO Response

Agree.

4.45 Issues regarding the ATO's interaction with tax agents more generally have been raised in earlier IGT reviews.¹⁴⁷ The IGT may consider this as part of a broader review into the ATO's services and support for tax practitioners which was announced as part of his 2012–13 forward work program. As stated in that work program announcement, the IGT considered that there would be some benefit in allowing time for the ATO to implement its initiatives under the Tax Practitioner Action Plan before a review is undertaken.¹⁴⁸

OPPORTUNITIES TO EXPEDITE PROCESSING

4.46 One of the chief stakeholder complaints arising from ITRIP processing is the lack of appropriate mechanisms for taxpayers or tax agents to intervene and expedite the process. The ATO acknowledges this and notes that taxpayers are only able to provide information when the ATO has requested information and not sooner. The ATO contends that this aligns with the principle that returns are processed in the order they are received.¹⁴⁹

4.47 However, submissions stated that such a situation creates additional anxiety and uncertainty and does not assist tax agents to plan their work effectively. It also creates an incentive for taxpayers and tax agents to seek other channels of engagement with the ATO to address delayed processing issues, such as the ATO Complaints section.

¹⁴⁷ IGT, *Review into improving the self assessment system*, 13 February 2013; Above n 61.

¹⁴⁸ IGT, *New IGT Work Program*, 10 October 2012; ATO, *Tax Practitioner Action Plan*, <<http://www.ato.gov.au/Tax-professionals/TP/Tax-practitioner-action-plan-2011-15/>>.

¹⁴⁹ Above n 76.

Using ATO complaints and hardship applications

4.48 In submissions to the IGT, some tax agents have noted that they were unable to progress their clients' returns through the ordinary ITRIP channels within the MEI business line. They, therefore, resorted to lodging formal complaints via the ATO's Complaints section as a means of bringing the case to the attention of an ATO officer. These tax agents have noted that they were able to more clearly ascertain reasons for delay and to progress their clients tax returns for processing more quickly through the complaints mechanism.

4.49 Indeed, the increased level of complaints received in relation to delayed refunds in 2011–12 outlined earlier in Table 13 lends support to this approach. While not as pronounced as in 2011–12, the statistics in relation to complaints in 2012–13 (year to date) also show an increase from 2010–11.¹⁵⁰

4.50 Submissions to the IGT have suggested that, on occasions, ATO Complaints staff have encouraged tax agents to lodge ITRIP complaints as a means of progressing the cases rather than pursuing the matter through the MEI business line. In discussions with the IGT, the ATO has acknowledged that in prior years, the varying work practices across different case actioning teams within the MEI business line has enabled some taxpayers and tax agents to resolve their delayed refund issues sooner.¹⁵¹

4.51 The ATO notes that such a situation is undesirable as it creates an uneven playing field. The ATO has taken action to ensure a consistent approach across its general ITRIP processing and cases which are escalated through ATO Complaints. This included an updating of the ATO Complaints section scripting for the management of complaints relating to ITRIP delays.

4.52 In the main, the updated scripting provides guidance and details regarding the ITRIP process and, relevantly, the date by which the taxpayer can either expect their refund to be issued or further information to be requested based upon when the income tax return was lodged. This information is drawn from an internal spreadsheet made available by MEI to the ATO Complaints section.¹⁵²

4.53 The ATO has advised that the spreadsheet used by the ATO Complaints section was an interim measure. The ATO has since established new procedures to include specific dates and timeframes in individual taxpayer delay letters which are attached to the taxpayers' correspondence history on the ATO's enterprise case management system, Siebel. ATO officers, including call centre staff, are able to access the letter and discuss relevant aspects of the taxpayer's case including timeframes and details of items proposed to be reviewed.

4.54 In addition to using ATO Complaints to raise concerns about the delays in issuing refunds, the IGT has also identified some instances of the complaints mechanism being used by taxpayers to bring issues of serious hardship to the ATO's attention. Where the taxpayer

150 The ATO has advised that in 2011–12, the complaints figure related only to ITRIP cases whereas in 2012–13, this was combined with HRR complaints. Care needs to be taken when examining trends in complaint levels.

151 Above n 51.

152 ATO, 'ITRI HRR Touchpoints July 2012', accessed from Quicksmart, internal ATO scripting system.

demonstrates that they are experiencing serious hardship, the ATO aims to deliver refunds in these cases within five working days.¹⁵³

4.55 Taxpayers may lodge a request for serious hardship consideration either following the lodgement of their income tax return, or at the same time as lodging their income tax return through a designated facsimile number.¹⁵⁴ The ATO has provided some guidance in relation to the type of material which individual taxpayers and business may put forward in support of a claim for hardship. These include documents such as official eviction notices, pending disconnection of essential services, bank overdraft notices or repossession notices.¹⁵⁵

4.56 Based on information provided by the ATO, the standardised ITRIP correspondence indicates that general information regarding hardship was included for the first time in its ITRIP letters in 2011–12.¹⁵⁶

4.57 The ATO caveats that provision of these documents may not necessarily result in a taxpayer being granted hardship status. Further, it notes that processing times may be impacted where the taxpayer has external liabilities such as with Centrelink or the Child Support Agency, or where there are multiple returns needing to be processed.¹⁵⁷

4.58 The ATO has advised the IGT that hardship applications are administered corporately by the CAS business line. Once the CAS business line has substantiated the taxpayer's hardship status, the case is referred to the relevant business line (in the case of ITRIP, the MEI business line) for priority processing.

4.59 While the ATO currently collects data in relation to hardship applications generally, it does not presently record data in relation to those which relate to ITRIP. It notes:

There is no data to determine the percentage of hardship requests that relate specifically to the income tax integrity program. Client Account Services have advised that for the period 1 July 2012 to 30 Dec 2012, the tax office received 3,006 hardship requests in total. Of those, 1,937 (64.4 per cent) were substantiated and processed under the hardship criteria.¹⁵⁸

4.60 As such, it is not known how many hardship cases involved ITRIP delays. Therefore, it is difficult to compare the relative timeframes of hardship priority processing against processing timeframes under the ITRIP generally.

IGT observations

4.61 The IGT acknowledges that hardship is a serious consideration and should rightly bear priority status where taxpayers can demonstrate the severe impact of delayed refunds.

4.62 In addition, there may also be other circumstances which may not, strictly speaking, give rise to hardship but are cases in which the ATO should give consideration to expedited

153 ATO, Financial hardship – what you need to know, <<http://www.ato.gov.au/General/Financial-hardship/In-detail/Financial-hardship---what-you-need-to-know/>>.

154 Ibid.

155 Above n 153.

156 Above n 76.

157 Above n 153.

158 Above n 118.

processing. Such cases include where the ATO is informed that the taxpayer is due to travel and will not be available to address the ATO's enquiries, or where a tax agent requires assistance to manage tax commitments during Tax Time. In the latter case, given the high demands on tax agents' time to lodge a high quantity of tax returns, it may not always be possible to respond to the ATO on a case by case basis. Therefore, a certain degree of flexibility for tax agents to initiate contact with the ATO may assist them better respond to the ATO's inquiries and to manage their Tax Time commitments to taxpayer clients.

4.63 The IGT appreciates the ATO's need to ensure that returns are processed in the order that they are received and to manage its resources accordingly so that lengthy delays are avoided where possible. However, the IGT also considers that there is benefit in the ATO exploring mechanisms or strategies whereby taxpayers and tax agents can initiate contact with the ATO to expedite the processing of held returns in appropriate cases.

4.64 In developing such strategies, the ATO should give consideration to implementing a hierarchy of priorities with cases of demonstrated serious hardship being given the highest level of priority processing. The hierarchy can then examine other situations in which some mechanism to expedite processing may be appropriate, such as those circumstances outlined above.

4.65 Moreover, in developing these strategies the ATO should consider ways in which it would distinguish between taxpayers who genuinely require priority processing of their income tax returns and those who do not. Such strategies may include the ATO requesting taxpayers to demonstrate the reasons why priority processing is appropriate, such as providing copies of travel documents where the taxpayer expects to be overseas at the time of the ATO's review.

4.66 ATO staff procedures should be augmented to ensure ATO staff consider the taxpayer's and tax agent's circumstances holistically and provide clear lines of escalation in cases where circumstances are outside the norm.

RECOMMENDATION 4.3

The IGT recommends that the ATO develop and adopt a differentiated approach in reviewing and processing income tax returns held under the ITRIP by:

- (a) the MEI and CAS business lines enhancing the management reporting of ITRIP serious hardship cases and using such findings to continually improve the management of these cases; and*

RECOMMENDATION 4.3 (CONTINUED)

(b) augmenting its pre-issue compliance procedures to:

(i) provide clear instruction and guidance to ATO staff to holistically consider taxpayers' or tax agents' circumstances and respond to these in a flexible manner; and

(ii) provide clear lines of escalation where taxpayers and their agents are unable to resolve any disputes which may arise directly with the ATO audit officer.

ATO Response

Agree.

CHAPTER 5 — ATO COMMUNICATION AND ENGAGEMENT

INITIAL COMMUNICATIONS WITH TAXPAYERS AND THEIR ADVISERS

5.1 Communication, particularly when a return is to be delayed, is critical in ensuring a productive working relationship amongst all parties, namely, the taxpayer, their tax agents and the ATO. Specifically, clear and appropriate communication as to expected timeframes and reasons for delays assists taxpayers and agents to better engage with the ATO and to address its concerns in an effective and efficient manner.

5.2 Where communication is insufficient or inadequate, it has the potential to give rise to significant uncertainty and anxiety on the part of taxpayers. This may also have a flow-on effect to tax agents acting as intermediaries between their clients on the one hand and the ATO on the other.

