

CHAPTER 1: INTRODUCTION

1.1 This is the report on the review conducted by the Inspector-General of Taxation (Inspector-General) of the administration of refunds of goods and services tax (GST) by the Australian Taxation Office (Tax Office) arising from the lodgment of Business Activity Statements (BASs). This report is made under section 10 of the *Inspector-General of Taxation Act 2003* (IGT Act).

1.2 The review was announced on 30 January 2004. Its terms of reference were announced on 31 March 2004 and are reproduced at Appendix 1 to this report. Details of how the review was conducted are given at Appendix 2.

1.3 The review was conducted pursuant to section 8(1) of the IGT Act, being a review conducted on the initiative of the Inspector-General. The decision to undertake the review was prompted by concerns raised with the Inspector-General by industry and tax practitioners.

1.4 A number of key findings were identified by the review. These and associated key recommendations are listed in Chapter 2. All other findings and recommendations are discussed in Chapters 4 to 7 under each of the four specific terms of reference. Chapter 3 contains a description of how GST refunds arise.

1.5 During the course of the Inspector-General's review, the Tax Office made or proposed a number of changes to its systems involved with the administration of GST refunds. Some of those changes directly addressed concerns raised with the Inspector-General. All changes made or proposed by the Tax Office are noted in this report wherever relevant.

1.6 The Commissioner of Taxation's response to the review is in Appendix 3. The Commissioner's detailed comments on each recommendation discussed in Chapters 4 to 7 of the report are set out immediately below each recommendation.

1.7 The assistance and co-operation provided by the Commissioner of Taxation and his officers to the Inspector-General and his team during the course of the review are gratefully acknowledged.

CHAPTER 2: SUMMARY OF KEY FINDINGS AND RECOMMENDATIONS

KEY FINDINGS

2.1 One significant design feature of a GST is that many entities registered for GST purposes will either occasionally, and in many cases regularly, claim refunds of GST.

2.2 It is crucial that the Tax Office has a robust system in place to process GST refunds promptly. There are three main reasons for this. Firstly, GST refunds generally reimburse GST registered entities for a tax which they should not be bearing. Secondly, any delay in paying those refunds will cause cash flow issues for these entities. Thirdly, entities that are entitled to GST refunds may face a competitive disadvantage if those refunds are not paid promptly.

2.3 It is also crucial that, where the Tax Office is not able to make a prompt payment of a refund, it has systems in place to notify affected taxpayers that their refund has been delayed.

2.4 In 2003-04, some 1.89 million GST returns (known as Business Activity Statements (BASs)) were lodged which claimed a total refund of about \$22 billion. Most of these refunds are automatically computer-processed, unless they are identified for manual checking.

2.5 The Tax Office states that, during 2003-04, it processed 94.4 per cent of all activity statement refunds within 14 days of all relevant information being provided. The Tax Office's performance compares favourably with other OECD countries

2.6 Activity statement refunds are not just made up of GST refunds. They also consist of refunds of other types of tax, including refunds of income tax to entities that are not registered for GST. The Tax Office does not have management information systems which state how many activity statement refunds that include GST refunds are processed within 14 days of lodgment, or within 14 days of all information being provided.

2.7 The Tax Office has information which shows that, during 2003-04, 4.3 per cent of all BAS refunds were stopped for manual checking. These stopped refunds amounted to approximately \$20 billion in dollar value and represent about 90 per cent of the total value of BAS refunds claimed.

2.8 The Tax Office has systematically stopped these 4.3 per cent of BAS refunds to determine, in a manual intervention, whether they should be further checked or otherwise reviewed prior to release of the refund.

2.9 Refunds to Government organisations and large ongoing businesses have been delayed for manual checking under these procedures.

2.10 After checking, most refunds are ultimately paid by the Tax Office. In some cases the amount of the refund is reduced. If paid after 14 days of all relevant information being provided, the Tax Office is required to pay delayed refund interest to the taxpayer.

2.11 The processes involved in checking stopped refunds have not resulted in the identification of a significant number of GST refund fraud cases.

2.12 As well, the Tax Office has indicated that, for large business taxpayers, during 2003-04 only \$14.5 million in additional tax was recovered as a result of stopping and checking \$7.35 billion of GST refunds. For Government and community sector taxpayers, only \$0.1 million in additional tax was recovered after stopping \$7.16 billion of GST refunds. For small business taxpayers, the Tax Office indicated that \$178.5 million of GST adjustments was achieved from pre-issue reviews of around \$5 billion of GST refunds. A further \$82 million of GST adjustments was recovered from small business taxpayers as a result of more detailed audit activity on refunds stopped for checking.

2.13 In all, some \$275 million (approximately) has been recovered from pre-issue reviews of \$20 billion of GST refunds. The additional tax recovered as a result of the practice of stopping and checking refunds was 1 per cent of all stopped refunds.

2.14 The majority of refunds stopped for manual checking are subsequently released and are refunded within 14 days of lodgment.

2.15 The Tax Office does not have management information to show the time it takes to process all GST refunds from the date of lodgment to the time of payment. It also has no information to show the time it has taken to process particular kinds of refunds (such as those which have been stopped for manual checking).

2.16 The Tax Office's management information systems currently only operate to monitor the length of time a GST refund spends within particular areas of the Tax Office. This monitoring starts from the time the refund has reached the particular area. However, there is no monitoring of the time that a GST refund spends in the area of the Tax Office which processes GST refunds after they have been cleared for payment.

2.17 The Tax Office states that BAS refunds not issued within 14 days are issued within a median time of approximately 30 days, where the refund is not subject to a detailed field audit.

2.18 The Tax Office has had a program which is chiefly aimed at stopping for manual checking all large refunds and refunds claimed by businesses and other entities lodging a BAS for the first time. Although the Tax Office has developed and is implementing improvements to this program, the Inspector-General considers that further improvements are required.

2.19 Overseas experience highlights that in the early stages of a GST there will be a propensity for some persons to fraudulently claim GST refunds.

2.20 Certainty in receiving refunds in a reasonable time is often critical for business and other entities in funding their working capital needs to run their enterprise. The Inspector-General believes that the Tax Office needs to better understand the risk profile associated with specific GST refunds and to move to a post-issue review of refunds where appropriate. The Inspector-General does not believe that the adjustments currently being

recovered by the Tax Office justify current delays in holding up of the dollar value of refunds.

2.21 The Tax Office has advised that it agrees with the general thrust of the Inspector-General's approach and is currently changing procedures in certain of its business line areas. Through these changes it is seeking to better respond to the risk profile of GST refunds. These changes include changes to improve the processes under which it advises taxpayers of the status of their GST refunds, including cases where the refunds may be offset against other tax debts.

KEY RECOMMENDATIONS

2.22 The following key recommendations are made to address unresolved problems identified by this report:

- The Inspector-General recommends that the Tax Office improve its systems to better match the risk issues associated with paying GST refunds. These systems need to achieve a better balance between paying GST refunds in a timely manner and preventing fraudulent or incorrect refunds from issuing.
- The Inspector-General recommends that the Tax Office establish 'whole of office' systems which measure the total elapsed time for the payment of GST refunds.

CHAPTER 3: GST REFUNDS — BACKGROUND

NATURE OF GST

3.1 The GST is a broad-based indirect tax, imposed on sales and other dealings in goods, services, property and other supplies at each point in the distribution chain, including the importation of goods. The GST rate is 10 per cent.

3.2 Entities that carry on an enterprise with an annual turnover of \$50,000 or more (or \$100,000 or more in the case of non-profit bodies) are required to register for, and pay GST.

3.3 Entities who are not required to register for GST may voluntarily register for GST. Entities who may wish to register for GST include very small enterprises, government bodies, charities and other non-profit bodies.

3.4 Generally, registration for GST enables an entity to claim input tax credits for any GST it has incurred (or in some cases paid) for supplies acquired.

3.5 The effect of the GST (in economic terms) is that the tax is levied only on the 'value added' by each entity in the supply chain from producer to consumer.

3.6 Consumers ultimately bear the GST. This is because consumers will pay GST that is charged to them as part of the purchase price of any goods, services or other taxable supplies. Unlike GST registered entities, they cannot claim an input tax credit for this GST.

3.7 Sales or other supplies made by an entity which is registered for GST may be either taxable, GST free, input taxed or outside the scope of the GST.

3.8 Sales or supplies which are taxable are generally subject to GST at the full rate of 10 per cent.¹ GST paid on acquisitions associated with these types of supplies may generally be claimed as input tax credits.

3.9 Sales or supplies which are GST free are not subject to GST. GST paid on acquisitions associated with such sales or supplies may still generally be claimed as input tax credits. Examples of goods and services which are GST free include the following:

- certain food which is for human consumption;
- most medical services and particular medical goods;
- most educational services and some goods; and
- most exported goods and services.

¹ Some taxable supplies effectively attract a concessional GST rate. For example, the supply of a long-term stay in commercial residential premises can effectively attract a GST rate of 5.5 per cent.

3.10 Sales or supplies which are input taxed are also not subject to GST. However, GST amounts paid on acquisitions associated with such activities either do not qualify as input tax credits or only qualify for reduced input tax credit status.

3.11 Input taxed items include:

- most financial supplies;
- sales of non-new residential property, that is, property which has not been newly constructed or substantially renovated; and
- rentals of residential property.

3.12 Items which are outside the scope of the GST include items which are not supplies, as defined in the GST law, and items which do not involve consideration. Such items do not attract GST. However, acquisitions which relate to such items do qualify for input tax credits. An example of an item which is outside the scope of the GST is a gift made to a charity.

3.13 Entities which are required to be registered for GST must lodge a Business Activity Statement (BAS) (also referred to in this report as a GST return) with the Tax Office at the end of each tax (reporting) period. Entities which are voluntarily registered for GST will generally lodge BASs in the same way as compulsorily registered entities.

3.14 The GST operates on a self assessment basis. Taxpayers are required to self-calculate their net GST position on the BAS and make any net payment of GST at the time of lodgment of the BAS. The Tax Office is required to pay delayed refund interest to a taxpayer if a BAS results in a GST refund to the taxpayer and that refund is not made within 14 days of lodgment of the BAS, or within 14 days of the taxpayer providing all information needed for the payment of the refund.

3.15 The tax or reporting period for GST can be monthly, quarterly, or annual. The reporting period mainly depends on the entity's level of turnover. Entities with a turnover of \$20 million or more are, for example, generally required to lodge monthly returns.

3.16 The method of lodging a BAS can be either by a paper return or by electronic means. Entities with a turnover of \$20 million or more are generally obliged to lodge their BAS by electronic means.

3.17 Entities that are not required to report their GST obligations monthly may choose to prepare monthly returns. Monthly returns may be beneficial to parties whose GST returns will record a net GST amount owing to them by the Tax Office, either for a certain time period or throughout the life of their activities. Monthly GST returns will allow these net refunds to be claimed sooner than would otherwise be the case if a quarterly or annual return were lodged.

MEANING OF TERMS 'GST REFUNDS', 'BAS REFUNDS' AND 'ACTIVITY STATEMENT REFUNDS'

3.18 Business Activity Statements also record amounts of tax other than the GST that may be due to be paid by the relevant entity to the Tax Office. These other amounts of tax include wine equalisation tax, luxury car tax, quarterly income tax instalments, Pay As You

Go withholding tax, and fringe benefits tax instalments. Therefore, where an entity is entitled to a refund of GST based in its activities during a particular reporting period, it will only receive an actual refund from the Tax Office if the amount of that refund is more than any other tax debts that might be recorded on the same BAS.

3.19 In this report, except where otherwise indicated, the term 'GST refund' refers to the net amount that may be paid to a taxpayer as a result of the lodgment of their BAS, to the extent that it comprises GST. The term 'BAS refund' refers to the total net amount that may be payable to a taxpayer as a result of lodgment of their BAS. These amounts may comprise refunds of tax other than GST.

3.20 As the most common component of the dollar value of BAS refunds is a GST refund, the Tax Office has, in material provided for the purposes of this Review, treated the two terms as being synonymous.

3.21 A Business Activity Statement is one particular type of activity statement which taxpayers lodge with the Tax Office. The other major type of activity statement lodged by taxpayers with the Tax Office is the Instalment Activity Statement. Instalment Activity Statements are lodged by taxpayers who do not pay GST, but who are subject to the Pay as You Go instalment system for income tax.

3.22 The Australian National Audit Office (ANAO) has noted that approximately 65 per cent of all activity statements lodged with the Tax Office are Business Activity Statements, while 35 per cent are Instalment Activity Statements.²

3.23 In this report the term 'activity statement refunds' refers to refunds which arise from the lodgment of either a Business Activity Statement or an Instalment Activity Statement.

ENTITLEMENT TO GST REFUNDS

3.24 For some parties who lodge a BAS, the GST position will always consist of a net amount of GST owing to them by the Tax Office (that is, they will always be entitled to a GST refund). Examples of entities which fall into this category include:

- entities that make GST free supplies (for example, certain food manufacturers, suppliers of medical services and exporters);
- entities that make financial supplies and who are entitled to reduced input tax credits (such as superannuation funds);
- parties which operate a joint venture for shared expenditure; and
- entities that may be registered for GST but make little or no supplies or supplies which are for no consideration, such as government agencies.

3.25 For other entities, the GST position may consist of a net refund for one or more particular tax periods. Examples of organisations which fall into this category are as follows:

² Australian National Audit Office, *The Australian Taxation Office's Collection and Management of Activity Statement Information*, Audit Report No. 33, 2003-04 Performance Audit at paragraph 1.6.