5.3 The ATO uses both a standardised suite of written correspondence as well as telephone contact to communicate events and outcomes as a result of ITRIP audits. The IGT has reviewed the suite of ITRIP written correspondence used by the ATO in the years between 2009–10 and 2012–13 and the ATO's procedures and instructions to staff, together with concerns raised in submissions. The following sections provide further details on different aspects of ATO ITRIP communication as well as the IGT's related observations.

COMMUNICATING REASONS FOR HOLDING RETURNS AND DELAYS

5.4 In submissions to the IGT, concern has been raised regarding the ATO's inability or unwillingness to disclose specific reasons for delays in processing and the specific elements of a taxpayer's return that caused it to be held.

5.5 One case study brought to the IGT's attention noted that despite ongoing requests by the tax agent for reasons for delay in processing his client's return, including a formal complaint, the ATO ultimately finalised the case by issuing the tax refund. No information was provided regarding why the return was held and delayed in the first instance.

5.6 Such a situation creates difficulties for tax agents in maintaining credibility with their clients as an absence of ATO explanation can raise doubt in the taxpayer's mind as to whether reasons for the delay related to the tax agent's diligence or professionalism. As a consequence, the ATO exposes itself to a risk that it will lose credibility and respect from the tax agent community, taxpayers or both.

5.7 In reviewing the standardised correspondence used by the ATO as part of the ITRIP between 2009–10 and 2012–13, the IGT notes significant shifts in the content and level of information provided in relation to the nature of the ATO's concerns and potential reasons why returns have been held.

5.8 In 2009–10, for example, the ATO's initial delay letter was accompanied by a schedule of items and original figures with instructions for taxpayers to review the items in the schedule and provide evidence to substantiate those claims. The letter carries a consequence that inaction on the part of the taxpayer will result in the claimed items being removed and the return adjusted accordingly.¹⁵⁹

5.9 The following year, the ATO took a more general approach with instructions that taxpayers should review their income tax returns and make voluntary disclosures on any errors or omissions in the attached generic schedule. This letter provided no details as to which particular items the taxpayer should focus on, unlike the letters in the previous year.¹⁶⁰

5.10 In 2011–12, the initial ATO delay letters were devoid of any specific instructions for taxpayers. The only references made to reasons for returns being held were a generic list of possible risks identified by the ATO. Specifically:¹⁶¹

Some of the common issues identified include:

- understated income and/or fictitious payment summary details;
- overstated or fraudulent deductions;
- non entitlement to claimed offsets/rebates; and
- instances of identity takeover.

5.11 The change in approach is likely to be a result of an expansion of the scope of the ITRIP's application from *e-tax* lodgements only, to include lodgements through other channels. While the IGT acknowledges the added difficulties in extracting areas of concern from non-electronic lodgement channels, it is nonetheless important that taxpayers and tax agents be made aware of the ATO's areas of concern.

5.12 With the benefit of user-testing of its standardised correspondence, the ATO received feedback on the uncertainty of a generic list of concerns, as contained in the ITRIP 2011–12 letters. Specifically, the simulation centre report noted the following:¹⁶²

The uncertainty regarding what caused the tax return to be selected for review may result in the recipient spending time reviewing parts of the tax return which are not the subject of the review. It may also result in the letter recipient calling the ATO to discover which parts they should start reviewing. Providing the information in this first letter may also cause the recipient to feel more certain about the review process.

5.13 This user feedback is consistent with observations made by the IGT in his *Review into the ATO's use of benchmarking to target the cash economy* (the Cash Economy Benchmarking review) regarding the ways in which bulk letter campaigns may influence taxpayer behaviours and impose a cost on them and the ATO. Specifically, that report noted the letter

159 Above n 76.

160 Ibid.

161 Ibid.

162 Above n 127, p. 11.

design issues resulting in taxpayers taking unnecessary action or contacting the ATO or their tax agents to seek clarification.¹⁶³

5.14 In line with the simulation centre recommendations, the initial delay letter was updated in 2012–13 to include a table of the items which may require verification. The letter was also amended to give guidance to taxpayers that they should ensure they have sufficient evidence to substantiate the claims, in case such evidence is requested.¹⁶⁴ An extracted sample of this table, included in the initial delay letter, is outlined below:¹⁶⁵

The table below shows the information provided in your <Year> income tax return that may require further verification:

Label/s on return	Section
13 P&T NPP Distribution from partnerships	Income Supplement
D1 Work-related car expenses	Deduction
D5 Other work-related expenses	Deduction
T1 Spouse (without dependant child or student), child-housekeeper or housekeeper (P)	Tax Offsets

IGT observations

5.15 The initial delay letter used in 2012–13 represents an improvement on the previous year's letter in providing taxpayers and their agents with the labels which may be the subject of the ATO enquiry. The ATO has advised that, where possible, it will seek to verify the labels of concern against third party data and will only contact taxpayers for further information if third party data verification is not possible.¹⁶⁶

5.16 However, the IGT remains concerned that the letters may still be somewhat uncertain, potentially leading taxpayers to gather or collate evidence in anticipation of ATO enquiries, or direct their tax agents to do so. In either case, there is a potential for time and costs to be incurred and borne by either the taxpayer or the agent. The IGT considers that much of this may be addressed through future enhancements in letter design and ongoing user-testing to discern areas of confusion and uncertainty and to address those prior to implementing standardised letters.

5.17 Notwithstanding improvements which the ATO may make in the future, the IGT notes there will always be instances in which cautious taxpayers, in seeking to do the right thing, may provide information to the ATO which is not strictly necessary. In such instances, the ATO should be in a position to acknowledge receipt of the information and inform these taxpayers or their agents of the next steps in the process and what the ATO intends to do with the information.

163 Above n 61, pp. 56–58.

164 Above n 76.

165 Ibid.

166 Ibid.

5.18 A similar issue was also encountered in the Cash Economy Benchmarking review where taxpayers provided information in response to the ATO's advisory letters, when a response was not strictly required.¹⁶⁷

5.19 This, together with recent observations made by the Commonwealth Ombudsman regarding the ATO's communication with individual taxpayers indicates that the ATO's awareness of the 'behavioural' responses to its letters presents an opportunity for improvement.¹⁶⁸

5.20 The IGT notes that applied research emerging from the United Kingdom through the Behavioural Insights Team within the UK Cabinet Office supports such an approach. The research notes:¹⁶⁹

... that even relatively minor changes to processes, forms and language can have a significant, positive impact on behaviour. Evidence also suggests that the effectiveness of interventions depends heavily on the context and setting, and that — in some instances — interventions in one domain might not be as effective when translated into other areas.

5.21 Accordingly, the Behavioural Insights Team notes that:¹⁷⁰

Central to this is the development of randomised controlled trials (RCTs), which are considered to be the gold standard of research trials.

This involves dividing the study population into two or more groups and randomly assigning individuals to each of these groups. By giving the intervention (for example the modified letter, the changed process, the new text message) to one of these groups while continuing to treat the other group as business per usual, we can determine the difference in effectiveness of each of the interventions. The key ingredient to this approach is the randomisation of individuals to groups, which enables us to assume that any difference in outcomes is attributed to the intervention rather than other factors.

5.22 In this respect, the IGT considers that there may be significant benefit in the ATO having regard to this applied behavioural insights research when considering improvements to its letter design process and communications with taxpayers. Such a process should specifically consider whether the proposed letters will generate the intended taxpayer response by reference to such matters as the level of content, detail and direction for taxpayers. It should also seek to minimise compliance costs arising for taxpayers, tax agents and the ATO itself by reducing unnecessary action.

5.23 Although the ATO already conducts some user-testing on Tax Time material, the ATO could ensure such user-testing seeks feedback from a diverse range of stakeholders to assure itself of the accessibility of its correspondence to the target group of taxpayers and tax

167 Above n 61, p. 24.

168 Joint Parliamentary Committee of Public Accounts and Audit, Ninth Biannual Hearing with the Commissioner of Taxation, Official Committee, Hansard, 23 September 2011, p. 15.

169 UK Cabinet Office Behavioural Insights Team, *Applying behavioural insights to reduce fraud, error and debt* (February 2012), p. 21.

170 Ibid.

agents. The development and inclusion of randomised controlled trials is an important design feature in this regard.

RECOMMENDATION 5.1

The IGT recommends that the ATO, having regard to the applied research emerging from the UK's Behavioural Insights Team:

- (a) assess the effectiveness of the ITRIP letters to generate the intended behavioural response from individual taxpayers through the use of randomised controlled trials in correspondence design; and*
- (b) ensure that it acknowledges and deals with any information received by taxpayers or their agents in response to the ATO's ITRIP letters, including in cases where the ATO has not specifically requested information be provided.*

ATO Response

Agree.

Use of Reason Codes

5.24 Tax agents had previously raised with the ATO concerns regarding the lack of clarity as to why returns had been held and the specific reasons for delays in processing of income tax returns. In 2012–13 the ATO adopted a system of reason codes to inform tax agents of reasons for their clients' returns being delayed.

5.25 Specifically, the process involved the ATO sending a monthly email to the relevant tax agent, with an attached spreadsheet containing details of each of their clients whose returns were delayed and an accompanying reason code to provide a generic reason for such delay. Tax agents are then able to check these codes against more detailed explanations on the ATO's website¹⁷¹ or through the Tax Agent Portal.

5.26 The eleven reason codes which were used by the ATO in 2012–13 are:¹⁷²

- Reason code 1: Potentially fraudulent and/or overstated claim.
- Reason code 2: Compromised TFN.
- Reason code 3: Manage an existing debt where the client is or has been insolvent and/or the debt requires further manual processing.
- Reason code 4: Compliance activities are being undertaken.
- Reason code 5: Verifying information provided in the return, cross-checking information held on our systems and/or performing manual calculations.