- entities engaged in an industry where large expenses are incurred during a particular time period. Examples of businesses which fall into this category include entities who make large acquisitions of goods during a particular tax period (for example, a retailer who builds up stock prior to Christmas or a food manufacturer who purchases large quantities of food items in the season when those items become available);
- entities who have recently commenced their business activities;
- entities who are winding down their business activities; and
- entities who are engaged in construction or similar projects where large expenses are incurred prior to revenue being derived from the project.

3.26 Entities may also become entitled to a GST refund for a particular period following a revision to an earlier BAS. Where the relevant revision arises because the entity has incorrectly treated an item as being subject to GST, the Tax Office is not obliged to revise the earlier BAS unless certain conditions are met.³ These conditions include a requirement that the entity reimburse the recipient of the supply if that recipient is a consumer.

3.27 For other types of revisions which generate a GST refund entitlement, such as arithmetical errors, the Tax Office is obliged under the law to revise the earlier BAS provided the revision is made within four years of the end of the relevant tax period. However, the Tax Office has indicated in a fact sheet that it will permit a credit revision to an earlier BAS to be made in a later BAS, provided certain time and dollar value limits are not exceeded.⁴

3.28 This review does not examine the Tax Office's practices in relation to claims for GST refunds based on an item being incorrectly treated as a taxable supply in a prior reporting period.

³ These conditions are set out in section 39 of the *Taxation Administration Act 1953*.

⁴ Australian Taxation Office, *Correcting GST Mistakes – 07/2004*, Fact Sheet, available on the Tax Office's website at www.ato.gov.au.

CHAPTER 4: ATO POLICY AND PROCEDURES RELATING TO THE PAYMENT OF GST REFUNDS

4.1 The first term of reference for this review has required the Inspector-General to identify and consider the adequacy and effectiveness of the Tax Office's policies and procedures relating to the manner in which it processes GST refunds arising from the lodgment of credit BASs. This chapter sets out the Inspector-General's findings and recommendations in relation to this term of reference.

NATURE OF TAX OFFICE'S POLICY FOR PROCESSING GST REFUNDS

4.2 The Tax Office states that it applies risk management methodologies to its administration of the tax system. This involves identifying risks and analysing their likelihood and potential consequences. The Tax Office states that it works in an environment where it is not practical to materially treat all risks, so its approach is to identify and take steps to properly manage the highest risks and to monitor lesser risks to prevent them from increasing.⁵

4.3 The approach which underlies the Tax Office processing of GST refunds reflects the Tax Office view that GST returns which show a net credit due to the taxpayer are the biggest risk in the GST system. This is based on overseas experience.⁶ The Tax Office has also advised that the *Financial Management and Accountability Act 1997* requires that it ensure the integrity of such refunds.

4.4 As a result of this approach, the Tax Office has specialised examination procedures which apply to GST refund returns only. These procedures do not apply to GST payable returns. Of the refund returns that are subject to these examination procedures, the majority will be examined prior to, rather than after, the refund is paid. This policy has not changed since the time when the GST was first introduced.⁷

4.5 The main risks associated with the payment of GST refunds are as follows:

- The first risk is that GST refunds may be paid to taxpayers in circumstances involving criminal fraud. For this purpose, the Tax Office uses the definition of fraud which has been provided in guidelines that have been issued to all Commonwealth Government agencies. These guidelines define fraud as 'dishonestly obtaining a benefit, both tangible and intangible, by deception or other means.'⁸
- The second risk is that the quantum of a GST refund that is paid to a taxpayer may be inflated because mistakes have arisen in the calculation of that refund.

5 Commissioner of Taxation, *Annual Report 2003-04*, at pp. 195-6.

6 Russell, Barrie, Deputy Commissioner, Goods and Services Tax, quoted in Hansard, Joint Committee of Public Accounts and Audit, *Review of Auditor-General's reports 4th quarter 2002-3*, 13 October 2003 at PA 12.

7 The GST started on 1 July 2000.

8 Attorney-General's Department, *Commonwealth Fraud Control Guidelines*, Guideline 2, available from www.ag.gov.au.

4.6 According to the Tax Office, GST refund cases involving mistakes could involve recklessness, deliberate evasion and dishonest claims as well as errors. The Tax Office considers that the range of behaviours leading to mistakes means that, unless there is clear evidence of an intent to defraud, it is more appropriate and faster to resolve these cases through the administrative powers of the Commissioner.

4.7 The Tax Office principally mitigates the above risks by intercepting GST refunds prior to their payment through the use of a control known as the risk rating engine (RRE).

4.8 The Tax Office has provided the Inspector-General with an overview of the function/purpose of the RRE and has further advised that the RRE is in the process of being significantly changed.

4.9 It is inappropriate for this report to discuss in detail the manner in which the RRE operates. However, in essence the RRE is applied at a particular point in the automated processes which the Tax Office uses to process GST refunds. It operates to flag those GST refund cases which the Tax Office considers should not be automatically processed and paid but which should be subject to manual examination by a tax officer.

4.10 The RRE was initially designed to operate on the basis of a number of risk characteristic tests and exception tests. However, a number of these tests were suspended with effect from October 2000.⁹

4.11 The Tax Office has advised that currently there are two levels of risk profiling within RRE processing. The first level is focused on identifying potential 'serious non-compliance' (fraudulent behaviour) and the second, on identifying potential general non-compliance (although serious non-compliance can originate from general non-compliance cases). It advises that all taxpayers are subjected to both levels of processing. However, the serious non-compliance processing focuses on characteristics of the taxpayer and whether the taxpayer is of concern to the Tax Office, while general compliance profiling focuses principally on the transaction, that is, details on the lodged activity statement.

4.12 Up until July 2004, there were three main criteria which would operate to halt a particular taxpayer's GST refund under the RRE process. They were as follows:

- the refund involved a new business;
- the refund exceeded certain dollar value thresholds; or
- the refund originated from a taxpayer with a high fraud risk profile or who was known to the Tax Office.

4.13 In the case of the second criterion, the level of the threshold depended on the size of the relevant enterprise.

4.14 From the beginning of July 2004, as discussed later in this chapter, the Tax Office has implemented more focused checks relating to unusual behaviours over time and has released cases with a good compliance history.

⁹ Australian National Audit Office, *Goods and Services Tax Fraud Prevention and Control*, Audit Report No. 55, 2002-03 Performance Audit, at paragraph 23 on p. 16.

4.15 The features of the RRE that operated prior to July 2004 led to approximately 90 per cent of the total value of GST refunds claims being stopped for checking during the 2003-04 year.¹⁰ These stopped refunds represented 4.3 per cent of the total number of GST refunds.¹¹

4.16 This result suggests that during 2003-04 the RRE may principally have targeted refunds based on their size. This is a rather narrow and unsophisticated risk management approach. Due to the policy design of the GST system, a relatively high level of refunds is to be expected.

Effect of manual intervention on prompt payment of refunds

4.17 The Tax Office's approach of subjecting the vast majority of the dollar value of GST refunds to manual checking has the obvious consequence of holding up these refunds for the time it takes these manual processes to be performed.

4.18 As such, this approach creates tension with one of the principal design features of Australian GST law – that refunds should be paid promptly. This feature is reflected in the current legislative provisions governing GST refunds which require the Tax Office to pay interest to taxpayers if GST refunds are not made within 14 days of lodgment of the relevant BAS or the provision of all relevant information.¹²

4.19 The principle that GST refunds should be paid promptly has been embedded in Australia's GST law for three main reasons. The first reason is that it is a core principle of GST laws worldwide that business-to-business transactions should generally bear no GST burden.¹³ The second reason is that any delay in paying GST refunds will cause cash flow issues for entities entitled to those refunds. The third reason is that a failure to pay GST refunds promptly to businesses and other entities entitled to those refunds will create economic distortions. For example, new firms may face a competitive disadvantage if they are subject to delayed refunds. Likewise, the competitiveness of GST free sectors (such as the export sector) may be harmed by significantly delayed GST refunds.¹⁴

Need to balance risk to revenue against prompt payment of refund claims

4.20 The Tax Office's approach to administering GST refunds must be one which achieves an appropriate balance between the competing priorities of protecting the revenue from mistaken or fraudulent claims and the necessity of ensuring that refunds are paid promptly.

10 This figure has been publicly stated by the Tax Office. See, for example, Granger, J., quoted in Hansard, Joint Committee of Public Accounts and Audit, *Review of Auditor-General's reports 4th quarter 2002-03*, 13 October 2003, at PA 15, and Monaghan, M., 'Making identity management work' Speech presented at the Information Security World Conference – 23-25 August 2004, downloaded from www.ato.gov.au on 7 September 2004.

11 ATO Minute No IGT-GST09-2004 at paragraph 2.1 on p. 3.

12 Sections 12 AA to 12 AD of *Taxation (Interest on Overpayments and Early Payments) Act 1983*. Note that the GST refund provisions contained in *A New Tax System (Goods and Services Tax) Act 1999* originally required the Tax Office to pay GST refunds within 14 days unless one of a number of exclusions were satisfied. These provisions were later amended, with effect from the start date of the GST, so as to exclude any legislative time frame within which a GST refund must be paid.

13 Ebrill, L., Keen, M., Bodin, J. and Summers, V., *The Modern VAT*, International Monetary Fund Washington D.C. 2001 at p. 157.

14 *ibid.*

4.21 In the view of the Inspector-General, the Tax Office's current approach to administering these refunds, through the operation of the risk rating engine and subsequent processes, has involved an inadequate application of risk management processes. The Tax Office has identified fraud and mistakes as risks that have to be managed but has adopted a simplistic method of assessing these risks. This approach has had the effect of delaying the vast majority of GST refunds in monetary terms and has involved the investment of close to one-quarter of its overall GST audit program effort.¹⁵ However, this approach may have yielded only minimal protection to the revenue, in terms of either the number of GST fraud cases detected or the value of mistaken claims detected.

4.22 The Tax Office advises that it has had a program operating since July 2003 to analyse BAS refund data and the state of the refund system. As discussed later in this chapter, from July 2004 it has implemented more sophisticated tests, together with an override facility in relation to certain GST refunds.

Refund cases involving fraud

4.23 Material provided by the Tax Office to the Inspector-General for the purposes of this review indicates that the risk rating engine processes do not result in the identification of a significant number of GST refund fraud cases.

4.24 The Tax Office was unable to provide the Inspector-General with details of the number of fraud cases involving GST refunds which have been completed over the four years since the commencement of the GST on 1 July 2000. It was able to provide the number of prosecutions for all GST-related offences for these years. The total number of such prosecutions was small, ranging from four in 2000-01 to 80 in 2003-04.

4.25 In addition, the Australian National Audit Office (ANAO) found in its 2003 review into the Tax Office's management of GST fraud that, at the time of its report, only 1.9 per cent of the GST fraud cases registered on the Tax Office's reporting systems for fraud identified the RRE as the referral source. The ANAO further stated that it recognised that a further 53 per cent of identified GST fraud cases 'would in all probability' have originated from work generated by the RRE. However, it also noted that in the sample of cases it examined the RRE was not identified as the referral source for any cases.¹⁶

Refund cases not involving fraud

4.26 During 2003-04, a number of the GST refunds stopped by the RRE were found to be partly payable because of mistakes. These mistakes were detected through manual desktop checking procedures.¹⁷

4.27 The total dollar value of adjustments made to these GST refunds was \$275 million. This is small compared to the \$20.574 billion total dollar value of all GST refund cases that

15 ATO Minute No IGT-GST11-2004 at paragraph 1.2 on p. 13.

16 Australian National Audit Office, *Goods and Services Tax Fraud Prevention and Control*, Audit Report No. 55, 2002-03 Performance Audit at paragraph 4.28 on p. 69.

17 In this report the term 'desktop' applied before a term refers to activities which are carried out inside the Tax Office and which do not involve a field visit to a taxpayer.

were initially stopped by the RRE.¹⁸ This suggests that the vast majority of GST refund cases that were initially stopped by the RRE during 2003-04 were later released by the Tax Office.

4.28 The Tax Office has not been able to advise the Inspector-General of the split of all of the above \$275 million of GST adjustments into adjustments which are of a permanent nature or of a (technical) timing nature.

4.29 Adjustments of a permanent nature are adjustments where the taxpayer has underpaid their GST or overclaimed their input tax credit entitlement and the underpayment or overclaim will not be reversed in a subsequent time period. Examples include input tax credits claimed by a purchaser where the supplier of the relevant item is not registered or required to be registered for GST.

4.30 GST adjustments which are of a (technical) timing nature are those adjustments which may be 'reversed' in a subsequent tax period. Examples include cases where a taxpayer has claimed an input tax credit for a particular transaction in one BAS, but is not in possession of a valid tax invoice for that transaction by the time of lodgment of that BAS. In this case, the credit is not claimable in the earlier BAS, but is claimable in the tax period when the taxpayer has obtained a valid tax invoice.

4.31 The Tax Office was able to advise the Inspector-General how much of the above adjustments relates to permanent and timing adjustments for large business taxpayers. It has advised that \$14.5 million of the above adjustments related to large business taxpayers and that, of this amount, \$12 million related to permanent adjustments and \$2.5 million to timing adjustments.

4.32 In many cases, the Tax Office's desktop checks on the refund related to only part of the claimed refund. However the entire amount of the refund was delayed until these checking processes were completed. This had the effect of unnecessarily delaying the portion of the refund which the Tax Office ultimately decided to release.

GST refunds involving net payable returns

4.33 The Tax Office through its overall compliance program undertakes a mix of pre- and post-issue checks on the correct reporting of GST liability. Refund cases are reviewed prior to the issue of the refund. In debit cases (some of which may also involve mistakes in relation to GST refunds) the Tax Office undertakes a post-issue review. It does not hold up the processing of cases where payments to the Tax Office are involved.

4.34 The weighting of the Tax Office's overall GST audit activities between examining GST refund returns and other audit activities (including the examination of GST payable returns) is illustrated in Appendix 4. This appendix contains a table provided by the Tax Office which shows its planned GST audit activities for 2004-05. In examining this table, it should be noted that the number of GST payable returns is about four times the number of GST refund returns.¹⁹

¹⁸ ATO minute No IGT-GST15-2004 at paragraph 9.1 on p. 6.

¹⁹ For the 2003-04 year, the Tax Office has advised, in ATO Minute No IGT-GST 09-2004 at paragraph 5.1 on p.7, that there were 7,904,276 original BAS statements with net amounts payable. By contrast, there were 1,890,128 original BAS refund returns.

Obligations to ensure the integrity of refunds

4.35 The Tax Office has justified its approach to checking GST refunds on its obligations to ensure the integrity of refunds under the *Financial Management and Accountability Act 1997*.

4.36 The Inspector-General notes that the efficiency and effectiveness of the Tax Office's processes for disbursing Government monies are not matters which are within the terms of reference of this review.

NATURE OF OPERATION OF THE RISK RATING ENGINE ON PARTICULAR TAXPAYERS

4.37 Once flagged by the RRE for verification, GST refund cases have been streamed to one of the following verification areas of the Tax Office prior to the refund being paid:

- the Serious Non Compliance branch (SNC) (for cases which appear to involve fraud);
- the Interpretation and Large Enterprise Compliance area (ILEC) (for cases involving large business taxpayers, being taxpayers who are part of an economic group with an annual turnover of over \$100 million);
- the Government and Community sector branch (GCS) (for refund cases involving large taxpayers in the government or community sector);
- a Compliance Verification Centre (CVC) (for all other small business cases, including small government and community sector taxpayers). A CVC will then refer a case to the General Field area where the refund is to be verified by detailed field activity.

Refund verification processes for large companies and government and non-profit bodies

4.38 During 2003-04 the risk rating engine operated to flag GST refunds exceeding certain dollar thresholds for manual checking.

4.39 This approach did not take into account the tax risk profile of the taxpayers being subjected to these processes. As a result, GST refunds which exceed certain dollar values for low-risk taxpayers, such as large companies and government entities, were delayed for the time that it took the Tax Office to perform these verification processes.

4.40 These processes may have taken only a few days to complete for a majority of these taxpayers. However, for a number of such taxpayers these processes took longer than a few days, through no fault of the taxpayer concerned. During 2003-04, 39 per cent of all refunds for large enterprise taxpayers that were stopped for verification were delayed for longer than 14 days. For government and community sector taxpayers, 3 per cent of such cases were delayed for longer than 14 days.

4.41 This review has also established that these verification processes generated \$14.5 million of GST adjustments for large enterprise taxpayers for the 2003-04 year. For the government and non-profit sector, \$0.1 million of tax adjustments could be attributed specifically to this activity.

4.42 The Tax Office has advised the Inspector-General that in 2003-04, \$7.35 billion of GST refunds claimed by large enterprise taxpayers were flagged for manual checking by the risk rating engine and \$7.16 billion of GST refunds were flagged for checking by this process for large government and community sector taxpayers. The adjustments made in respect of these manual interventions therefore represent 0.2 per cent of the total refunds held for large taxpayers and 0.0014 per cent of the total refunds held for large government and community sector taxpayers.

4.43 The Tax Office has advised that during the 2003-04 year, it raised \$1.1 billion of GST tax adjustments (excluding penalties and interest) from all GST audit activities.²⁰ It has also advised that the total amount of GST collected in 2003-04 was \$33.2 billion.²¹ These figures give a ratio of GST adjustments from all audit activity to net GST collected of 3.3 per cent. This percentage is 16.5 times that which was achieved from RRE-generated verifications for large enterprise taxpayers and 2,357 times that which was achieved from RRE-generated verifications for government and community sector taxpayers.

4.44 The above figures suggest that the Tax Office should consider minimising or reducing the level of pre-issue checks applied to these forms of entity and redirecting the resources that are applied to this activity to other forms of audit activity.

Tax Office response made during the review

4.45 The Tax Office has stated during the course of this review that both its Interpretation and Large Enterprise Compliance (ILEC) and Government and Community Sector (GCS) branches propose to introduce an override process into the operation of the RRE in relation to large publicly listed companies, and any large taxpayer that has a minimum of a five-year history with the Tax Office (that is, has been registered for any tax for a minimum of five years) that indicates a satisfactory compliance record. It is estimated that 1,453 refunds, from some 4,114 ILEC taxpayers (not all will lodge refund claims), amounting to \$5 billion would be released before being verified. ILEC and GCS will select a relevant sample of these refunds to verify after the refund has been paid to the taxpayer (post-issue checks). This policy has been progressively implemented from July through to December 2004.

4.46 The Tax Office has also advised that it is developing appropriate criteria for Government and Community Sector (GCS) in relation to 197 Government market segment entities, the majority of which are entitled to claim refunds. It is expected that close to all of these entities will become subject to the override policy. This will result in a reduction of \$4.6 billion in stopped refunds for this sector.

4.47 GCS also manages 372 large market entities in the health sector. Some of these entities are entitled to claim refunds. This sector is currently being evaluated to determine the number of entities that would meet the criteria for inclusion in the override process.

Inspector-General's comments

4.48 The Tax Office's response indicates that \$5 billion of GST refunds for ILEC taxpayers will no longer be potentially subject to manual pre-refund checks.

²⁰ Commissioner of Taxation, *Annual Report 2003-04* on p. 65.

²¹ *ibid* at p. 40.

4.49 The Tax Office's current approach to this issue means that the balance of GST refunds for ILEC taxpayers may continue to be subject to the existing pre-refund checking processes.

4.50 The Inspector-General notes that the Tax Office's proposed processes for government organisations means that in the future the GST refunds for 'close to all' such taxpayers may now be issued without verification prior to payment. This reflects the low likelihood of any overpaid amounts being difficult to recover.

Verification activities for small business taxpayers

4.51 This review has also established that the risk rating engine and subsequent verification processes (other than those involving field audit activity) have resulted in \$178.5 million of GST adjustments in the 2003-04 year for small business taxpayers. A further \$82 million of GST adjustments was recovered from small business taxpayers as a result of more detailed audit activity on refunds stopped for checking.

Failure of RRE criteria to recognise the nature of the taxpayer's industry or prior compliance history

4.52 Both taxpayers and tax practitioners raised concerns that the Tax Office's 2003-04 RRE processes for checking GST refunds for both large and small business taxpayers did not allow either the nature of the taxpayer's industry, the life cycle stage of the taxpayer's business or their past history in terms of previous compliance checks to halt the risk rating engine flagging the case for the application of manual checking procedures.

4.53 As a result of this, taxpayers asserted that they were having successive refunds delayed despite being in an industry where GST refunds were the norm or where the taxpayer's previous compliance history indicated that such a procedure was inappropriate. Businesses and other enterprises that stated that they were subject to these repeated verification process included property developers, exporters and business making other forms of GST free supplies, such as food.

4.54 The Inspector-General notes that the risk rating engine's pre-July 2004 process of halting all refunds over certain dollar values supports these submissions made by taxpayers. This process meant that the payment of a GST refund could be delayed even in cases where the refund was not unusual for the taxpayers concerned.

4.55 This type of approach for processing GST refunds is not consistent with that which has been recommended by the International Monetary Fund (IMF) and other international parties. The IMF recommends that revenue authorities should have processes in place to check GST refunds prior to payment when the refunds involve new businesses and *unusually* large refunds.²² The term 'unusually large' is interpreted as being abnormal in view of the expected circumstances of the taxpayer.

4.56 The Tax Office has also provided material to the Inspector-General which confirms taxpayers' concerns that, in certain cases, their BAS refunds were halted by the RRE, despite their earlier refunds having been recently checked.

22 Ebrill, L., Keen, M., Bodin, J. and Summers, V., *The Modern VAT*, International Monetary Fund Washington D.C., 2001 on p. 162.

4.57 The Tax Office has advised that during the period from 1 July 2003 to 29 February 2004, a total of 20,020 taxpayers had multiple refund activity statements stopped for verification activity. Overall, this represented 77,128 activity statements, or an average of four activity statements per taxpayer which had to be verified before the funds were released.²³

4.58 The above approach to processing GST refunds is not in accordance with the Tax Office's Compliance Model. Under this model, the nature and scale of any Tax Office audit activity needs to take into account the taxpayer's attitude to tax compliance. A GST refund policy which halts refunds for all taxpayers on the basis of the size of the relevant refund does not take into account a taxpayer's compliance profile.

Tax Office response made during the review

4.59 The Tax Office advises that it has had significant new approaches in train to review the impact of the RRE on particular taxpayers since July 2003. The Tax Office advises that it was well advanced in the process of improving the RRE tests to take account of earlier BAS reviews of businesses as well as industry characteristics prior to the commencement of this review. It states that these new measures have been implemented from July 2004.

4.60 Under these new measures, pre-refund checks will no longer be conducted where the relevant taxpayer has previously been the subject of a verification check within a certain time period and the amount of the refund claimed is not unusual for that particular taxpayer, for example, because of the nature of its industry²⁴ or because of the season during which the refund is claimed.²⁵

4.61 The Tax Office has advised that this strategy will account for around 40 per cent of the work items generated by the risk rating engine.²⁶

Inspector-General comment

4.62 The Inspector-General considers that these initiatives should result in Tax Office practices for pre-refund checks being more closely aligned with the objective of ensuring that pre-refund checks are conducted only on *unusually* large GST refunds.

4.63 However, these new measures have not been in place for a sufficient period of time for the Inspector-General to assess at this stage the extent to which this measure might meet this objective.

Key recommendation

4.64 The findings referred to above in relation to the first term of reference for this review lead to the following key recommendation.

23 ATO Minute No IGT-GST06-2004 on p. 12.

24 ATO Minute No IGT-GST02-2004 at paragraph 8.4.3.

25 ATO Minute No IGT-GST03-2004 at paragraph 5.3.1.

26 ATO Minute No IGT-GST03-2004 at paragraph 5.6.3.

KEY RECOMMENDATION 1

The Inspector-General recommends that the Tax Office improve its systems to better match the risk issues associated with paying GST refunds. These systems need to achieve a better balance between paying GST refunds in a timely manner and preventing fraudulent or incorrect refunds from issuing.

Tax Office Response

4.65 The Tax Office agrees with this recommendation. Since the introduction of the GST the Tax Office has had effective systems in place to prevent the payment of fraudulent or incorrect GST refunds and its performance in paying GST refunds in a timely way compares favourably with other tax administrations.

4.66 The Australian National Audit Office, in its performance review of Goods & Services Tax Fraud Prevention & Control in 2002-03 acknowledged this effectiveness in its statements:

‘The ATO has well structured compliance programs that, although not specifically directed at GST fraud, incorporate fraud prevention strategies, detection capabilities and enforcement policies’²⁷.

‘The ATO has implemented a highly visible GST compliance program with broad coverage across business that aims to:

- identify incorrectly calculated/or avoided tax;
- provide assurance that the GST system is working as intended; and
- assess the effectiveness and targeting of education programs.’²⁸

4.67 The ANAO found that the GST General Compliance program is based on the ongoing assessment of the GST compliance risks facing the Tax Office and forms part of an overarching compliance program.

4.68 With the benefit of our experience in administering the GST, the Tax Office has been able to refine its refund integrity program. A program of change was set in train in July 2003 with the outcomes implemented from July 2004. The program in particular focuses on assessing the likelihood and consequences of GST refunds being fraudulent or incorrect. This program has resulted in additional more sophisticated case selection rules, as well as an override facility which provides more automated streamlining of cases with an historical record of good compliance and regular refund claims. As a result of the changes made to date, it is anticipated that the number and value of refunds delayed for verification will be substantially reduced in 2004-05 and future financial years. This program will continue with further monitoring of refunds.

²⁷ Australian National Audit Office, *Goods and Services Tax Fraud Prevention and Control*, Audit Report No. 55, 2002-03 Performance Audit at paragraph 19 on p. 15, and paragraph 3.34 on p. 61.

²⁸ *ibid* at paragraph 3.21 on p. 57.

OTHER CONCERNS WITH TAX OFFICE PROCESSES FOR GST REFUNDS

Third party verifications

4.69 Submissions to this review raised concerns that GST refunds were delayed, prior to payment, while Tax Office verification staff made checks with third parties to confirm the veracity of tax invoices of the taxpayer claiming a refund of input tax credits. It was submitted that, under these procedures, the Tax Office also seeks to verify that the supplier has accounted for their part of the transaction and has remitted the GST collected to the Tax Office.

4.70 One submission noted that:

'It is only when both sides of the transaction are to the satisfaction of the Tax Office that the GST refund is remitted to the taxpayer claiming the input tax credit.'²⁹

4.71 Concerns were also raised that there were no administrative or legal reasons for the delay arising from these checks. It was asserted that, in cases where a taxpayer claiming an input tax credit has a legitimate tax invoice and there is no obvious perception of collusion between the supplier and purchaser to subvert the GST regime, then there was no reason to withhold the GST refund simply because the supplier had not fulfilled its obligation.³⁰

4.72 Submissions also noted that third parties who were contacted under these procedures may not process these requests for confirmation on a timely basis. This is because third parties are generally aware that these requests do not relate to their own tax affairs but those of other taxpayers. This awareness exists even though Tax Office staff are not permitted, under the secrecy provisions of the taxation law, to disclose to the third party the nature of the review they are conducting or the tax affairs of the recipient of an invoice.