¹⁷¹ A complete list of the codes and associated reasons are accessible here: <<http://www.ato.gov.au/Tax-professionals/TP/Reasons-for-delay>>.

¹⁷² Ibid.

- Reason code 6: Processing other forms and/or payments for the client.
- Reason code 7: Manage an existing debt for the client.
- Reason code 8: Verify the identity of the client and/or tax agent.
- Reason code 9: Natural disaster impacts.
- Reason code 10: Awaiting advice from other Commonwealth Government agencies.
- Reason code 11: Accounting action in progress.

5.27 A sample of this report which the ATO issues to tax agents is provided in Figure 5 below.

Figure 5: Sample report sent to tax agents

Electronic Tax Returns Delayed — Individuals					Advice Date:
Delayed Processing Advice					23/10/2012
Newly Advised Clients					
First name	Surname	Tax agent Client Identifier	Period	Type of Return	Reason Code for Delay
Joe	SMITH	APJF30	2012	Income	6
Total New Clients					1
Previously Advised Clients					
First name	Surname	Tax agent Client Identifier	Period	Type of Return	Reason Code for Delay
John	DOE	FJ305	2012	Income	2
Jessica	CITIZEN	JFS93	2011	Fringe Benefits	3
Magnus	JONES	LKF205	2012	Income	1
Total New Clients					3

Source: ATO

5.28 Submissions to the IGT have noted that the reason codes are an improvement and provide a focus for discussion between tax agents and their clients. However, submissions have also suggested that the codes, while a good initiative, are so broad as to not be sufficiently informative.

Grouping fraud with overstated claims and lack of specificity of reason codes

5.29 It is clear from the list above that the ATO's reason codes are general in nature. For example, the ATO advises that reason code 1 'potentially fraudulent and/or overstated claim' is the code that it applies to all returns which are delayed as a result of review under the ITRIP or the HRR program. It notes that the remaining codes are applied to returns which are delayed for reasons unrelated to ITRIP or the HRR program, such as where it identifies that a return has been lodged with a TFN that the ATO considers to be

compromised (reason code 2).¹⁷³ Two concerns were raised by stakeholders in relation to the ATO's current reason codes which are addressed below.

5.30 The first issue of significant concern related to the ATO's grouping of 'potentially fraudulent' and 'overstated claim' in the one category as denoted by reason code 1 above. Taxpayer submissions to the IGT have noted the considerable shock and anxiety caused by the perception that the ATO considers them to be fraudulent. This is especially so for taxpayers who have a good compliance history and who strive to continue to comply in relation to their tax obligations.

5.31 Similarly, where returns were lodged through tax agents, submissions to the IGT have highlighted the tensions this has created between agents and their clients. In these cases taxpayers can perceive that their agent has acted fraudulently or negligently in the lodgement of the return.

5.32 As discussed earlier in this report, the difficulties and impacts associated with grouping fraud together with overstated claims are exacerbated by the ATO's public communications which emphasise the fraud element.¹⁷⁴

5.33 The ATO acknowledges the need to distinguish between those taxpayers making a mistake while trying to do the right thing, and those who are intentionally disregarding their taxation obligations. As the ATO noted in the Second Report of its Cash Economy Taskforce:¹⁷⁵

The community expects fairness and individual treatment. The ATO needs to recognise and differentiate between those trying to do the right thing and those who intentionally disregard their taxation obligations. This will require the ATO to be firm, but also fair, in bringing to account those who are not meeting their obligations.

... Importantly, the ATO needs to be sure that those already in the system have full knowledge of their obligations and have been given every opportunity to comply. The ATO must be sure that previous good behaviour, or a history of poor behaviour, is acknowledged and taken into consideration in current dealings. The use of stronger enforcement measures on an industry or individual taxpayer will be supported by evidence that lesser measures have proved unsuccessful.

5.34 The second concern in relation to the ATO's reason codes is that they do not appear to accurately reflect the taxpayer's circumstances and the reasons why the tax return has been delayed for processing. Examples provided by stakeholders include:

- reason code 1 [potentially fraudulent and/or overstated claim] being used where taxpayers have lodged nil tax returns;
- reason code 6 [processing other forms and/or payments for the client] in cases where no other lodgements or payments have been made to the ATO;

173 Above n 57.

174 See for example, ATO, Compliance Program 2012-13, above n 2, p. 17.

175 ATO, *Improving Tax Compliance in the Cash Economy* (April 1998), pp. 57 and 58.

- reason code 7 [manage an existing debt for the client] where tax agents cannot see any debt owing by the taxpayer to the ATO through the Tax Agent Portal; and
- reason code 11 [accounting action in progress] which stakeholders have suggested is vague and does not specifically point to any factor which should delay processing of the tax return.

5.35 Moreover, the IGT observes some overlap between reason codes 3 and 7, both of which appear to centre on ATO's management of debt which may be owing by the taxpayer.

5.36 During the course of this review, the IGT was advised that the ATO is in the process of updating its reasons for delay to more accurately reflect the circumstances surrounding the delay and to address feedback from tax agents regarding some confusion which currently exists between reason codes 1 and 4. The ATO intends to use the updated reason codes from 1 July 2013.¹⁷⁶ As at the date of this report, the ATO had not yet finalised its drafting of updated reasons for delay and as such, it was not possible to review the content of these updated reasons.

IGT Observations

5.37 The IGT considers that there is significant merit in communicating reasons for delays with greater specificity. This is likely to better inform tax agents and allow for more meaningful engagement between the agent and their client as well as with the ATO and minimise costs for all parties. The IGT acknowledges that greater specificity may only be achievable to an extent, having regard to the high volumes of interactions within this market segment. However, where it is not possible to achieve a high degree of specificity, the IGT considers that the ATO could supplement its standardised letters with direct contact points to ATO officers who are able and authorised to provide taxpayers and their agents with more specific reasons.

5.38 A key area in need of greater specificity is more clearly distinguishing between fraud and overstated claims. It is important to remember that such a distinction necessarily turns on the intent and mindset of the person lodging the income tax return, which is not always readily discernible by automated processes. This is recognised in recent academic literature.¹⁷⁷

5.39 Notwithstanding this difficulty and the ATO's move away from a focus on fraud in official communications, it is critical that the ATO develop mechanisms to differentiate between the types of risks, behaviours and taxpayer categories to ensure that compliance activities are both appropriate and proportionate to the situation. A failure to do so creates an appreciable risk of reduced community confidence in the ATO as a fair administrator and potentially undesirable behaviours being generated.

5.40 The IGT recognises that the ATO is seeking to better differentiate not only between cases of fraud and over-claiming, but also between higher risk over-claiming and lower risk

¹⁷⁶ Above n 57.

¹⁷⁷ Kathleen M Carley et. al., 'Predicting Intentional and Inadvertent Non-compliance,' paper delivered at IRS Research Conference, Washington DC, June 29 – 30, 2010.

over-claiming.¹⁷⁸ In doing so, the ATO should also be mindful to ensure that its public communications reflect the fact that the vast majority of income tax returns reviewed are not dishonest or fraudulent.

RECOMMENDATION 5.2

The IGT recommends that as part of its ITRIP work to improve communication of reasons for delays in processing of income tax returns, including through the use of reason codes, the ATO:

- (a) better distinguish between ‘potential fraud’ and ‘overstated claims’ cases;*
- (b) provide greater specificity as to why certain tax returns have been held for review, such as what label or what claims the ATO is seeking to address; and*
- (c) implement a mechanism for taxpayers and their agents to easily obtain more information where specific reasons cannot be provided in correspondence.*

ATO Response

Agree in principle.

Changes to IT systems and business processes will be required to implement the requirements of this recommendation around updated reason codes. In some cases these requirements are quite complex. This work will be subject to prioritisation on the Enterprise Solutions and Technology Forward Program of Work.

REQUESTING TAXPAYER INFORMATION AND RELATED TIMEFRAMES

Information requests

5.41 The ATO’s general approach to information gathering for ITRIP cases is outlined in its pre-issue compliance business procedures. These procedures outline a general process to assist ATO officers in actioning pre-issue compliance cases.

5.42 Relevantly, these procedures instruct ATO officers that:¹⁷⁹

The preferred method of contact is by phone, however, a letter is required if:

- you have been instructed to issue a letter by your team leader
- the review item requires a more detailed explanation
- you are instructed to issue a letter by the relevant method.

¹⁷⁸ Above n 13, pp. 4 and 5.

¹⁷⁹ ATO, ‘Pre Issue Compliance Business Procedures’, internal ATO document, task 6.

5.43 The instruction notes that where telephone contact is successful, the ATO officer is to seek additional information from the taxpayer to address the risks identified by the ITRIP. Specifically, the instruction states:¹⁸⁰

If phone contact successful:

Obtain information and determine if documents are required from the taxpayer. The intent of phone contact is to:

- quickly obtain information,
- focus the review on the main areas of risk,
- discuss available documentation, and
- determine which risks require substantiation documents to be supplied (sampling).