Tax Office response made during the review

4.73 The Tax Office has made the following response to these concerns.

4.74 Firstly, it has stated that its procedures do not support claims that it is only when both sides of a transaction are to the satisfaction of the Tax Office that the GST refund is remitted to the taxpayer claiming the input tax credit.

4.75 Secondly, the Tax Office has stated that it will continue to undertake third party checks in some situations. It advises that it has concerns about the integrity of some refund claims. For example, it notes that there have been a number of fraud cases where large refunds have been claimed for heavy equipment for which tax invoices have been produced. The Tax Office further advised that third party checks have subsequently shown these tax invoices have been artificially generated and the reported transactions did not occur.

²⁹ Taxpayers Australia Inc, *Review of ATO's Administration of GST refunds arising from the lodgment of Business Activity Statements*, Submission to Inspector-General of Taxation, dated 30 April 2004.

³⁰ *ibid.*

4.76 The Tax Office believes that removal of these checks would have a severe impact on the integrity of the refund system and encourage even greater levels of fraudulent behaviour.³¹

Inspector-General comment

4.77 The Inspector-General notes that the above Tax Office response does not address the concerns raised about delays arising from third party verifications in cases which do not involve fraud.

Delayed refund interest

4.78 Tax Office policy is that where a GST refund has been delayed and the delay is due to Tax Office processing procedures, or to Tax Office verification procedures which involve merely the verification of entries made on a BAS, delayed refund interest will be paid to the taxpayer. This payment should be made automatically, that is, without any request for payment by the taxpayer. The interest is calculated from the day that is 14 days after the date of lodgment of the BAS up until the day the relevant refund is paid.³²

4.79 The rate of delayed refund interest is the same as that which applies to overpayments of tax, which is currently 7 per cent less than the General Interest Charge. It is calculated on a simple interest basis. For the quarter ended December 2004 the rate of delayed refund interest was 5.44 per cent.³³

4.80 In a number of submissions made to this review, taxpayers who experienced delays of more than 14 days from the date their BAS was lodged (or relevant information was provided) until the date when their GST refund was paid claimed that delayed refund interest was not automatically paid to them. These taxpayers claimed that they were required to specifically contact the Tax Office and request that this interest be paid.

4.81 The non-automatic payment of delayed refund interest was also observed in a number of GST refund cases examined by staff of the Inspector-General during fieldwork conducted for this review.

Tax Office response made during the review

4.82 The Tax Office has advised that delayed refund interest will not be automatically calculated when a refund is processed manually rather than by a computer. According to the Tax Office, there are only a limited number of circumstances where a refund will be processed manually. These include cases where there is an indicator on the taxpayer's account which prevents the refund from being automatically issued, cases where the refund is to be paid into a taxpayer's bank account and it exceeds a very large threshold, and cases where the refund may need to be issued urgently.³⁴

4.83 These comments lead to the following recommendation.

31 ATO Minute No IGT-GST11-2004 at paragraph 8.1 on p. 11.

32 ATO Receivables Policy at paragraph 84.2.9.

33 Australian Taxation Office, General interest charge (GIC) rates, Fact Sheet, downloaded from www.ato.gov.au on 16 November 2004.

34 ATO Minute No IGT-GST18-2004 at paragraph 2.2 on p. 4.

Subsidiary recommendation 1

The Inspector-General recommends that the Tax Office establish systems which identify all cases where delayed refund interest should be paid.

Tax Office response

4.84 The Tax Office agrees with this recommendation. We are confident that we now have business processes in place to identify and pay delayed refund interest in all applicable cases. We acknowledge that prior to system enhancements in July 2003 there were limited instances in which delayed refund interest was not routinely paid.

CHAPTER 5: CURRENT TAX OFFICE TIME FRAMES AND PERFORMANCE STANDARDS FOR ISSUING GST REFUNDS

5.1 The second term of reference involves an examination of the current time frames which apply to the processing of various types of GST refunds and of the performance standards which the Tax Office uses in relation to issuing GST refunds on a timely basis. This chapter sets out the Inspector-General's findings and recommendations in relation to this term of reference.

5.2 A summary of Tax Office processes relevant to GST refunds is set out in Appendix 5.

CURRENT TAX OFFICE TIME FRAMES FOR PROCESSING OF ROUTINE REFUNDS

5.3 During the course of this review a major concern raised by taxpayers and tax practitioners was that the Tax Office took too long to issue GST refunds generally and, in particular, took too long to issue a refund where the refund was subject to certain verification checks.

5.4 The Commissioner of Taxation has stated publicly that routine electronically lodged GST refund claims (that is, refunds that are not stopped for verification or other reasons) should be paid within four days of lodgment. In a speech given on 15 April 2004, the Commissioner stated that, with new enhancements that were to be made to the Business Portal from mid-2004, taxpayers who lodged electronically would be able to receive real time confirmation of the processing of their statement and that their refund would then be paid within three working days of that notification.³⁵

5.5 The Tax Office has also stated to the Inspector-General that routine refunds claimed via a paper return will be paid within six working days of lodgment.³⁶

5.6 For routine GST refunds, the Tax Office was only able to provide the Inspector-General with performance statistics for the time taken for all GST refunds to reach the stage of having been assessed by the RRE. The Tax Office does not prepare performance statistics for the time taken after clearance for payment by the RRE or by a verification area of the Tax Office. This part of the refund process occurs within the Operations business line of the Tax Office and is known as the 'refunder process'. However, according to the Tax Office this process should take one day to complete for routine GST refunds. A further two-day period is then required by the banking system to deposit the refund into the taxpayer's bank account.

35 Commissioner of Taxation, *The Art of Tax Administration: Two Years On*, Speech given to the 6th International Conference on Tax Administration: Challenges of Globalising Tax Systems, 15 April 2004, downloaded from www.ato.gov.au on 5 May 2004.

36 ATO Minute No IGT-GST01-2004 at paragraph 2.1 on p. 4.

5.7 Based on the advice that the refunder process will usually take three days to complete, the material that was provided to the Inspector-General shows that, during 2003-04, most (that is, 98 per cent of) electronically lodged routine BAS refund claims were paid to taxpayers within six working days of lodgment of the claim.³⁷ On a calendar day basis, this time period equates to a minimum period of eight days (including a weekend). During that year, the overwhelming majority (that is, 91 per cent) of routine BAS refund claims lodged by paper returns were paid within 10 working days of lodgment.³⁸ This 10 working day period equates to 14 calendar days.

5.8 The Inspector-General notes that the Tax Office's 2003-04 annual report indicates that it is endeavouring to improve current processing times for refunds, and to therefore improve the service it provides to taxpayers. One future initiative in this regard will be the increased automation of its refund process.³⁹

5.9 The Inspector-General also notes that the Tax Office currently publishes certain weekly activity statement processing statistics on its website. However, these only indicate the percentages of activity statement refunds that are processed within 14 days. They do not provide a break-up between GST refunds and other activity statement refunds claimed, or between paper refund returns and electronic refund returns.

5.10 This leads to the following recommendation.

Subsidiary recommendation 2

The Inspector-General recommends that the Tax Office publish statistics to advise taxpayers, on a regular basis, of the number of days it will take the Tax Office to pay a GST refund after lodgment of either a paper or electronic BAS.

Tax Office response

5.11 The Tax Office agrees with this recommendation. The Inspector-General acknowledges that the Tax Office currently publishes weekly activity statement processing statistics on the percentages of activity statement refunds that are processed within 14 days on our website. In addition to these statistics, we will publish the average expected time to pay a routine activity statement refund. The information categorised below based on prior week's turnaround time will be published on a weekly basis.

- Paper lodgments
 - Original and revision business activity statements
 - Original and revision instalment activity statements
- Electronic lodgments
 - Original and revision business activity statements
 - Original and revision instalment activity statements

37 This figure is derived from figures supplied by the Tax Office in ATO Minute No IGT-GST16- 2004.

38 *ibid.*

39 Commissioner of Taxation, *Annual Report 2003-04* on p. 48.

CURRENT TIME FRAMES FOR PROCESSING OF NON-ROUTINE REFUNDS

5.12 According to material that has been published by the Tax Office, there are five main reasons why GST refunds may be delayed. Refunds which have been delayed for one of these five reasons are referred to as non-routine refunds in this report.⁴⁰

5.13 These reasons are as follows:

- another activity statement for the taxpayer is overdue or is still being processed;
- the taxpayer has not provided to the Tax Office details of the bank account into which the refund can be paid;
- a previous electronic funds transfer refund has been rejected for the taxpayer;
- the taxpayer's account has an intercept in progress for either the refund in question, another refund or another assessment; or
- the Tax Office has decided to confirm the accuracy of the GST refund prior to its payment.

5.14 This list does not include a sixth possible reason – the operation of edit, scanning and exception tests which are conducted within the processing area of the Tax Office prior to a paper-lodged refund being processed electronically. This review has ascertained that these checks may result in a refund being delayed, sometime for several days.

5.15 The first four reasons for a GST refund being delayed and the additional sixth reason involve activities conducted by the Operations business line of the Tax Office. This is the business line responsible for the processing of GST refunds.

5.16 The fifth reason why a GST refund may be delayed – that it is being held up for verification – involves activities which are carried out by one of the compliance/auditing areas of the Tax Office.

5.17 If the proposals referred to earlier in this report are fully implemented by the Tax Office, GST refunds for many large enterprise taxpayers and government taxpayers may no longer be delayed due to pre-issue verification checks.

5.18 Delays in GST refund processing caused by pre-issue verification checks may also no longer arise for many small business taxpayers.

5.19 The following material discusses the reasons for possible GST refund delays which may continue to apply to certain GST taxpayers in the future under the following two broad headings:

- processing activities which may continue to cause a delayed GST refund; and
- verification activities which may continue to cause a delayed GST refund.

⁴⁰ Australian Taxation Office 'Why Activity Statement refunds are delayed or held', issue recorded in Issues Register of the ATO/Tax Practitioners' Forum, downloaded from www.ato.gov.au on 5 May 2004.

PROCESSING ACTIVITIES WHICH MAY DELAY A GST REFUND

Overdue and revised activity statements

5.20 A GST refund will not be paid where another activity statement is outstanding, or is lodged but not yet processed. The Tax Office has advised that once all overdue activity statements are processed the refund will automatically issue, provided that all other conditions are met.

5.21 Tax Office procedure is to pursue any outstanding activity statements, initially by letter, escalating to telephone contact where lodgment of the outstanding statements is not forthcoming.

5.22 The Tax Office has advised that, at any single point in time, approximately one-third of the GST refund cases that are held up because they are awaiting processing within the 'refunder' area of the Tax Office are delayed because of outstanding activity statement lodgments.⁴¹

5.23 In examining cases during the course of this review, the Inspector-General found that GST refunds were being delayed under this heading in situations where the outstanding activity statement was an activity statement which revised prior period amounts.

Tax Office response made during the review

5.24 The Tax Office has recognised that there are no lodgment issues associated with revised business activity statements and therefore no need to hold refunds in these circumstances. As a result, in September 2004 changes were made to the refund process to exclude revision activity statements from consideration when determining whether a refund should be released.⁴²

Lodgment processes for revised BASs

5.25 A significant percentage of delayed refund cases that were sampled by the Inspector-General during the course of this review involved revised credit activity statements.

5.26 Up until August 2004, revisions to activity statements could not be made by electronic means, even where the refund was large and involved a large company or other enterprise. This meant that revision statements for all taxpayers needed to be in either paper form or by way of a letter.

5.27 Paper revision forms are subject to the same edit, scanning and exception tests that apply to all paper-lodged activity statements. Where revisions are lodged by letter, the figures in the revision letter need to be manually keyed into the Tax Office's computer systems. All these processes create the potential for delays.

41 ATO Minute No IGT-GST06-2004 at paragraph 1.2 on p. 3.

42 ATO Minute No IGT-GST13-2004 at paragraph 2.4.

Tax Office response made during the review

5.28 During the course of this review, the Tax Office has advised that it has now introduced a process under which a revised BAS can be lodged electronically. It advises that this should have the result of reducing the volumes of all revisions, including credit revisions, that are sent on paper and which may require manual keying and other forms of manual intervention.

5.29 The Tax Office has also advised that new procedures have been introduced so that credit revisions that are set out on paper are identified, separated out from other correspondence and given priority actioning.⁴³

Absence of bank account details or incorrect bank account details

5.30 The Tax Office has advised that generally refunds are not able to be paid if bank account details are not recorded. Refunds are generally required under the law to be paid directly into a taxpayer's bank account. There are, however, a limited number of situations where these details are not required because the Tax Office has agreed to pay the GST refund by way of cheque.⁴⁴

5.31 Where bank account details are required for payment of the refund, a letter to the taxpayer is automatically generated requesting the provision of these details.⁴⁵ Once the financial institution details are updated, the Tax Office has advised that the refund will automatically issue, provided that all other conditions are met.

5.32 The Tax Office has advised that, as at June 2004, approximately two-thirds of the refunds that were held up during the refunder process were held up due to the absence of bank account details.⁴⁶

Taxpayer concerns

5.33 In submissions made to this review, taxpayers raised a number of concerns about the Tax Office's failure to pay a GST refund unless bank account details for the particular taxpayer had been provided.

5.34 Firstly, taxpayers submitted that there was no procedure whereby a taxpayer who lodged a GST refund for the first time could notify the Tax Office of their bank account details on the BAS form itself. These taxpayers submitted that the BAS form should be amended so as to include a space which allowed for them to provide or update their bank account details.

5.35 Secondly, one submission noted an instance where the Tax Office had paid a GST refund into a wrong bank account. As a result, the taxpayer originally entitled to the refund had experienced a significant delay in receiving their correct refund entitlement.

43 ATO Minute No IGT-GST13-2004 at p. 4 and ATO Minute No IGT-GST16-2004 at paragraph 5.1 on p. 6.

44 The Tax Office has advised that examples of cases where it will pay a GST refund by way of a cheque in favour of the taxpayer include cases where the taxpayer's religion precludes the operation of a bank account and where the taxpayer is either a foreign diplomat or a foreign government entity, and has no place of business or residence in Australia (ATO Minute No IGT-GST02-2004 at paragraph 4.4.3).

45 ATO Minute No IGT-GST02-2004 at paragraph 2.3 on p 4.

46 ATO Minute No IGT-GST06-2004 at paragraph 1.2 on p 3.

5.36 Thirdly, submissions noted that the Tax Office had adopted a policy of requiring that the bank account into which any refund was paid must be in the name of the taxpayer who was entitled to the refund. This had caused a number of refunds, such as those claimed by subsidiaries in large company groups or by funds being managed by a single fund manager, to be delayed. This delay arose because the large company group or fund manager operated only one bank account for all of its subsidiaries or funds under management.

Tax Office response made during the review

5.37 The Tax Office has advised that, from August 2004, taxpayers are able to update their bank account details on-line via the business and tax agent portals. The Inspector-General notes that this initiative will go some way towards addressing one of the above concerns raised by taxpayers.

5.38 The Tax Office has also advised that it has concerns about the ability for bank account details to be changed via the BAS. It has stated that the ability to change bank account details by someone completing the form presents an unacceptable fraud risk, especially for large business entities.⁴⁷

Inspector-General's observations

5.39 The Inspector-General notes that these comments by the Tax Office may be based, in part, on a lack of awareness of the nature of controls within large business entities which apply to BAS forms which may mitigate this Tax Office concern.

5.40 The Inspector-General also notes that the concerns raised about the need to provide bank account details for the particular entity to which the refund is to be paid appear to have been rectified by the issue of Practice Statement PS LA 2004/7. This practice statement was issued early in the course of this review.

5.41 The Inspector-General notes that the Tax Office has provided detailed instructions to its staff on how to deal with reclaiming refunds paid to incorrect accounts. These guidelines appear to adequately address the issue of ensuring that a quick remedy is provided to taxpayers whose refunds have not been paid because they have been paid into another taxpayer's account.⁴⁸

Existence of intercepts

5.42 The existence of intercepts (being situations where a refund is stopped because of an indicator or notation on a taxpayer's account with the Tax Office) is a further reason for a GST refund being delayed.

5.43 Intercepts which result in the offset of the GST refund against other outstanding debts are the subject of the fourth term of reference for this review and are discussed in the next chapter.

⁴⁷ ATO Minute No IGT-GST11-2004 at paragraph 2.1 and 2.2 on p. 6.

⁴⁸ These are contained in Operations Practice Note 2004/024 which forms part of attachment B to ATO Minute No IGT-GST06-2004.

5.44 One particular circumstance involving an intercept other than an offset was raised in submissions made by taxpayers to this review. This was where the automatic processing of a refund was stopped because the taxpayer had lodged a request for amendment to one or more previous income tax assessments. The Inspector-General was advised that a GST refund could be stopped in this case even though the relevant amendment sought to decrease, not increase, the amount of income tax previously paid.

5.45 This leads to the following subsidiary recommendation.

Subsidiary recommendation 3

The Inspector-General recommends that the Tax Office take steps to ensure that credit amendments to income tax assessments do not inappropriately halt the payment of GST refunds.

Tax Office response

5.46 The Tax Office agrees with this recommendation. However, our current processing systems do not enable differentiation between credit and debit amendments, therefore it is not possible to release a GST refund without waiting for an income tax amendment to be finalised and the transactions posted to the account.

5.47 We acknowledge this deficiency in our current system and will take steps to ensure that these issues are addressed with the introduction of our new processing systems in January 2008.

5.48 As an interim arrangement, we will commence a review of the existing practice of temporarily holding refunds pending the finalisation of credit income tax amendments.

Edit, scanning and exception checks

5.49 During this review the Inspector-General observed that there was a process carried out by the Operations area of the Tax Office to check that a refund amount shown on a paper-lodged GST return had been shown in whole dollars only. The Tax Office has advised that, during 2003-04, this process was applied to all paper-lodged refund claims which exceeded a certain small dollar value. This amounted to 45 per cent of all paper refund BASs.⁴⁹ This review found that this process caused some GST refunds to be unnecessarily delayed – for up to several days in some cases.

5.50 The Inspector-General recommends that the Tax Office continue to explore alternative ways of dealing with this dollar and cents problem. The current procedure results in a large number of refunds being taken off-line from automatic processing procedures where only a very small percentage of those refunds will have the problem which the procedure is designed to detect.

5.51 The Inspector-General also notes that the Tax Office has not advised taxpayers or tax practitioners that GST refunds lodged by paper could be delayed for this reason.

⁴⁹ ATO Minute No IGT-GST16-2004 at paragraph 2.3 on p. 3.

5.52 The Inspector-General further notes that refunds can be delayed due to the Tax Office detecting errors which taxpayers have made in completing their GST return. The Tax Office publishes a list of certain errors it is finding in BASs in its Activity Statement Updates. However, these lists do not contain a complete listing of typical errors. The Tax Office has not published a stand-alone guide to provide taxpayers with guidance on the typical errors which are being made and how to prevent them.

5.53 The above observations lead to the following recommendations.

Subsidiary recommendation 4

The Inspector-General recommends that the Tax Office address the problem of ensuring that amounts shown on paper-lodged GST returns have been shown in whole dollars only in a way which does not involve large number of refunds being taken off-line from automatic processes.

Subsidiary recommendation 5

The Inspector-General recommends that the Tax Office publish on a regular basis, comprehensive lists of clerical errors commonly made on a BAS which could delay a GST refund.

Tax Office response to subsidiary recommendation 4

5.54 The Tax Office agrees with this recommendation and will further review the existing risk assessment processes.

5.55 With a view to reducing the number of activity statements taken off-line, we have already made a number of changes to reduce the incidence of scanning errors and in particular, errors relating to the inclusion of 'cents'.

5.56 We have made adjustments to the format of the activity statements:

- Earlier versions contained the words 'Show whole dollars only'. This instruction now reads 'Show whole dollars only (do not show cents)'.
- We have changed the format of the amount fields on the form to show crossed-out cent boxes. This indicates at each label that it is not appropriate to include cents.
- We have adjusted our templates to shift the placement of fold lines on the form to ensure they do not fall across labels, causing misreads during the scanning process.

5.57 In addition to the physical form changes we take a proactive approach to client education. We publish details of common errors, including instructions not to include cents, in the Activity Statement Update bulletin. We are looking to improve our current broad-based approach to addressing errors, by implementing a model which identifies recurring mistakes and tailors our education response. In cases where adjustments are necessary due to recurring incidences of including cents on the activity statement, direct contact will be made with the client.

5.58 In addition, we will review the existing risk assessment process with an end to end focus to determine whether the material risk presented by the taxpayer recording cents on the activity statement is addressed by alternative controls in our processing systems.

Tax Office response to subsidiary recommendation 5

5.59 The Tax Office agrees with this recommendation and has been publishing information about common errors made by taxpayers in the GST system, including BAS errors. These lists have regularly featured in Activity Statement Update. Paper copies of Activity Statement Update accompany the quarterly BAS sent to taxpayers and electronic copies are placed on the ATO internet site.

5.60 The Tax Office will now publish a regular comprehensive list of BAS errors on an on-going basis via the Business and Tax Agent Portals and the ATO internet site. Activity Statement Update will include references to these information sources.

VERIFICATION ACTIVITIES WHICH MAY DELAY A GST REFUND

5.61 Concerns raised by taxpayers in connection with delays caused by verification activities undertaken by the Tax Office on GST refund claims fall into the following two broad categories:

- concerns relating to verification activities which are in the nature of desktop checks on the relevant refund claims; and
- concerns relating to more detailed audit activities conducted on GST refund claims, for example, those which have involved a field visit to the relevant taxpayers.

5.62 Each of these concerns is discussed below.

Desktop verification procedures

Nature of concerns raised

5.63 A major concern of taxpayers raised in numerous submissions made to this review was that desktop verification processes, being the processes carried out by the various areas to which GST refunds were streamed after being flagged by the RRE, took too long to complete.

5.64 Submissions received from many taxpayers and their advisers noted that delays in processing GST refunds that were referred to verification areas for desktop checks affected particular industries – particularly exporters, property developers and taxpayers who made GST free supplies, such as those involving food or health services.

5.65 At one consultation meeting conducted with practitioners, several practitioners who were tax agents for pharmacies noted that these taxpayers regularly had their refunds delayed for lengthy periods whilst undergoing verification activities and that almost every second BAS was queried.

5.66 These practitioners commented that this has meant that some pharmacies are actually switching to a quarterly lodgment basis even though it means they are waiting considerably longer to claim their refunds. The reasoning behind the change is that, where a reviewed BAS has not been processed before another credit BAS arrives, the Tax Office 'stops' not only the new refund, but also the existing refund. This flow-on effect is a major problem and taxpayers have worked out they can circumvent the problem by allowing the Tax Office three months to release the first BAS refund before lodging the next one.

5.67 Submissions also noted that a refund could be especially delayed by these verification procedures where there had been a one-off transaction by a taxpayer – such as a large capital purchase. One submission by a professional association supplied a number of examples of this kind of case where the first contact was made by Tax Office verification staff with the relevant taxpayer or their agent only after four to five weeks had elapsed from the date of lodgment of the relevant BAS.⁵⁰

Performance of verification areas in processing GST refunds

5.68 The Tax Office does not routinely prepare management information reports which indicate the turnaround times for GST refunds processed by verification areas conducting desktop reviews. The method by which each such verification area monitors its performance in the processing of GST refunds is by way of certain weekly reports. In the case of one verification area (ILEC) these weekly reports were only introduced during the course of this review.

5.69 During this review, the Tax Office was asked to prepare data for the 2003-04 year which indicated the length of time refunds that were subject to this form of verification spent in both the Tax Office overall and within each verification area prior to being paid.

5.70 The Tax Office was only able to provide data indicating the length of time such refunds spent within each verification area. This is not an ideal indicator of the total length of time which GST refunds that are subject to verification actually spend in the Tax Office. This is because such a refund will spend a minimum of one day in the Operations area of the Tax Office prior to being allocated to a verification area. It will spend a further one day in the Operations area after leaving the relevant verification area before it is approved for payment. The operation of the banking system will then mean that it will take an additional two days before the refund is actually paid into the taxpayer's bank account.

5.71 The data supplied by the Tax Office, while not an ideal method of assessing Tax Office performance on the processing of refunds that have been subject to verification, nevertheless provides some indication of the extent to which refunds which are streamed to verification areas are being processed by the Tax Office on a timely basis.

⁵⁰ Taxation Institute of Australia, *Review into the tax administration of GST refunds arising from the lodgment of business activity statements*, Submission to Inspector-General of Taxation dated 8 June 2004.

5.72 The first set of data supplied by the Tax Office was the median number of days that a GST refund case that is delayed for more than 14 days will spend in each relevant verification area. This data was as follows:

- CVCs – 30 days
- ILEC – 27 days
- GCS – 21 days
- General Field – 67 days⁵¹

5.73 The other data supplied by the Tax Office was material which recorded for each verification area, and also for particular types of verification cases within the CVC and ILEC verification areas, the number and dollar value of refunds that were processed in that area during intervals of 0-4 days, 5-9 days and then at various intervals up to 90-plus days.

5.74 The first 0-4 day period allows an assessment to be made of the extent to which each verification area is processing GST refunds under certain 'early release' procedures. These procedures allow refunds to be released within a very short time period without the relevant taxpayers being contacted.

5.75 The second time period of 5-9 days was selected because refunds that are processed by verification areas within this time period should, according to the Tax Office, generally be paid to the taxpayers within an elapsed time period of 14 days from the date of lodgment. This takes into account that it will take a minimum of three working days or five calendar days after a refund has been approved by a verification area for it to be processed by the Operations area of the Tax Office and the banking system and then paid into a taxpayer's account.

Processing performance for small business taxpayer refunds and other refunds processed by CVCs

5.76 The table below, provided by the Tax Office, indicates the degree to which refund cases processed within CVCs during 2003-04 were processed in that area within designated time intervals.

Table 1: GST refund cases referred to CVCs in 2003-04

Days	Cases	Per cent	Refund \$	Per cent
0-4	24,747	34.18	-2,306,995,785	45.90
5-9	10,989	15.18	-952,784,590	18.96
Sub-total	35,736	49.36	-3,259,780,375	64.86
10-14	7,520	10.38	-556,285,751	11.07
15-29	16,777	23.17	-868,993,096	17.29
30-59	10,018	13.83	-309,482,988	6.16
60-89	1,325	1.83	-29,134,573	0.58
90-plus	1,036	1.43	-2,257,405	0.04
Total	72,412	100.00	-5,025,934,188	100.00

5.77 The above table reveals that, during 2003-04, approximately 49 per cent of all CVC GST refund cases in terms of number and 65 per cent in terms of dollar value were processed within the CVC area in nine calendar days. This means that approximately 51 per cent of

51 ATO Minute No IGT-GST15-2004 at p. 4.

GST refunds in terms of number and 35 per cent in terms of dollar value were not paid to taxpayers within 14 days.