Include a detailed note about the conversation and seek a timeframe for a response from the client if information has been requested. Include in your note:

- the person you have spoken with
- the information you requested
- the date that the response is due, and
- any other relevant information provided during the course of the telephone call

5.44 As the IGT observed in the *Review of the Australian Taxation Office's use of early and Alternative Dispute Resolution* (the ADR review), the ATO is not a party to the transactions which it seeks to review. As such, information is required from taxpayers to enable the ATO officer to arrive at the correct decision. However, the IGT also notes that sometimes, taxpayers may be unclear as to the exact nature of the ATO's inquiry and therefore may not understand what information is requested or how it is likely to assist the ATO to address its concerns.¹⁸¹

5.45 In the case of ITRIP reviews, submissions to the IGT have noted that the ATO's initial communications regarding areas of concern are sometimes unclear. Where the ATO does not clearly communicate its concerns and its area of inquiry, it may be difficult for taxpayers to appreciate the ATO's information requests. The IGT's recommendation 3.2 in the ADR review aimed to address this issue by ensuring taxpayers understood the reasons for information requests and enabling engagement and discussion on the scope and relevance and any alternative evidence which may assist the ATO.¹⁸² The ATO agreed with the recommendation but considered that it applied to larger more complex cases within the Large Business and International and Small and Medium Enterprise market segments.¹⁸³

180 Ibid.

181 IGT, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution*, 31 July 2012, pp. 28-30.

182 Ibid, p. 32.

183 Ibid.

IGT observations

5.46 The IGT considers that dialogue and engagement of the type described above can, and should, occur in all compliance activities, including high volume cases such as those under the ITRIP. This is even more important in the present circumstances where the ATO interacts with a wide taxpayer population with varying degrees of tax technical proficiency. In particular, where taxpayers are not represented by tax agents, it is incumbent on the ATO to ensure that taxpayers understand the case against them and the reasons for information being sought. In the latter stage of this review, the ATO indicated to the IGT that its officers have begun to contact taxpayers by telephone to assist them with ATO enquiries before their case is finalised.¹⁸⁴

5.47 The IGT notes that the ATO's pre-issue compliance business procedures do not expressly instruct or provide guidance as to how ATO officers can seek to ensure taxpayers possess the level of understanding necessary to manage ITRIP audits. It is implicit in the instructions that, given the ATO's preference for telephone contact, the ATO officers would verbally engage with taxpayers or their agents to outline the specific areas under review, what information is sought and why it is relevant to the ATO's inquiry.

Timeframes to provide information

5.48 Where telephone contact is made and additional information is to be provided, ATO officers are to allow 21 days for the provision of such information with a further seven days extension available at the taxpayer's request and subject to consideration of surrounding circumstances.¹⁸⁵ Where telephone contact cannot be made, ATO officers are instructed to make detailed notes of the attempts. Officers are then required to make three further attempts before issuing correspondence to advise of any proposed adjustments and request that substantiating information be provided within 21 days.¹⁸⁶

5.49 Submissions to the IGT have raised concerns that the 21 day period is sometimes insufficient. In this regard, stakeholders observed that the 21 day period is relatively short, especially where the information requested by the ATO may be difficult to obtain or where relevant parties are unavailable. Submissions have also compared the relatively short time allowed to taxpayers to provide information with instances of the ATO taking many weeks before making first contact with the taxpayer or their agent.

5.50 The ATO's procedures allow for limited extensions of time (to a maximum of seven days) based upon reasons provided by the taxpayer. Whether such an extension is sufficient, however, is dependent on the particular taxpayer and tax agent circumstances. These procedures make some reference to the possibility of longer or additional extensions of time subject to the ATO officer conferring with a technical adviser. However, the procedures do not outline when and in what circumstances extensions of time beyond the seven days would be granted.¹⁸⁷

184 Above n 92.

185 Above n 179, task 6.

186 Above n 179, task 6.

187 Above n 76.

5.51 The ATO has advised that in developing longer term improvements to its management of ITRIP cases, it is seeking to provide taxpayers with sufficient time to provide the requested information.¹⁸⁸ The ATO proposes to clarify in its internal procedures that stated timeframes are negotiable and should be based on the specific circumstances of the taxpayer or their agent.¹⁸⁹

IGT observations

5.52 In addition to ensuring an appropriate level of understanding by the taxpayer, the IGT believes that ATO officers should possess greater authorisation, within appropriate guidelines, to allow extensions of time for taxpayers and tax agents to provide additional information. This would provide a more flexible platform for the ATO, taxpayers and their agents to effectively negotiate suitable timeframes within which to provide the requested information.

5.53 Where ATO officers possess greater authorisation and more guidance for good decision-making, the negotiations as to timeframes are likely to be more streamlined as the circumstances requiring technical adviser interjection should be limited. Accordingly, those cases in which referral to a technical adviser for consideration should only include those in which the circumstances are unique or more complex.

5.54 Extensions of time necessarily result in further delays in processing of tax returns and issuing of tax refunds. This consequence should be communicated clearly by the ATO to taxpayers and their agents to ensure they appreciate this trade-off.

RECOMMENDATION 5.3

The IGT recommends that the ATO augment its ITRIP information gathering procedures, including relevant written guidance or scripting, to:

- (a) ensure that taxpayers understand the nature of the ATO's inquiry and information which may assist to address the ATO's concerns, including how the requested information is likely to impact any potential adjustments; and*
- (b) authorise ATO officers to grant extensions of time for the provision of additional information in appropriate circumstances, such as where the relevant taxpayers are unavailable or the information is difficult to obtain.*

ATO Response

Agree.

188 Above n 179.

189 Above n 92.

COMMUNICATING REASONS FOR ADJUSTMENTS

5.55 It is important for the ATO to communicate specific reasons why it has made adjustments to a taxpayer's return. For individuals who prepare and lodge their own tax returns, this provides a good opportunity to better inform them for future years. For tax agents, the provision of specific reasons for adjustments enables a meaningful dialogue to be had between the agent and their client regarding improvements to future years' lodgements.

5.56 The ATO's standard finalisation letters (used since 2010) has a table for indicating which labels have been adjusted, the adjusted amount and a standardised reason for amendment. The reason provided in these letters is extracted from an internal spreadsheet by the ATO audit officer and incorporated into the finalisation letter.

5.57 The IGT's review of this spreadsheet shows that while it canvasses a wide range of income tax return items, many appear to have generic reasons, including:¹⁹⁰

- as per your response we have removed the income declared in your return;
- as per your response we have reduced the income declared in your return;
- our records show you omitted this income from your tax return;
- income has been returned correctly; or
- based on your response we have increased the income declared in your return.

5.58 In dealing with specific deduction claims, the ATO's list of reasons seems more expanded. Outlined below are the available standard reasons for adjusting interest expense deduction on rent:¹⁹¹

- we have removed this claim from your return as you did not reply or provide the requested information by the response due date in the letter;
- as per your response we have removed the interest deductions declared in your return;
- you did not apportion your interest expense to account for private use of the funds;
- you did not provide evidence of your interest expense;
- your rental property was not rented on a commercial basis;
- you did not claim the interest expenses according to your ownership interest in the property;
- you did not provide the loan documentation to establish your entitlement to the interest deductions;
- interest expenses relate to a different financial year;

¹⁹⁰ ATO, 'COG RFD Enhancements Spreadsheet', internal ATO document.

¹⁹¹ Above n 190.

- interest deductions have been returned correctly; or
- based on your response we have increased the interest deductions declared in your return.

5.59 The ATO has advised that given the high volume of cases involved in the ITRIP, and in particular during 2011–12 when focus was shifted to processing and releasing refunds as quickly as possible, it was not practicable to deliver detailed reasons for adjustments made to taxpayer returns.

5.60 The ATO notes that subsequent feedback from tax agents suggested that this practice of using generic reasons created some difficulties for tax agents in managing their relationships with their clients.¹⁹²

5.61 A further concern which has been raised with the IGT is that it does not appear that the ATO considers additional information provided by taxpayers prior to the ATO arriving at its final position. This may be symptomatic of the reasons for adjustments not being clear and sufficiently detailed.

5.62 In this respect, the ATO's pre-issue compliance business procedures do not outline any specific instruction or guidance as to how an ATO officer is to consider taxpayer-provided information in the conduct of their audit or review. It does, however, generally instruct:¹⁹³

Make a decision on the outcome of the review based on available information.

If further information is considered necessary, phone the client, their representative or any third party and allow a further seven days to provide additional information.

5.63 It is reasonable to assume that by 'available information', the instructions refer to all available information whether it is derived from the ATO's systems, the ATO officer's independent research or information provided by taxpayers and their advisers.

5.64 These procedures, however, do not direct ATO staff to communicate with taxpayers or their advisers regarding how they considered the information in finalising the ATO position.

IGT observations

5.65 The IGT considers that where ATO officers and taxpayers have not had meaningful discussions about how the information obtained may affect potential adjustments of the taxpayer's return, the limited reasons contained in the finalisation letter may lead taxpayers to the view that ATO officers have not, or have not sufficiently, considered the taxpayer's information. This perception may also be as a result of taxpayers' returns, in some cases, being adjusted before the additional information provided by the taxpayer is received by the ATO.

192 Above n 70; Above n 14.

193 Above n 179.

5.66 The IGT notes that in developing longer term improvements for the management of ITRIP cases, the ATO intends to provide more detailed reasons for adjustments to taxpayers through its audit finalisation letters. The ATO also aims to deliver even more detailed reasons when requested by taxpayers if those contained in correspondence are inadequate.¹⁹⁴

5.67 The IGT considers that improvements in the ATO's communication of reasons for adjustments made to taxpayers will improve the taxpayer and tax agent experience in relation to ITRIP. It will provide on the one hand an understanding of the reasons for adjustments and what further information may be provided in support of any review requests and, on the other, it will serve as a means to educate taxpayers on perceived ATO risks in relation to their returns for future years.

5.68 In developing such a mechanism, the IGT considers that the ATO should seek to ensure that:

- the provision of improved reasons does not unnecessarily delay the processing of tax returns and issuing of tax refunds; and
- the process is informal and minimises time and cost on the part of the taxpayer or their agent.