5.78 However, the table does indicate that, of the cases that have been processed within nine days, most of these (being approximately 34 per cent of the total number of CVC cases, and 46 per cent of the total dollar value of CVC cases) were processed within 0-4 days. This suggests that, during 2003-04, the early release processes adopted by the Tax Office may have accounted for a significant number of the CVC cases that were finalised within nine days in the CVC area itself (or 14 days in the Tax Office overall).

Inspector-General comment

5.79 The Tax Office's failure to process 51 per cent of the refunds that were subject to verification processes within the CVC area within nine days during the 2003-04 year appears, at first glance, not to be an acceptable performance result. However, there may be mitigating explanations for this outcome.

5.80 This statistic would, for example, be acceptable if, as the Tax Office has estimated in material provided to the Inspector-General, it is correct to say that at any single point in time approximately 50 per cent of the refunds that are delayed within the Tax Office are held up because the Tax Office is waiting for the taxpayer to provide relevant information.⁵²

5.81 This statistic may also be acceptable on the basis of the amount of permanent tax adjustments that arise from these delayed refunds.

5.82 On the other hand, during this review, taxpayers and tax practitioners stated that refunds could be delayed while they were transferred between CVC centres in different states or within a CVC. Taxpayers and practitioners were aware of transfers involving different CVCs because, in some cases, they were asked to provide relevant tax invoices and other documentation supporting the refund claim to both the original CVC and then again to a different CVC. GST refund cases examined by the Inspector-General also indicated that transfers of cases between CVCs or between CVCs and other verification areas of the Tax Office could be a reason for a GST refund being unduly delayed. Particular examples of cases where this occurred were cases involving financial supplies.

5.83 The Tax Office's present systems are such that it can only speculate on possible causes for these refunds being delayed.

Changes introduced in 2004

5.84 The above table indicates the performance achieved by CVCs during the 2003-04 year. The Tax Office has advised the Inspector-General that the combined effects of new streamlined procedures introduced in early 2004 and a new override process introduced from July 2004 have meant that the performance times for CVC cases have improved from those indicated in the above table.

52 ATO Minute No IGT-GST03-2004, dated 7 June 2004, at paragraph 9.3.

5.85 For example, the Tax Office has advised that, prior to the adoption of the proposed new override process, 46 per cent of CVC cases were being finalised via the early release of refund process as at August 2004.⁵³

5.86 However, the Inspector-General notes that an increase in the rate at which cases are released under early release procedures will automatically improve the percentage of cases that are processed within nine days, without necessarily resulting in an improvement in the turnaround times for those cases that are subject to more detailed verification procedures involving contact with the taxpayer.

5.87 The Tax Office has also advised that, as at September 2004, 1,950 small business taxpayers that would normally have their refunds verified by a CVC have been subject to the above override process. The Tax Office anticipates that this will account for over 5,000 refunds. The Tax Office also expects that the number of overrides for small businesses will increase in future months.

5.88 The Tax Office further advises that its Strategic Risk Management area is also currently identifying public listed companies in its small business segment to determine the extent to which the override will apply for these entities. The cases selected will use the same criteria as are being used for large enterprise taxpayers, as discussed earlier in this report.⁵⁴

Tax Office reporting processes for delayed refunds

5.89 During fieldwork in relation to this review, the Inspector-General observed that the Tax Office prepares weekly performance reports on cases held within CVCs. These reports provide considerable detail, including the aged status and dollar values of such cases.

5.90 However, these reports have a primary focus on the throughput of cases managed within CVCs rather than analysing why refunds have been delayed. They do not, for example, reveal the nature or size of the potential adjustments associated with the refunds which have been delayed.

5.91 Also, although these weekly reporting processes provide information on the throughput of refund cases, they have not operated to manage the throughput of all such cases.

5.92 Firstly, these weekly reports only provide aged status and other details for cases that have been held within the CVC for more than 10 days. These reports therefore do not provide details for CVC cases which have been in CVCs for 10 days or less.

5.93 Secondly, these weekly reporting processes do not immediately detect that certain GST refunds have been delayed for more than 14 days since lodgment of the relevant BAS.

5.94 These reporting processes only detect GST refund cases which have been delayed for more than 10 days from the time that they have actually reached a CVC. They do not detect and start to monitor GST refund cases which, at some time before this 10-day period expires, have become cases which have spent more than 14 days in the Tax Office due to the time they have already spent in the Operations processing area.

⁵³ ATO Minute No IGT-GST09-2004 at paragraph 5.4.2.3 on p. 10.

⁵⁴ ATO Minute No IGT-GST11-2004 at p. 5.

Processing performance for large enterprise taxpayer refunds

Processing performance for ILEC GST refunds overall

5.95 The table below, provided by the Tax Office, indicates the degree to which refund cases processed within ILEC during 2003-04 were processed in that area within designated time intervals.

Table 2: GST refund cases referred to ILEC in 2003-04

Days	Cases	Per cent	Refund \$	Per cent
0-4	1,635	42.17	-4,514,953,931	61.39
5-9	743	19.17	-1,938,669,988	26.36
Sub-total	2378	61.34	-6,453,623,919	87.75
10-14	385	9.93	-368,259,401	5.01
15-29	623	16.07	-386,587,034	5.26
30-59	323	8.33	-80,371,144	1.09
60-89	78	2.01	-18,880,494	0.25
90-plus	90	2.32	-47,101,413	0.64
Total	3,877	100.00	-7,354,823,405	100.00

5.96 This table indicates that, during 2003-04, around 42 per cent of ILEC refund cases in terms of numbers and around 61 per cent of such cases in terms of dollar value were processed within ILEC within 0-4 days. This means that at least 58 per cent of the total number of ILEC-held refunds and 39 per cent of the total dollar value of such refunds were not processed under ILEC's early release procedures.

5.97 At the end of nine days, 61 per cent of ILEC refund cases, in terms of number, and 88 per cent, in terms of dollar value, had been processed within ILEC. However, this still means that 39 per cent in terms of the number of held refunds and 12 per cent in terms of the dollar value of such refunds were not paid in the 14-day calendar day period after lodgment of a BAS.

Inspector-General comment

5.98 The Tax Office's processing performance for GST refunds involving large enterprise taxpayers is better than that achieved for refunds involving small business taxpayers. For example, for ILEC taxpayers the Tax Office has processed 42 per cent of GST refunds in 0-4 days in terms of number and 61 per cent of such refunds in terms of dollar value. For taxpayers whose refunds were reviewed by CVCs, the corresponding percentages were 34 per cent and 46 per cent respectively.

5.99 However, for large enterprise taxpayers 39 per cent of the refunds in terms of number and 12 per cent of such cases in terms of dollar value were not processed by the end of nine days within ILEC and 14 days within the Tax Office overall.

5.100 As with CVCs, this may or may not be an acceptable performance result, depending on the causes of these delays.

5.101 The incorrect referral of ILEC refund cases to other areas of the Tax Office prior to being sent to the correct area within ILEC is one cause of GST refunds being delayed. The Inspector-General observed this problem particularly in relation to refund cases involving financial supplies. This is discussed in further detail below. However, this problem was also observed for non-financial supplies GST refund cases.

5.102 Under its present systems the Tax Office does not know the nature and extent of causes of GST refunds being delayed, as it does not routinely track the actual causes of refund delays within ILEC.

5.103 The Inspector-General also notes that the sum of the net tax adjustments arising from refunds that were checked by ILEC, being \$14.5 million, was considerably less than that which was achieved by CVCs. This figure suggests that the process of checking the vast majority of GST refunds for large enterprise taxpayers before they are paid, and delaying 39 per cent of the number of such refunds for more than 14 days, may not be justified on a risk management versus cash flow consequence basis.

Processing performance within different segments of ILEC

5.104 ILEC is divided into five industry segments and two general segments. The five industry segments deal with large taxpayers engaged in the following industries:

- resources and energy;
- technology, information, communications and entertainment ('TICE');
- property and construction;
- general insurance; and
- financial services.

5.105 The two general segments are Cap North and Cap South. Cap North deals with all ILEC taxpayers in NSW and Queensland who do not fall within one of the above five specific industry segments. Cap South deals with all ILEC taxpayers who are in the other Australian states who do not fall into one of the above five industry segments.

5.106 For the financial services segment, one cause of refund delays is the incorrect allocation of ILEC GST refund cases to other areas within ILEC or to a CVC prior to being forwarded to the financial services segment of ILEC. This can occur because ILEC is responsible for processing the GST refunds for all financial services taxpayers. However, many financial services refunds will initially be allocated to a CVC. They will then be referred to the ILEC area if they are considered to be of a complex nature. Some financial services cases will also be allocated to another area of ILEC before they are identified as cases which should be dealt with by the financial services segment.

5.107 A number of the financial services cases observed during fieldwork conducted during this review had been reallocated five to twelve times, either within ILEC or between CVCs and ILEC, before being actioned by a tax officer.

5.108 The Inspector-General notes that the level of complexity of GST refunds involving financial services taxpayers may not be significantly greater than that which arises for other types of taxpayers, such as, for example, those involved in property transactions. Complexity may therefore not be a valid reason for the special processing structure which the Tax Office has adopted for financial supplies GST refund cases.

5.109 The Inspector-General also notes that, despite the high volume of GST refunds involving financial services taxpayers that have been subject to examination by ILEC staff, few adjustments have actually been made. The Tax Office has provided figures to the

Inspector-General which indicate that, of the \$14.5 million of net GST adjustments that were made as a result of the refund verification work performed by ILEC, \$2.7 million related to taxpayers whose refunds were examined by the financial services segment.⁵⁵

Inspector-General observations on ILEC's processing performance for GST refunds overall

5.110 The Inspector-General notes that the Tax Office has introduced an override arrangement for certain ILEC taxpayers. However certain ILEC taxpayers may still be subject to the existing pre-refund checking processes in ILEC. If this is the case, then the Tax Office needs to ensure that refunds that will continue to be checked by its ILEC area are processed on a timely basis. These procedures should include a focus on the reasons why refunds are being delayed within ILEC overall and within each ILEC segment, particularly within the financial services segment.

Processing performance for large Government and Community Sector taxpayer refunds

5.111 The GCS branch of the Tax Office is responsible for managing GST compliance for large taxpayers (that is, generally taxpayers with an annual turnover of \$100 million or more) in the government, health, education and non-profit sectors.

5.112 Material provided to staff of the Inspector-General indicates that, for the 2003-04 financial year, there were 1,641 GST refund cases, representing approximately \$7.16 billion in dollar value, referred to the GCS branch as a result of the RRE processes. Of these, 46 cases (or 3 per cent of cases), representing a total GST refund value of \$45 million, were not processed within 14 days of lodgment.

5.113 The fieldwork conducted by staff of the Inspector-General indicated that one cause of long refund delays for certain GCS taxpayers is the allocation processes used by the Tax Office to determine whether a case should be referred to the GCS branch.

5.114 A GST refund case will be allocated to the GCS branch if the taxpayer's record within the Tax Office has both a large enterprise client (LEC) indicator on its account and an Australian and New Zealand Standard Industry Classification (ANZSIC) code which denotes that the taxpayer falls into one of the industry segments handled by the GCS branch.

5.115 The ANZSIC code which is recorded for each taxpayer is generally that which the taxpayer has nominated in its initial application for GST registration. This ANZSIC indicator may not therefore be a correct reflection of whether the taxpayer is the type of taxpayer which the Tax Office regards as a GCS taxpayer.

5.116 Of the 22 GCS branch-delayed GST refund cases examined by staff of the Inspector-General, 11 involved delays that were due to these allocation processes. Of these 11 cases, five involved large private sector clients with large refund amounts and involved delays ranging from five to 28 days.

5.117 The Inspector-General notes that the Tax Office will introduce more streamlined processes for GST refunds involving government entities under proposed new override processes. A certain number of taxpayers' GST refunds may still be reviewed by the GCS

55 ATO Minute No IGT-GST09-2004 at p. 6.

branch. For these taxpayers, the Inspector-General suggests that the Tax Office consider introducing a separate 'GCS' indicator similar to the existing LEC indicator so that any large GST refund cases that are to be examined by the GCS branch are streamed directly to that branch for examination.

Tax Office response made during the review

5.118 The Tax Office has advised that it is including in its information technology plans the introduction of a specific Government and Community Sector indicator that would operate in addition to the taxpayer-provided ANZSIC code.⁵⁶

Verification procedures for GST refunds involving a detailed audit

Nature of concerns raised

5.119 During the course of this review, a number of taxpayers raised concerns about the Tax Office's policies for withholding GST refunds during the period that a detailed audit is being conducted by the Tax Office.

5.120 These concerns include the following:

- all GST refunds due to a taxpayer could be delayed under this process for periods of up to 12 months or more, even where the taxpayer was engaged in the type of business which would ordinarily always give rise to GST refunds, such as an export business, or in a business which would give rise to very large refunds at certain times, such as a property developer;
- the above delays in refunds could create very serious cashflow difficulties for the taxpayers concerned;
- refunds could be withheld under this process even where the underlying issue had been previously resolved by the Tax Office in a review conducted a number of years earlier;
- the audit process could be delayed by Tax Office staff requesting information already provided to the Tax Office;
- the withholding of a refund in such cases prejudged the result of the audit;
- the Tax Office has no legal power to withhold GST refunds;
- a decision to stop refunds in these circumstances will not be reviewed internally by the Tax Office; and
- only legal action is available to a taxpayer seeking the release of refunds prior to the conclusion of an audit.

5.121 The Inspector-General has not examined the nature of activities conducted by the Tax Office during detailed audits involving GST refunds, nor the above taxpayer concerns with these activities, as these subjects extend beyond the terms of reference of this review.

⁵⁶ ATO Minute No.IGT-GST11-2004 at paragraph 6.2.