5.69 Another way in which taxpayers and their advisers may be assured that the ATO has considered information provided by the taxpayer or their agent is through direct dialogue and engagement. The ATO's preference for telephone contact in the conduct of ITRIP cases should facilitate timely and informal discussions between the ATO officer, the taxpayer and/or their agent as to how the ATO officer has considered the information, what implications this may have for potential adjustments and what further information may assist to address the ATO's concerns and to finalise the audit or review.

5.70 Consistent with the IGT's observations in his ADR review, such a dialogue early in the ITRIP process could assist to limit the need for lengthy detailed reasons for adjustments as the ATO officer, the taxpayer and their agents should be able to achieve a common understanding of the reasons for adjustments, how information provided has been considered and how it has impacted the adjustments.

194 Above n 70; Above n 14.

RECOMMENDATION 5.4

The IGT recommends that the ATO:

- (a) consult with external stakeholders on strategies to improve the specificity of communicated reasons for adjustments; and*
- (b) provide specific reasons for ITRIP adjustment decisions including how the ATO has considered information provided by taxpayers in making adjustment decisions.*

ATO Response

Agree.

CONTACTING TAXPAYERS DIRECTLY

5.71 An ancillary issue to those set out above relates to the ATO contacting taxpayers directly in ITRIP cases where taxpayers have listed tax agents as primary contacts and neither has indicated to the ATO that the taxpayer should receive correspondence directly.

5.72 Submissions to the IGT have indicated that where this occurs, it has the potential to create some anxiety for taxpayers, requiring the tax agent to first allay their client's concerns before dealing with the ATO in relation to the concern itself.

5.73 The ATO is also aware of this feedback from tax agent participants through its simulation centre.¹⁹⁵

A majority of tax professional participants want to receive all letters before their client receives them

This request was made to allow the tax professional time to read the letter and make initial preparations prior to communicating with their client. In some cases, the tax professional would actively contact their client before the client receives the letter to let the client know what has happened and what the next steps will be. This allows the tax professional to communicate with the client before they are in 'panic-mode' from receiving the letter.

Not providing the tax professional with the letter before their client can result in the client calling the tax professional and ask questions the tax professional is unable to answer as they have not read the letter. The tax professional then needs to get the client to either tell them what the letter is about — which can be error prone as the client may miss important details; or send them a copy of the letter, which has time delays involved. Providing the tax professional with the letter before the client allows the tax professional to be better prepared when communicating with their client and allows for higher-value tax professional-client communications.

¹⁹⁵ Above n 127, p. 10.

5.74 Concerns along similar lines were raised with the IGT in the Cash Economy Benchmarking review.¹⁹⁶ Specifically, the IGT noted:¹⁹⁷

Some tax agents expressed frustration with the fact that the letters were sent directly to taxpayers, even where the tax agent was listed as the authorised contact. Tax agents submitted that they received phone calls from clients regarding benchmarking letters which the tax agent knew nothing about. Tax agents felt this ‘put them on the back foot’, and expressed concern that it made them look unprofessional and undermined their relationship with their client. One representative body expressed the view that if the tax agent is the authorised contact, then all communication should go to them first, and it is their prerogative rather than the ATO’s, to determine how to approach the client. Nevertheless, some tax agents also expressed the view that they did not mind having the ATO contact their clients directly for these types of matters, as long as the tax agent was given the choice or at least informed first.

IGT observations

5.75 The IGT acknowledges the ATO’s past efforts to consult with tax agents on the most appropriate points of contact to receive tax-related correspondence. The IGT also acknowledges that different taxpayers and tax agents will have different preferences on the receipt of correspondence and contact by the ATO. Much of this is generated by varying working dynamics and relationships between the tax agent and their client, and between them and the ATO. It may not be possible for the ATO to accommodate every permutation of this relationship.

5.76 The ATO’s system allows some election for preferred addresses and contact points for tax matters. Taxpayers and tax agents can elect different contacts for different tax matters. The ATO advises that in relation to all income tax matters, the primary contact address which it uses is the address that is reported on the taxpayer’s most recently lodged income tax return, unless either the taxpayer or the tax agent specifically requests another address to be used.

5.77 The IGT recognises that there may also be instances in which the ATO may need to contact taxpayers directly. In such cases, it is important to appreciate that some taxpayers may require the assistance of their tax agent to respond to the ATO. It is therefore beneficial to ensure that where the ATO intends to write directly to taxpayers that it identifies a means through which it can inform tax agents so that they may better prepare themselves for client interactions.

5.78 The IGT also recognises that there are certain circumstances in which it would not be desirable for the ATO to give notice of direct contact with taxpayers. For example, where the ATO is investigating cases concerning unregistered preparers or identity crime. However, such circumstances should be rare and should not form a part of the ATO’s general ITRIP correspondence.

196 Above n 61, p. 62

197 Ibid, p. 57.

RECOMMENDATION 5.5

The IGT recommends that the ATO consult with the tax profession to identify and implement strategies to:

- (a) ensure that specific ITRIP audit correspondence and enquiries are directed to the person designated by the taxpayer; and*
- (b) inform tax agents of ITRIP correspondence which the ATO proposes to use during Tax Time and on which their clients may seek advice and assistance.*

ATO Response

Agree.

CHAPTER 6 — ADJUSTMENTS AND DISPUTATION

PROPORTIONALITY OF ADJUSTMENTS MADE

6.1 Submissions consider that the costs and adverse impacts in holding refunds are disproportionate to the risks. Stakeholders claim that the ITRIP holds returns for long periods of time for what are considered to be very small sums. Examples brought to the IGT's attention include returns in which the expected refund was \$348, and in other cases, taxpayers with low assessable income levels of between \$10,000 and \$30,000. A further example included a nil return lodged in 2012 being held because it was considered potentially fraudulent or contained an overstated claim.

6.2 Other concerns raised with the IGT in relation to proportionality of action under the ITRIP relate to large refunds being withheld by the ATO where the only concern related to a minor amount. In one example, the taxpayer originally claimed a refund of about \$55,000. The ATO retained the entire sum pending further verification despite its concern being limited to \$3,900 of that \$55,000. Similarly, in another submission the entire refund of \$10,000 was withheld pending a \$100 adjustment.

6.3 In response to direct query from the IGT, the ATO has advised that:¹⁹⁸

Each risk model includes defined parameters designed to address the spectrum of risks across the program. These parameters are established to ensure that the focus is aligned to the higher risk transactions enabling low risk matters to be addressed through alternative treatment options. For example, income tax returns identified as being potential identity takeover would be held given the level of risk. However, other transactions identified as possible over-claiming at a particular label but with a low level of refund would not be held and the matter considered as part of other treatment options.

The performance of each of the expert business rules is monitored on a regular basis and is formally reviewed and evaluated with an annual revision undertaken to ensure continuous performance improvement.

6.4 The ATO has provided a stratified data set illustrating the amounts of original refunds claimed in 2010-11, 2011-12 and 2012-13 year to date (as at 11 February 2013). It has provided a similar data set to illustrate the amounts of adjustments made to tax returns held in those particular years. It notes that during the 2010-11 year, the ITRIP was moved to the Siebel system and as such, the data extracted for that year only represents about 75 per cent of the actual number of returns stopped and adjusted. This data is outlined in Tables 17 and 18, below.

198 Above n 98.

Table 17: Stratified claimed refund amounts for all stopped returns for the lodgement years ending 30 June 2011 to 2013 (YTD)

Original refund claimed amount	Financial year in which returns were stopped					
	2010–11		2011–12		2012–13 YTD	
	#	%	#	%	#	%
Amount payable (DR assessment)	129	0.48	78	0.07	54	0.11
Nil payable/refundable	58	0.22	6	0.01	12	0.03
\$1 — \$1,000	1,232	4.59	1,878	1.77	1,297	2.73
\$1,001 — \$2,000	3,937	14.67	12,888	12.15	6,996	14.71
\$2,001 — \$3,000	5,835	21.74	27,271	25.71	10,927	22.98
\$3,001 — \$4,000	5,640	21.01	23,051	21.73	8,415	17.70
\$4,001 — \$5,000	3,681	13.71	14,457	13.63	6,430	13.52
\$5,001 — \$10,000	5,552	20.69	22,518	21.23	11,076	23.29
\$10,001 — \$15,000	553	2.06	2,474	2.33	1,548	3.26
\$15,001 — \$20,000	116	0.43	594	0.56	396	0.83
\$20,001+	82	0.31	546	0.51	360	0.76
Unknown	25	0.09	306	0.29	39	0.08
Total	26,840	100	106,067	100	47,550	100

Source: ATO data extracted as at 11/2/2013.

6.5 The materiality of returns stopped by ITRIP is illustrated in Table 17, above. It is useful in considering concerns raised by taxpayers that the ITRIP is unnecessarily stopping returns with no tax refund due or with very small tax refunds. Based on the data in Table 17, across all years provided, the numbers of returns stopped with \$1,000 or less in refunds claimed, no tax payable or refundable, or tax payable positions are relatively small. They were 5.29 per cent in 2010–11, 1.85 per cent in 2011–12 and 2.87 per cent in 2012–13 (year to date). The data also illustrates that across all years, about three quarters of returns stopped claimed refunds of \$5,000 or less.