5.122 However, the subject of the ATO's audit practices generally may be the subject of further review by the Inspector-General in accordance with the priorities of his work program.

TAX OFFICE PERFORMANCE STANDARDS

5.123 The Tax Office does not have separate performance standards for the processing of GST refunds and BAS refunds. However, it does have a separate service standard for the processing of activity statement refunds. As indicated earlier, activity statement refunds can involve the refund of taxes other than the GST.

5.124 The service standards for activity statement refunds are part of the Taxpayers' Charter. These standards are as follows:

- The Tax Office will aim to process activity statement refunds within 14 days of receipt in the Tax Office.⁵⁷
- Where the Tax Office requests additional information to complete the processing of an activity statement refund, it will aim to process that refund within 14 days of the receipt of that additional information.⁵⁸

5.125 The Tax Office has advised that it currently measures its effectiveness in processing GST refunds based on a standard of 92 per cent of activity statement refunds being issued within 14 days.⁵⁹

International performance standards for GST refunds

5.126 The Tax Office advises that it has been monitoring the performance of other revenue agencies in the processing of GST refunds through their annual reporting documents (where they are in English and relevant). The four countries the Tax Office has examined are the United Kingdom (UK), Ireland, New Zealand (NZ) and Canada.⁶⁰

5.127 The Tax Office has prepared the following table summarizing performance for 2002-03 for these countries compared with Australian performance for 2003-04.⁶¹

57 Australian Taxation Office, *Our Service Standards*, downloaded from www.ato.gov.au on 4 August 2004.

58 ATO Minute No.IGT-GST03-2004, dated 7 June 2004, at paragraph 7.2 on p. 9.

59 *ibid* at paragraph 7.4.

60 *ibid* at paragraph 10.2.

61 *ibid* at paragraph 10.3.

Table 3: Comparison of Australian GST refund performance in 2003-04 with 2002-03 refund performance of certain other countries

Country	Performance standard	Standard achieved
Australia	92% in 14 days	94.4%
UK	90% in 14 days	N/A
UK	90.3% in 30 days by value	90.8%
Ireland	85% in 10 days	80%
Ireland	100% in 30 days	93%
NZ	100% in 21 days	97.9%
Canada	100% in 21 days	96%

5.128 The Tax Office notes that in comparing the above figures the following points should be noted:

- the Australian standard applies to returns whether verified or not;
- the UK standard only applies to correct returns. Interest only applies after 30 working days;
- the New Zealand standard is based on 'non-queried' returns. It does not include refunds where manual intervention is required; and
- Canada reviews 41 per cent of refund returns, compared to the Tax Office's review of approximately 4 per cent of refund returns. Canada formally audits 5 per cent of refund returns.⁶²

5.129 The Tax Office considers that, in the light of the above table, its performance in processing BAS refunds:

'is likely to be at world's best practice. From this comparison it is clear that the Tax Office compares favourably.'⁶³

5.130 However, the Inspector-General notes that the above international comparison of BAS refund processing times must be viewed with some caution, bearing in mind that differences exist in the administration and policy of goods and services taxes in the above countries.

5.131 A number of the differences in administration are referred to in Appendix 3 of the ANAO's report in March 2004 on activity statement processing.⁶⁴ For example, this report notes that, at the time of the report, in Canada, lodgment by way of the internet was not available and in the United Kingdom all VAT returns, including those that were submitted electronically, were printed out when received and keyed in by staff.

62 *ibid* at paragraphs 10.4 to 10.8.

63 *ibid* at paragraph 10.8, p. 11.

64 Australian National Audit Office, *The Australian Taxation Office's Collection and Management of Activity Statement Information*, Audit Report No. 33 2003/4 Performance Audit.

Time frames achieved

5.132 The Tax Office has reported that, for the 2003-04 year, it exceeded the above standard of 92 per cent within 14 days in each month. It states that during this year it processed 94.4 per cent of activity statement refunds (in terms of the number of cases) within 14 days.⁶⁵

5.133 The Tax Office measures its achievement against the 14-day performance standard on the basis of the number of refunds which attract payment of delayed refund interest against the total number of activity statement refunds processed.⁶⁶

5.134 Delayed refund interest is generally calculated from 14 days after the date of lodgment. However, in certain cases, such as where a BAS is incomplete or incorrect, bank account details have not been provided, there are outstanding BASs or where the Tax Office has requested further or fuller GST returns from the taxpayer, this interest is payable only from the date which is 14 days after the relevant outstanding information is provided.

5.135 The Tax Office calculation of the number of activity statement refunds that have not been paid within 14 days does not consist of all cases where a refund has been delayed for more than 14 days after lodgment. Instead, it consists of those cases which have been delayed in circumstances which attract delayed refund interest.

5.136 The Tax Office has advised that it processed 1.89 million BAS refunds during 2003-04 and paid out \$22.219 billion of net BAS refunds.⁶⁷

5.137 As noted above, the 94.4 per cent performance result achieved by the Tax Office does not specifically apply to GST refunds, but to activity statement refunds generally. The Tax Office is not able to provide a break-up of this result for GST refunds specifically.

5.138 However, if this same result does apply to GST refunds, the material supplied by the Tax Office shows that, during 2003-04, approximately 5.6 per cent of 1.89 million BAS refunds, or approximately 106,000 BAS refunds, were not processed and paid within 14 days of all relevant information being provided to the Tax Office.

Inspector-General comments

5.139 The current performance standard for GST refunds is based on a view that GST refunds, BAS refunds and activity statement refunds are all processed in the same time frames. It is also based on a view that the Tax Office's performance in processing GST refunds should be judged on the number of cases where it was required to pay delayed refund interest, rather than the number of cases where a refund was not paid within 14 days.

5.140 The current performance standard for GST refunds also focuses on the number of activity statement refunds processed within a certain time period. It does not refer to the dollar value of those refunds.

65 ATO Minute No IGT-GST18-2004 at p. 3.

66 ATO Minute No IGT-GST14-2004 at paragraph 11.1.

67 ATO Minute No IGT-GST09-2004 at p. 7.

5.141 The principal means by which the Tax Office monitors the dollar value of delayed refunds cases is through the measures adopted to monitor the amount of delayed refund interest paid.

5.142 During 2003-04, the performance standard used by the Tax Office has not given a transparent view of the nature of GST refunds that were not paid within 14 days of lodgment. As indicated previously in this report, 4.3 per cent of the total number of GST refunds were stopped for manual checking. These involved approximately \$20 billion of refunds in dollar value.

5.143 Of this \$20 billion, at least \$1.8 billion (approximately)⁶⁸ were GST refunds for small business taxpayers that were not paid within 14 days of lodgment. At least \$0.9 billion (approximately)⁶⁹ were GST refunds for large enterprise taxpayers that were not paid within this time period. A further \$45 million were GST refunds that were not paid within 14 days of lodgment for government and community sector taxpayers. An additional \$850 million were GST refunds referred for a GST field audit or to the Tax Office's Serious Non Compliance area and were therefore unlikely to have been paid within 14 days of lodgment.⁷⁰

5.144 These figures indicate that, during 2003-04, at least 16 per cent in dollar value terms (being \$3.6 billion out of \$22 billion) of GST refunds was not paid within 14 days of lodgment. These figures do not include GST refunds held for more than 14 days since lodgment due to the absence of bank account details or outstanding BASs.

5.145 The above comments therefore lead to the following recommendation.

Subsidiary recommendation 6

The Inspector-General recommends that the Tax Office supplement its existing performance standard for activity statement refunds processing, which is based on the number of refunds processed, by regularly publishing supplementary management information which indicates the average dollar value of refunds held for more than 14 days after lodgment for either verification purposes or for other reasons.

Tax Office response

5.146 The ATO agrees with this recommendation. This information will be provided with our performance statistics for our 2004-05 outcomes.

End to end management of GST refunds

5.147 During the course of this review, the Inspector-General has found that each area of the Tax Office responsible for dealing with GST refunds (other than the area which deals with the processing of GST refunds after they have been cleared for payment) had

68 This amount has been calculated as 35.14 per cent of \$5,025,934,188 and is based on the figures shown in the table in paragraph 5.76 of this report.

69 This amount has been calculated as 12.25 per cent of \$7,354,823,405 and is based on the figures shown in the table in paragraph 5.95 of this report.

70 ATO Minute No IGT-GST15-2004 at paragraph 9.1 on p. 6.

procedures to ensure that such refunds were actively managed within the relevant area and therefore were not subject to undue delay.

5.148 However, the Inspector-General has found that these procedures are defective in a number of respects. The principal defect is that they only operate to monitor the length of time a GST refund spends within each specific area of the Tax Office. There is no overall process which exists to monitor the length of time from lodgment to the actual time of payment.

5.149 These processes have meant that refunds which have been delayed within one area of the Tax Office have, for example, not been treated as cases requiring priority handling when they are subject to other subsequent stages of processing within the Tax Office. Essentially, these processes mean that the Tax Office is not actively managing its processing of GST refunds on an 'end to end' basis.

5.150 The Tax Office does not prepare historical reports which indicate why, for example, in the 2003-04 year, approximately 106,000 BAS refunds attracted delayed refund interest.⁷¹ Similarly, there are no reports available which indicate why, during 2003-04, other refunds which did not attract delayed refund interest were delayed for more than 14 days after the date of lodgment of the relevant BAS. The number of these other refunds may add considerably to the 106,000 figure, given that the Tax Office has estimated that, at any single point in time, approximately 85 per cent of BAS refunds that are being held by the Tax Office for more than 14 days involve refunds which do not attract delayed refund interest.⁷²

5.151 The Tax Office does prepare certain snapshot reports. These reports do not allow determination of the predominant causes of refunds being delayed over an elapsed period of time, such as the 2003-04 year, and of what steps are necessary to reduce these causes of delay.

5.152 The above observations lead to the following recommendation.

KEY RECOMMENDATION 2

The Inspector-General recommends that the Tax Office establish 'whole of office' systems which measure the total elapsed time for the payment of GST refunds.

Tax Office response

5.153 The Tax Office agrees with this recommendation. By June 2005, the Tax Office will be in a position to regularly measure the elapsed time for activity statement refunds, and will address remaining systemic and procedural issues which might currently impede a 'whole of office' view for refunds. The Refund Integrity Steering Committee and Refund Business Management Group will oversee this work, and will consult with the Inspector-General's office in resolving issues.

71 ATO Minute No IGT-GST18-2004 at paragraph 2.1 on p. 3.

72 ATO Minute No IGT-GST01-2004 at paragraph 1.1.

GST refunds delayed within the 14-day period

5.154 The Tax Office also does not currently prepare reports which show actual GST refunds achievement within the period of 14 days from lodgment, for example, how many refunds are processed within 0-4 days or 5-9 days etc of lodgment.

5.155 A number of submissions made to this review suggested that there are a very significant number of GST refunds which are delayed beyond the time they should reasonably take to process. In particular, they assert that many refunds are paid just inside a 14 -day period.

5.156 In the absence of any Tax Office reports being prepared to monitor the number of GST refunds which are held for time periods of less than 14 days, the Tax Office does not have systems in place to enable comment on the validity of these claims, or to facilitate appropriate steps being taken to address these concerns.

5.157 Taxpayers and tax practitioners have further stated that they do not understand why, in a self assessment environment, the Tax Office uses the 14-day period as its benchmark for the payment of GST refunds.

5.158 It was submitted that, at least for routine refunds⁷³ which are not taken off-line for verification activity, a shorter time frame was more appropriate.

5.159 A shorter time frame was considered to be especially applicable to electronically lodged activity statements.

5.160 As discussed earlier in this report, the Tax Office's performance statistics for electronically lodged returns for the 2003-04 year suggest that it is appropriate to advise taxpayers that they can expect routine refunds lodged via electronic means to be in their bank accounts within six working days of lodgment (or eight calendar days, including a weekend).

5.161 The above comments lead to the following recommendation.

Subsidiary recommendation 7

The Inspector-General recommends that the Tax Office introduce an eight day service standard for the processing of 'routine' electronically lodged GST refunds.

Tax Office response

5.162 The Tax Office agrees with this recommendation. The Tax Office undertakes to process all routine activity statements lodged electronically within eight days. Tax Office service standards will be amended to reflect this.

5.163 The Tax Office considers 'routine' activity statements to be those that go through processing without any manual intervention, including exception errors and verification activities.

⁷³ As discussed in paragraph 5.4 of this report, the term 'routine refunds' refers to refunds that are not stopped for verification or other reasons.

CHAPTER 6: TAX OFFICE POLICIES FOR OFFSETTING REFUNDS AGAINST OTHER TAX DEBTS

6.1 The third term of reference involves an examination of the effectiveness of the Tax Office's policies and procedures to ensure that GST refunds are not inappropriately offset against other tax debts.

6.2 During this review, taxpayers raised a number of concerns about the Tax Office's policies and procedures for offsetting GST refunds against other tax debts. The principal concern was that the Tax Office does not provide them with full details of any offsets undertaken in respect of GST refunds due to them.

NATURE OF TAX OFFICE'S POLICY FOR OFFSETS AGAINST GST REFUNDS

6.3 The Tax Office's policy for offsetting BAS refunds (including those which arise from GST refunds) against other tax debts and amounts due to other Government agencies, is described in Chapter 72 of the *ATO Receivables Policy*. This policy is available on the Tax Office's website at www.ato.gov.au.

6.4 This policy is based on legislative provisions contained in Division 3 of Part IIB of the *Taxation Administration Act 1953* (TAA) which make it mandatory for the Commissioner to offset a BAS refund against any tax debt of the taxpayer which is outstanding.