Table 18: Stratified adjusted tax liability amounts for the lodgement years ending 30 June 2011 to 2013 (YTD)

Adjusted refund amount	Financial year in which returns were stopped					
	2010–11		2011–12		2012–13 YTD	
	#	%	#	%	#	%
Negative adjustment	866	4.39	1,249	1.99	816	3.17
Nil	1,312	6.65	4,163	6.62	1,635	6.36
\$1 — \$1,000	5,397	27.38	14,255	22.67	5,807	22.58
\$1,001 — \$2,000	3,406	17.28	11,740	18.67	4,917	19.12
\$2,001 — \$3,000	3,035	15.39	14,591	23.20	3,179	12.36
\$3,001 — \$4,000	1,796	9.11	6,079	9.67	2,222	8.64
\$4,001 — \$5,000	1,061	5.38	3,273	5.20	2,045	7.95
\$5,001 — \$10,000	1,750	8.88	5,687	9.04	4,113	15.99
\$10,001 — \$15,000	379	1.92	1,006	1.60	637	2.48

Adjusted refund amount	Financial year in which returns were stopped					
	2010–11		2011–12		2012–13 YTD	
\$15,001 — \$20,000	124	0.63	344	0.55	181	0.70
\$20,001+	129	0.65	348	0.55	149	0.58
Unknown	460	2.33	153	0.24	16	0.06
Total	19,715	100	62,888	100	25,717	100

Source: ATO data extracted as at 11/2/2013

6.6 When examining the materiality of adjustments made to ITRIP returns, the data in Table 18 shows that across all three years about one third of returns were adjusted by a value of \$1,000 or less (38.4 per cent in 2010–11, 31.3 per cent in 2011–12 and 32.1 per cent in 2012–13). Expanding this to include adjustments of up to \$5,000 shows that these account for the vast majority of adjustments made, being 85.6 per cent in 2010–11, 88 per cent in 2011–12 and 80 per cent in the 2012–13 year to date.

6.7 A direct comparison between the two sets of data contained in Tables 17 and 18 suggests that while the ITRIP may have selected returns with relatively high refund claims, the amounts by which these refunds have been adjusted are small. This suggests that following review of these returns and contact with taxpayers, the claims have either been substantiated in full or in part leading only to partial adjustments. The implications may be that the ATO should consider releasing refunds in more instances and conducting compliance action after the assessment is issued if necessary.

6.8 While the taxpayer's experience may be that the ITRIP is unnecessarily stopping returns which bear minimal risk to the revenue, the data provided in the above tables suggest that returns with low level refunds are a relatively small proportion of overall returns stopped by the ITRIP. However, the IGT also notes that the perception of what is and is not proportional is often reflective of the taxpayer's specific circumstances. The ATO needs to strike an appropriate balance between the need to protect the revenue and to minimise any adverse impacts on taxpayers.

OBJECTION AND LITIGATION

6.9 Decisions arising out of the ITRIP are subject to the usual rights of objection and appeal under Part IVC of the Taxation Administration Act 1953. Data provided by the ATO, and outlined in Table 19, suggests that the level of objections lodged by taxpayers is relatively low with 6.5 per cent and 9.5 per cent of returns adjusted as a result of the ITRIP, in 2010–11 and 2011–12 respectively. The 2012–13 year to date data shows a decrease in objection rates.

Table 19: High level summary of objections by lodgement year¹⁹⁹

	Financial year		
	2010–11	2011–12	2012–13 YTD
Total number of audits/reviews conducted	34,600	79,944	35,101
Total returns adjusted following audits/reviews	26,287 ²⁰⁰	62,888	25,717
Total objections lodged against audits/reviews above	1,718	6,028	721
Percentage of audits/reviews objected against	5%	8%	2%
Percentage of adjusted returns objected against	6.5%	9.5%	2.8%

Source: ATO

6.10 While the objection rates of ITRIP adjusted returns are relatively low, the IGT notes that they exceed the enterprise level objection rates (being the rate of objection across all compliance activities resulting in adjustments), in 2010–11 and 2011–12 which were 4 per cent²⁰¹ and 4.7 per cent,²⁰² respectively.

6.11 In analysing the high level outcomes from objections lodged by taxpayers, the IGT observes that the vast majority of cases result in an objection being allowed in full²⁰³ or in part. The proportion of objections allowed in full or in part was 62 per cent in 2010–11, 78 per cent in 2011–12 and 67 per cent in 2012–13 (year to date). A summary is contained in Table 20, below.

Table 20: Objection outcome analysis²⁰⁴

Recorded outcome	Financial year					
	2010–11		2011–12		2012–13 YTD	
	Volume	%	Volume	%	Volume	%
Allowed in full	708	41	3,496	58	347	48
Allowed in part	359	21	1,068	18	134	19
Disallowed	327	19	768	13	168	23
Invalid	93	5	146	2	27	4
No outcome recorded	114	7	289	5	22	3
Other	20	1	33	<1	0	0
Withdrawn	97	6	228	4	23	3
Total	1,718	100%	6,028	100%	721	100%

Source: ATO

6.12 The high rates of objections being allowed suggest a need for the ATO to better refine the ITRIP to select cases bearing higher risk. It is also indicative of the need to enhance

199 ATO, communication with the IGT, 12 March 2013; Above n 70.

200 Based on the ATO's advice that the original figure 19,715 is only representative of about 75 per cent of the population, the IGT uplifted the figure (19,715/0.75) for comparative purposes. This figure is indicative only and should not be taken to be determinative of actual figures.

201 ATO, *Your Case Matters*, First edition, p. 4.

202 ATO, *Your Case Matters*, Second edition, p. 2.

203 An objection allowed in full is not necessarily indicative of full reversals of ATO decisions. It only indicates that all aspects of the taxpayer's objection were allowed by the ATO.

204 Above n 199.

and improve the engagement and communication between the ATO and taxpayers at the audit stage to ensure that correct information is requested and provided in a timely manner. The IGT considers that the earlier recommendations in this report aimed at improving ITRIP information gathering and auditor communication would help to minimise this issue.

6.13 Where a taxpayer is dissatisfied with the ATO's objection decision, they may seek to appeal that decision to the Administrative Appeals Tribunal (AAT) or the Federal Court of Australia. Statistics provided by the ATO, in Table 21, in relation to such appeals demonstrate that very few matters progress down this route.

Table 21: ITRIP cases that have been appealed to the Tribunal²⁰⁵

Litigation venue	Outcome	Financial year			Total
		2010–11	2011–12	2012–13 YTD	
Administrative Appeals Tribunal	Settled	3	3	0	6
	Not applicable	8	16	1	25
	Withdrawn		2		2
	Conceded	1			1
	Favourable		1		1
	Dismissed	1			1
Small Taxation Claims Tribunal	Settled	2	7		9
	Not applicable		11	1	12
	Favourable		1		1
	Partly Favourable	1			1
Total		16	41	2	59
Litigation matters as a percentage of objections allowed in part or disallowed		2.33%	2.23%	0.66%	
Litigation matters as a percentage of total compliance activities		0.05%	0.05%	0.01%	

Source: ATO

6.14 Of those cases which have progressed to the AAT (including the Small Taxation Claims Tribunal), the majority have been finalised by way of settlement, withdrawal or concession by the taxpayer or the ATO. Similar to the experience in objections, this is likely a result of further information being provided by the taxpayer.

6.15 While the IGT acknowledges the generally very low levels of litigation in relation to ITRIP cases, it is also important to acknowledge that the low numbers of cases proceeding to litigation do not necessarily reflect the actual level of dispute that individual taxpayers may have with ATO decisions. As noted in recent academic research, personal costs of dispute represent a considerable barrier to accessing tax justice in cases involving low dollar values.²⁰⁶

6.16 The costs associated with litigation were also recognised by the IGT in the ADR review and recommendations were made for ongoing engagement to resolve disputes early

²⁰⁵ Above n 199.

²⁰⁶ Binh Tran-Nam and Michael Walpole, 'Access to tax justice: How costs influence dispute resolution choices,' (2012) 22 JJA 3, p. 3.

to avoid the need for more formal processes.²⁰⁷ Relevantly, the IGT also recommended that the ATO undertake a pilot to utilise in-house trained ATO facilitators to assist in resolving less complex disputes.²⁰⁸ The IGT considers that in appropriate circumstances, disputes arising under the ITRIP would be suitable for such a pilot.

RECOMMENDATION 6.1

The IGT recommends that the ATO make use of the in-house facilitators pilot program or other informal dispute resolution process to address and resolve disputes arising out of the ITRIP.

ATO Response

Agree.

REVERSALS PILOT

6.17 The ATO recognises that in some instances, ATO audit officers make decisions to adjust taxpayers' returns based on limited information. The ATO acknowledges that this is attributable to a number of factors not affecting the legality of the taxpayer's claim, including:²⁰⁹

- the taxpayer has not been able to reply to ATO requests for information or has not sought an extension of time to provide information requested;
- the information requested is not readily available to the taxpayer and they are unable to substantiate their claims; or
- the taxpayer chooses not to respond to ATO requests for information.

6.18 During the course of the IGT's review, between April and June 2013, the ATO undertook a program of work to pilot and implement the use of the Commissioner's power to effect 'administrative reversals' to resolve disputes against ITRIP decisions. An 'administrative reversal' is a mechanism through which the taxpayer or their agent can request the ATO to informally review the initial adjustments processed based upon further information provided to substantiate the taxpayer's original claims.

6.19 The ATO's pilot was aimed at cases in which adjustments were made after the ATO did not receive a response to its enquiries from taxpayers or their agents.

6.20 Where information provided by the taxpayer or their agent sufficiently addresses the ATO's concerns, the original claims are reinstated and an amended notice of assessment is issued as a consequence of the ATO auditor's adjustments being reversed.

207 Above n 181, p. 42.

208 Above n 181, p. 44.

209 Above n 199.

6.21 Through this ‘administrative reversals’ pilot, the ATO aimed to improve the efficiency of the ITRIP and to provide a simplified process through which the taxpayer may seek to dispute any adjustments made to their return while minimising the time and cost impacts for all parties. This is achieved as a result of the reversals process being less formal and therefore less costly and time consuming than the more formal objections process discussed earlier.

6.22 Following an evaluation of the pilot in July 2013, the ATO has advised that the piloted process will be extended and expanded to include all cases in which adjustments have been made after no response was received from taxpayers or their agents. The ATO aims to implement a permanent, ongoing administrative reversals process to address ITRIP cases by October 2013.

6.23 Importantly, while the administrative reversals approach is intended to simplify the process and deliver more efficient outcomes for taxpayers and the ATO alike, it does not supplant a taxpayer’s rights under Part IVC of the *Taxation Administration Act 1953* to object to the ATO’s decision and to litigate where appropriate. This is why the ATO intends to apply administrative reversals only to those cases in which adjustments were made after no response was received from the taxpayer or their agent. The ATO considers that where the taxpayer has previously responded and has not been able to substantiate their claim, the taxpayer should exercise their rights under objection to challenge any adjustments which have been made.

IGT observations

6.24 The IGT sees considerable merit in the ATO making greater use of administrative reversals to minimise the impact on taxpayers of disputing ATO decisions. It may also assist to minimise the instances of taxpayers not seeking to formally dispute ATO adjustments by reason of such disputes being too time consuming or costly.

6.25 The IGT also appreciates the ATO’s efforts to ensure that the administrative reversals process does not unduly impact upon, or protract, the period for objections. However, the IGT notes that there may be some circumstances in which a matter could be resolved more efficiently when considered as an administrative reversal as opposed to an objection. Whether an administrative reversal may be appropriate depends on a number of different factors such as when the taxpayer contacts the ATO, the issues which the taxpayer is seeking to dispute and the evidence which the taxpayer proposes to provide in support of their claim.

6.26 Diverting objections cases to administrative reversals, in appropriate circumstances, may be achieved by the ATO encouraging taxpayers to engage with it to discuss any potential disputes which may escalate through the objections process.²¹⁰ In doing so, the taxpayer and the ATO officer may identify and arrive at a common understanding of the issues in dispute and choose the most appropriate channel to facilitate the resolution of the matter.

210 ATO, Correct a mistake or dispute a decision, <<http://www.ato.gov.au/General/Correct-a-mistake-or-dispute-a-decision/>> (18 July 2013).

6.27 In so doing, there is a need to maintain an appropriate balance between encouraging taxpayers and tax agents to respond to audit requests in the first instance and utilise an informal review process as the most cost-effective and efficient means of revisiting adjustments where information is provided outside of set timeframes.

6.28 Moreover, when implementing a new initiative it is important to ensure that taxpayers and tax agents are aware of these different options. A robust communications strategy will increase awareness of the ATO's use of administrative reversals, how it differs from the objections process and reduces the risk of taxpayers lodging objections with the ATO where a reversal may be more timely and cost-effective.

RECOMMENDATION 6.2

The IGT recommends that the ATO:

- (a) update its finalisation letters to invite taxpayers to contact the ATO before disputing any adjustments to enable ATO officers to understand the dispute and provide advice as to the most appropriate channel for resolving the dispute; and*
- (b) implement a communications strategy to ensure that taxpayers and tax agents are aware of administrative reversal as a cost effective dispute resolution mechanism and how taxpayers and tax agents may seek such reversals in appropriate cases.*

ATO Response

Agree.

ATO USE OF DEFAULT ASSESSMENTS

6.29 In December 2011, the ATO undertook a pilot program in relation to the use of default assessments pursuant to section 167 of the ITAA 1936 as a means of processing and releasing ITRIP returns in a more timely manner.

6.30 Section 167 empowers the Commissioner to issue an assessment based on his judgement of the amount of tax due or payable. This may occur as a result of the taxpayer having not lodged a return,²¹¹ where the Commissioner considers the return lodged to be unsatisfactory²¹² or where the Commissioner has reason to believe the taxpayer has derived assessable income and has not lodged a tax return.²¹³

6.31 The ATO's pilot applied both to self-preparers as well as tax agent-lodged returns with a particular focus on cases where the ATO suspected that the person preparing the tax

211 Section 167(a) of the *Income Tax Assessment Act 1936*.

212 Section 167(b) of the *Income Tax Assessment Act 1936*.

213 Section 167(c) of the *Income Tax Assessment Act 1936*.

return was an unregistered tax agent and the ATO has been unable to contact the taxpayer to verify the accuracy of the information lodged in the tax return.

6.32 In its briefing to the IGT in March 2012, the ATO noted the success of the pilot. It noted that 133 default assessments were issued together with letters explaining the nature of the assessments, the review process available to taxpayers and the possibility of reinstatement of disallowed claims following the receipt of further evidence by the ATO.²¹⁴

6.33 In January 2012, the ATO's use of default assessment was implemented more generally and applied against those cases which were held as a result of risks identified in the pattern detection model of ITRIP. Data supplied by the ATO indicates that in 2011–12 it completed 7,669 audits under this program and made adjustments to the sum of \$22.1 million.²¹⁵

6.34 The ATO notes from its experience that taxpayer response to letters advising taxpayers of default assessments and inviting further engagement to substantiated claims has been very limited.²¹⁶ Indeed, during 2011–12, the ATO only recorded 867 (or 11 per cent) cases in which taxpayers requested a review of the adjustments. Of these, 251 (or 29 per cent) resulted in adjustments in full in favour of the taxpayers, 529 (or 61 per cent) resulted in partial adjustments in favour of the taxpayer and 87 cases (or 10 per cent) in which the original ATO adjustments were upheld.²¹⁷

6.35 The ATO has noted informal feedback from tax agents that the use of default assessments has caused difficult working relationships between them and their clients. Taking on board this feedback, the ATO has indicated to the IGT that it would no longer apply the use of default assessments to tax agent-lodged ITRIP cases. However, it would continue to pursue this course of action in relation to self-prepared lodgements in appropriate instances.

6.36 While the use of default assessments may provide some finality and certainty in the conduct of ITRIP cases, it also imposes a burden on the taxpayer who is then required to formally challenge such an assessment. In continuing to make use of default assessments, the ATO should be mindful to strike an appropriate balance between the efficiency and effectiveness of this strategy and the impost that default assessments can have on taxpayers who may not be represented by tax agents. These taxpayers may feel they cannot, or are ill-equipped, to dispute ATO default assessments even though they consider them to be incorrect or inaccurate.

6.37 The IGT considers that default assessments should only be used as a last resort, that is, where the taxpayer has not responded to the ATO and all alternative channels of communication have been exhausted. Even then, the ATO must be cautious to ensure that the lack of taxpayer communication is not due to incorrect taxpayer contact details for example.

214 Above n 15, p. 3.

215 Above n 98, p. 5.

216 Above n 15, p. 3.

217 Above n 98, p. 5.

6.38 The ATO has advised the IGT that it already only uses default assessments as a last resort. The ATO only uses default assessment in relation to taxpayers who have been identified as being unlikely to respond and unable to substantiate their claims. It notes that about 89 per cent of taxpayers issued with default assessments do not challenge the adjustment. The ATO considers this to be indicative of awareness by these taxpayers of a lack of entitlement to these claims.

6.39 As previously stated taxpayers may not challenge default assessment for reasons such as feeling ill-equipped to take on the ATO. The IGT believes that further analysis of the patterns and features in the 11 per cent of cases constituting genuine claims, including any reasons for non-response to the ATO's initial enquiry, may assist the ATO to better reduce instances of unnecessary use of default assessments.

6.40 The ATO also notes that for the 11 per cent of taxpayers who have made claims which they can substantiate, it currently offers informal administrative reversals as a means of reversing any adjustments which have been made by the default assessment. It advises that details of how to request a reversal are outlined in its default assessment finalisation letter which issues to taxpayers independently of the default notice of assessment.

6.41 In its default assessment finalisation letter, the ATO states:²¹⁸

Your right to request a review of our decision

If you believe we have made an error or mistake in respect of the adjustments we have made to your return, you can write to us and request a review of our decision. You will need to:

...

We will consider the information you provide to support your claims and if appropriate we will make further adjustments to your return. In this instance, we will issue you with an amended notice of assessment.

6.42 The IGT notes that while the ATO's letter attempts to convey details of its informal reversals approach, the absence of words denoting the informality and the lack of distinction between this process and the objections process may lead taxpayers to conclude they are one and the same. Moreover, as the standard form notice of assessments only refers to the formal objections process, they may further contribute to taxpayers believing that they must lodge an objection to challenge the default assessment.

6.43 Accordingly, while the IGT acknowledges the ATO's intention to provide a cost-effective and efficient means for reversing default assessment decisions, the IGT considers that it must communicate this option in an effective manner. In doing so, the ATO should emphasise the less formal nature of reversals and clearly distinguish between reversals and the taxpayer's statutory rights to object and litigate.

6.44 The ATO also acknowledges that there may be scope for it to further refine the general tone of the finalisation letter so as not to discourage taxpayers making genuine claims from engaging with the ATO.

218 Above n. 76.

RECOMMENDATION 6.3

The IGT recommends that the ATO:

- (a) undertake an analysis of the patterns and features of cases where default assessments have had to be reversed and accordingly use the findings to limit the instances of default assessment being issued; and*
- (b) refine default assessment finalisation letters to encourage taxpayers with genuine claims to engage with the ATO by, for example, clearly communicating the availability of administrative reversal process and to distinguish this process from the statutory rights to object.*

ATO Response

Agree.

APPENDIX 1 — TERMS OF REFERENCE AND SUBMISSION GUIDELINES

BACKGROUND

The Australian Taxation Office (ATO) currently holds 19.3 million active tax file numbers for individual taxpayers.¹ Each year, it receives approximately 12.4 million income tax lodgements from this market segment, over 10 million of which contain claims for deductions, offsets or credits totalling \$54.1 billion.² It is the largest market segment accounting for 49 per cent of total net tax collections.³

The ATO takes a risk-based approach to the management of its compliance activities. Given the high volume of transactions within this segment, the ATO uses computerised approaches to stop returns for integrity checking where certain risk indicators or flags are triggered. Broadly, these indicators or flags are triggered where there are potentially incorrect or fraudulent claims. Consequently, some refunds owing to taxpayers are delayed pending the outcome of the ATO's checking. This overall process is the essence of the ATO's 'income tax refund integrity program'.

In 2011, the ATO's parameters for detecting such claims resulted in a higher number of returns being stopped. This appeared to contribute to lengthy delays of refunds issuing and increased complaints to both the ATO and the Commonwealth Ombudsman.⁴

In response to these complaints the ATO undertook a significant review of its income tax refund integrity program, taking on board feedback received from the Ombudsman. This feedback reflected taxpayers and tax practitioners concerns relating to timely processing of returns, issuing of refunds and better explanations for any delays or adjustments made.⁵

Despite the improvements made as a result of the above ATO review, the Inspector-General of Taxation (IGT) has continued to receive representations from taxpayers and tax practitioners regarding delayed tax refunds arising from the integrity program. Specific concerns raised include whether the delay and its impact on taxpayers are proportionate to any potential risk. The inadequacy of the ATO's communications regarding these delays or adjustments has also been cited.

This IGT review is one of three concurrent reviews examining the ATO's compliance approach to individual taxpayers. It aims to explore the underlying causes for these concerns with a view to identifying opportunities for improvement.

1 Australian Taxation Office (ATO), *Annual Report 2011-12* (2012) p 39.

2 ATO, *Compliance Program 2012-13* (2012) p 10; ATO, *Taxation Statistics 2009-10* (2012) p 10.

3 ATO, above n 1, pp 53-54.

4 Commonwealth Ombudsman, Submission No 4 to Joint Committee of Public Accounts and Audit, *Annual Public Hearing with the Commissioner of Taxation*, 14 September 2012, p 4.

5 Ibid.

The other two reviews conducted in this area are the review into the ATO's administration of the excess contributions tax and the review of the ATO's use of data matching.

TERMS OF REFERENCE

In accordance with subsection 8(1) of the Inspector-General of Taxation Act 2003 (IGT Act 2003), the IGT will review the ATO's income tax refund integrity program (or individuals' delayed income tax refunds) with a specific focus on:

ATO systems and processes

The strategy underpinning the integrity program and its expected outcomes including the impact on taxpayers.

The accuracy of the integrity program in detecting incorrect or fraudulent claims.

The efficiency of the integrity program in terms of the timeliness of actions taken and mechanisms for early intervention to release refunds in appropriate cases.

The effectiveness of the improvements made to the integrity program to address the problems experienced in the 2010-11 financial year.

Impact on taxpayers and tax practitioners

The impacts of the integrity program on taxpayers and tax practitioners including financial impacts.

The proportionality of adverse impacts on taxpayers to the potential risk to revenue identified by the integrity program.

The nature of support and assistance provided by the ATO to taxpayers and tax practitioners impacted by the integrity program.

ATO communications

The effectiveness of ATO communication and action taken to minimise adverse impacts on taxpayers and tax practitioners, including whether taxpayers:

- a. received timely notification of their tax returns being held for integrity checking and were provided with reasons for such action;*
- b. were provided with an opportunity to provide additional information or evidence to expedite the checking;*
- c. were informed of the length of time the integrity checking was expected to take and when they might expect their refunds; and*
- d. received any advice as to action they might take to streamline return processing in future years.*

SUBMISSION GUIDELINES

The IGT invites you to provide written submission to assist in this review. The IGT envisages that your submission will be divided into two parts:

- your experience in dealing with the ATO's income tax refund integrity program (or delayed income tax refunds); and
- opportunities for improvement.

Your experience in dealing with the ATO

It is important to provide detailed accounts of your experiences in dealing with the ATO. It would be useful to provide a timeline of events outlining your key interactions with the ATO including any correspondence, telephone communications, information requests and responses from the ATO. It would also be helpful to understand the time taken to deal with the ATO and any costs you incurred, such as the retaining of a tax practitioner to assist you in these dealings. Separately tax practitioners may wish to outline any irrecoverable costs incurred.

It is important to provide details of specific factors, including the ATO practices and behaviours that, in your view, delayed resolution of the issues, resulted in increased costs and impacted on your personal or business affairs. The IGT also seeks examples of positive factors in the ATO's income tax refund integrity program.

The following questions are designed to assist you in setting out your experiences.

Questions for consideration — your experiences

Q1. When and how did you first become aware that your return, or your clients' return(s), had been held by the ATO for integrity checking? Did the ATO contact you or did you have to contact the ATO to check on the status of the return? Please specify the financial year of the return in question.

Q2. How much time elapsed between lodgement of the return and when you were made aware that it would be held for integrity checking?

Q3. Did the ATO communication provide you with an explanation as to:

- a. the reason(s) why the return was stopped;
- b. the specific issue it was checking;
- c. the time the checking was expected to take; and
- d. any action you could take to address its concerns?

Q4. What action did you take or what further information did you provide to the ATO to address its concerns? What action did the ATO take as a consequence of the additional information or action you took?

Q5. Overall, how long did the ATO take to issue your tax refund? Was the refund processed and issued in a timely manner? How did the ATO update you on further delays? Did they provide sufficient reasoning? Please explain your views.

Q6. What impact has dealing with this matter had on you? For example, did you incur additional costs such as seeking assistance from a tax practitioner? Please quantify any additional costs. How could these have been minimised?

Q7. If you are a tax practitioner with a significant number of clients who were the subject of data matching processes, what impact did this have on you or your practice? Were you satisfied with the level and quality of information and supported provided by the ATO?

Opportunities for improvement

The IGT also invites you to identify opportunities to improve the ATO's processes and procedures in identifying potential errors in income tax lodgements and in undertaking refund integrity checks.

Your submission may outline alternative frameworks, actions, practices or behaviours which, in your view, could minimise costs or adverse impacts arising from the current system and its operation.

Set out below are questions to help you outline any improvements which you believe could be made in this area.

Questions for consideration — improvements

Q1. How could the ATO's income tax refund integrity program be improved?

Q2. Having regard to the possible risk to government revenue, how should the ATO verify potentially incorrect or fraudulent claims? Should the ATO stop a refund until all checks are completed or should the ATO issue the refunds and conduct compliance activities and take recovery action afterwards? In balancing negative impact on taxpayers with risk to government revenue, should certain thresholds or amounts be considered for triggering refund integrity checking? Please explain your views.

Q3. How could the ATO's communication and taxpayer engagement in relation to refund integrity checks be improved? Who should the ATO communicate with in relation to integrity checks? For example to the taxpayer or tax practitioner or both?

Q4. Should time limits be imposed on integrity checks? Should these be indicative or strict timeframes? What do you consider as reasonable timeframes? Should these timeframes vary in certain circumstances? Please explain your views.

Q5. Currently taxpayers receive basic interest after a certain period of time has elapsed as compensation for delayed refunds. Would it be appropriate for taxpayers and tax practitioners to receive further compensation for delays extending beyond any fixed refund retention period? If so, what form should this compensation take and what factors should be considered? Please explain your views.

Q6. Are there other specific improvements you would like to raise?

Submission lodgement

Submissions should address the terms of reference and submission guidelines set out above. It is not expected that each submission will necessarily address all of the issues and questions raised.

The closing date for submissions is 18 December 2012. Submissions may be sent by:

post to:	Inspector-General of Taxation GPO Box 551 SYDNEY NSW 2001
fax to:	02 8239 2100
email to:	[for enquiries regarding this review, please email enquiries@igt.gov.au]

Confidentiality

Submissions provided to the IGT are dealt with in strict confidence. This means that the identity of the taxpayer and/or of the tax practitioner and any identifying information contained in such submissions will **not** be made available to any other person, including the ATO. Sections 23, 26 and 37 of the IGT Act 2003 safeguard the confidentiality and secrecy of such information provided to the IGT – for example, generally the IGT cannot disclose the information as a result of a Freedom of Information request, or as a result of a court order. Furthermore, if such information is the subject of legal professional privilege, disclosure of that information to the IGT is protected and will **not** result in a waiver of that privilege.

APPENDIX 2 — ATO RESPONSE



Mr Ali Noroozi
Inspector-General of Taxation
GPO Box 551
SYDNEY NSW 2001

Dear Ali

Review into the ATO's compliance approach to individual taxpayers – income tax refund integrity program

Thank you for the opportunity to comment on your report on the review into the ATO's compliance approach to individual taxpayers – income tax refund integrity program.

I welcome your observation that the ATO has made improvements to the income tax refund integrity program since 2011-12 and has made further improvements to the program in 2013-14. We also welcome your constructive feedback and note that a number of your recommendations are aimed at assisting us to continually improve the quality of the program.

Our response to your recommendations is attached at Annexure 1. We agree or agree in principle with all recommendations as presented in your report.

Finally, I would like to acknowledge the efforts of all involved in undertaking this review.

If you require further information on our response, please contact Steve Vesperman, Deputy Commissioner.

Yours sincerely

A handwritten signature in black ink, appearing to be 'MK', with a horizontal line underneath.

Mark Konza
A/g Second Commissioner of Taxation

26 August 2013

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[To minimise space, the appendix to the ATO's response has not been reproduced here, but has been inserted into the text of this report underneath each of the recommendations to which that text relates.]