6.5 Although Chapter 72 is the official Tax Office policy statement on offsetting BAS refunds against other tax debts, the Inspector-General was only able to obtain a fuller understanding of the nature of this policy from additional material gathered for the purposes of this review from both the Tax Office⁷⁴ and taxpayers.

6.6 From this additional material, the Tax Office's policy is to automatically offset a BAS refund against another tax debt unless, generally, one of the following conditions applies:

- the BAS refund or debt against which it is to be offset is less than \$500;⁷⁵
- the relevant tax debt is not yet due and payable (this exception does not apply however to other BAS debts);
- the tax debt is the subject of a payment arrangement or a deferral of recovery agreement;
- the tax debt is disputed;
- the tax debt arises from a tax which is subject to special statutory rules which impact on the ability to offset;

⁷⁴ This information was principally provided in ATO Minute No IGT-GST14-2004.

⁷⁵ The \$500 threshold figure is not mentioned in the ATO Receivables Policy and was advised to the Inspector-General in ATO Minute No IGT-GST14-2004.

- the tax debt involves a Tax Office account which is held on a computer system which cannot yet interact with the refunder process (This currently applies to all superannuation accounts); or
- the taxpayer can demonstrate that the offset would cause serious financial hardship.⁷⁶

6.7 The Tax Office has indicated that the above seven circumstances do not apply where the amount to be offset involves child support. In these cases the BAS refund must be offset against the child support debt and the balance paid to the Child Support Registrar rather than to the taxpayer.⁷⁷

6.8 Where an offset is required, the Tax Office has advised that an intercept or indicator is set on the taxpayer's account and the refund is temporarily stored while the Tax Office's systems effect the necessary transactions or transfers. During this period no other action is possible on the account.⁷⁸

6.9 The Tax Office has also advised that where an offset occurs, it is determined and processed in accordance with a pre-set hierarchical order.⁷⁹

6.10 Where an offset has been made, the Tax Office is generally obliged by law to refund to the taxpayer any remaining credit on their running balance account.

6.11 However, there are a number of circumstances where this refund will not occur automatically and where the taxpayer must request the Tax Office to make this refund.

6.12 One such circumstance is where the amount left in the taxpayer's running balance account arises from a voluntary amount of tax previously paid by the taxpayer. In this case, the law requires that the Tax Office can only refund this amount upon request by the taxpayer.⁸⁰

6.13 Other circumstances where it will be necessary for a taxpayer to request payment of any credit left in their account after an offset include where the taxpayer has a payment arrangement and has not been advised that the offset forms part of the arrangement, and where the refund has been applied to a disputed debt.⁸¹

6.14 The *ATO Receivables Policy* also acknowledges one further instance where taxpayers will need to request a refund – where the refund has been inadvertently set against an income tax amount which is not yet due and payable.⁸²

6.15 The Tax Office has advised that apart from the above kinds of circumstances, once an offset has been made it will generally pay any remaining credit balance due to the taxpayer automatically.⁸³

76 ATO Receivables Policy at paragraphs 72.4.1 to 72.4.82.

77 ATO Receivables Policy at paragraph 72.4.6.

78 ATO Minute No IGT-GST10-2004 at paragraph 2.2.3 on p. 4.

79 This hierarchy is set out in the ATO Receivables Policy at paragraph 7.6.1.

80 Section 8AAZLF(2) of the TAA.

81 ATO Minute No IGT-GST02-2004 at paragraph 4.3.2.

82 ATO Receivables Policy at paragraph 72.4.14.

83 ATO Minute No IGT-GST14-2004 at paragraphs 1.3 and 3.1.

TAXPAYER CONCERNS

6.16 Taxpayer concerns raised about the offsetting process may be grouped under the following headings:

- the transparency and readability of the Tax Office's offsets policy;
- the Tax Office's processes for refunding any credit balance to taxpayers; and
- the Tax Office's communication processes with individual taxpayers concerning offsets made on their accounts.

Each of these concerns is discussed in more detail below.

Transparency of offsets policy

6.17 Submissions made during the course of this review noted that the existence and location of the Tax Office's offsetting policy were unknown to many tax practitioners. It was also noted that Tax Office staff do not direct taxpayers or tax practitioners to this policy. Even where tax practitioners were aware that this policy was on the Tax Office's website, it was indicated that this policy was difficult to locate.

6.18 Additional concerns were raised about the readability of this policy. It was suggested that the Tax Office produce a simple guide on when it will withhold BAS refunds, including the circumstances in which this will be done by way of offset.

Inspector-General's comments

6.19 The Inspector-General agrees with these concerns.

6.20 The Inspector-General particularly notes that the *ATO Receivables Policy* does not give a complete and clear indication to taxpayers of the circumstances in which a BAS refund will be offset against other tax or Commonwealth debts. The Inspector-General was only able to compile a better picture of this policy by drawing upon other ATO material provided by the Tax Office during the course of this review and additional material provided by taxpayers.

6.21 The Inspector-General also notes that Chapter 72 of the *ATO Receivables Policy* does not contain a simple summary of the circumstances in which offsetting will or will not occur.

6.22 In addition, Chapter 72 has a number of important omissions as to current Tax Office practice. For example, it does not set out the thresholds below which offsetting will not occur. It also does not indicate the circumstances in which, after an offset, any balance remaining on the taxpayer's account with the Tax Office will not be automatically refunded to the taxpayer, but will only be so refunded at the taxpayer's request. It also does not indicate that superannuation accounts will not be automatically offset, due to systems constraints.

Tax Office policy for paying credit balances

6.23 Numerous examples were provided to the Inspector-General during the course of the review where automatic payment of refund amounts left in a taxpayer's account after an offsetting process did not occur. These instances included additional situations to those listed above. An example of these types of cases is where the relevant refund had been held pending detailed Tax Office compliance activity.

Tax Office communication processes concerning offsets

6.24 In the *ATO Receivables Policy*, the Tax Office acknowledges that the present state of its information technology systems is such that taxpayers may not be provided with full details of all automatic offsets. The Tax Office states that it is endeavouring to adjust its systems so that this information can be provided. In the meantime, it notes that where an offset has occurred the taxpayer may contact the Tax Office to obtain the exact details of the offset.⁸⁴

6.25 The above comments lead to the following recommendation.

Subsidiary recommendation 8

The Inspector-General recommends that the Tax Office provide clearer guidance to taxpayers generally of the circumstances in which an offset involving a GST refund will occur and when a taxpayer will need to request the Tax Office to pay any credit balances that arise after an offset is made.

Tax Office response

6.26 The Tax Office agrees with this recommendation. The guidelines on when the Tax Office will offset a taxpayer's credit entitlement will be reviewed to develop clearer information for the community, particularly in relation to offsets involving GST refunds and when a taxpayer will need to request a refund of any credit balances that arise after an offset is made. In developing these guidelines the Tax Office will consult with the Inspector-General and the Special Tax Advisor to the Ombudsman. The improved guidelines on offsetting will be published by May 2005.

6.27 The *ATO Receivables Policy* has recently been positioned in a more prominent location on the Tax Office website and should result in improved accessibility.

⁸⁴ *ATO Receivables Policy* at paragraph 72.4.82.

CHAPTER 7: TAX OFFICE COMMUNICATION PROCESSES TO TAXPAYERS CONCERNING GST REFUND DELAYS

7.1 During the course of this review taxpayers and their advisers raised a number of concerns about aspects of Tax Office communication processes with taxpayers in relation to GST refund delays. These concerns are discussed below.

7.2 These concerns will continue to be applicable, to the extent that the Tax Office continues to subject GST refunds to pre-issue verification processes and other forms of delay prior to payment.

COMMUNICATION ON STATUS OF GST REFUNDS

7.3 A recurrent theme raised in submissions received for this review by both taxpayers and tax practitioners was that the Tax Office did not have in place a formal process to ensure that taxpayers were immediately notified that their GST refunds would be delayed, for example, because of verification activity.

7.4 One professional association noted that:

‘Where the ATO proposes to delay a refund, the relevant taxpayer should be contacted within a reasonable time and advised of the “true” nature for the delay’.⁸⁵

7.5 Another submission noted that:

‘Our tax agents and business members noted that the ATO rarely contacts a business or agent to inform them about a delay in a refund. It is the taxpayer that has to contact the ATO to find out the reason for the hold-up and how this can be overcome. The ATO as a matter of course should contact a taxpayer by both letter and a phone call to inform them of a delay in their refund and try to immediately rectify the problem. This should be before the 14-day time period expires so as to maximise the chance of meeting the deadline’.⁸⁶

7.6 In November 2004, the Institute of Chartered Accountants noted that the second top tax administration ‘bugbear’ identified in a survey of its members was that the Tax Office does not proactively and promptly advise the tax agent/taxpayer if a refund is being held back, and the reason why.⁸⁷

85 The Institute of Chartered Accountants in Australia, *Review of ATO administration of GST refunds arising from the lodgment of Business Activity Statements*, Submission to Inspector-General of Taxation, dated 30 April 2004 at p. 4.

86 State Chamber of Commerce (New South Wales), *Inquiry into the GST refund system*, Submission to Inspector-General of Taxation, dated 28 April 2004.

87 CA Tax Bulletin, Edition 46/2004, dated 22 November 2004 at paragraph 3.

7.7 Taxpayers and tax practitioners also stated that, in many cases, a time period well in excess of 14 days had elapsed after the lodgment of a credit BAS before any Tax Office contact was made. Some taxpayers had experienced delays in excess of four weeks before any such contact had been made.

Tax Office response made during the review

7.8 The Tax Office has advised that, as of 16 August 2004, the portal channel provides the ability for all GST registered businesses to lodge their Business Activity Statements and to be able to monitor the progress of their BAS within the Tax Office, regardless of whether their lodgment was by paper or electronic.

7.9 It has also advised that the types of message which taxpayers receive on the status of their refunds have been further expanded since October 2004.

7.10 However, neither the August 2004 nor October 2004 releases provides any automated email messages to taxpayers where refunds could exceed the charter standards. This facility is being considered for implementation in a subsequent release.

7.11 The Tax Office states that it intends to commence all cases requiring verification within 14 days and to make contact with all taxpayers in that time period. During peak periods, a small number of cases can arise where this will not happen. However, it notes that there are cases where taxpayer contact information is not up to date and they have difficulty locating taxpayers. They consider that the proposed automated messaging referred to above will provide the means for taxpayers to be advised.⁸⁸

Inspector-General comment

7.12 The Inspector-General notes that the above initiatives may alleviate the concerns noted above of the Tax Office's failure to notify taxpayers on a timely basis of the status of their GST refund, particularly when it has been selected for review.

PROCESSES FOR TAXPAYERS TO HELP EXPEDITE REFUNDS

7.13 Another concern of taxpayers was that there were no processes available for them to expedite their refund claim by providing the relevant supporting documentation either with the relevant BAS or to a nominated Tax Office staff member who was familiar with the taxpayer's affairs. This concern was principally raised by taxpayers in the small business segment.

7.14 A number of submissions pointed out that, under current refund verification processes, taxpayers who do not have a client manager within the Tax Office must wait to be contacted by the tax officer who is handling their refund case before they are able to provide this documentation.

88 ATO minute No IGT-GST11-2004 at paragraph 1.6 on p. 4.

7.15 One submission made the following suggestion in this regard:

'A system should be implemented whereby taxpayers/agents are able to explain in advance unusual circumstances or transactions giving rise to a GST refund at the time of the BAS lodgment rather than waiting for a verification/information request from the ATO'⁸⁹

7.16 These concerns were also raised, to a certain extent, by large enterprise taxpayers and their advisers. This is despite the fact that these taxpayers have far greater access to, and better channels of communication with, the Tax Office through the Tax Office having allocated key client managers (KCMs) to many of the taxpayers in this market sector.

7.17 However, the Inspector-General notes, from his consultations with taxpayers and their representatives, that many large enterprise taxpayers do not appear to know the identity or contact details of their KCM. When this was raised in meetings with the Tax Office, the Tax Office advised that it was likely that many large taxpayers did not know who their KCM was because of personnel changes within the Tax Office structure and to their own corporate structure.

7.18 The Inspector-General agrees with the above concerns. This leads to the following recommendation.

Subsidiary recommendation 9

The Inspector-General recommends that, where a large enterprise taxpayer has a GST refund which is being delayed for verification, the electronic message which is sent to the taxpayer to notify them that their GST refund has been delayed contain the name and contact details of the taxpayer's key client manager. For all other taxpayers whose refunds are to be subject to verification, the Inspector-General recommends that the Tax Office provide the relevant taxpayer with the name of the Tax Office staff member who will be dealing with their case at the earliest possible opportunity.

Tax Office response

7.19 The Tax Office agrees with this recommendation. In relation to large market taxpayers, notification by email of a refund delay will include the name and contact details of the key client manager.

7.20 In relation to other taxpayers, initial contact with taxpayers in relation to a refund already requires the contact name and phone number to be provided. This practice will continue. The Tax Office is also instituting a notification process to inform taxpayers that their refund claim is being subject to verification at the earliest opportunity. The objective is to contact all taxpayers who may experience a delay in their refund due to verification within 14 days of lodgment.

7.21 Improvements to the ATO's Business Portal allow GST registered businesses to lodge their business activity statements and to be able to monitor the progress of their activity statements within the Tax Office, irrespective of the channel they chose to lodge it by. That is, whether their lodgment was by paper or electronic, GST registered businesses

⁸⁹ Taxation Institute of Australia, *Review into the tax administration of GST refunds arising from the lodgment of business activity statements*, Submission to Inspector-General of Taxation dated 8 June 2004.

can view the status of their Business Activity Statement. At present the portal does not provide any automated e-mail messages to taxpayers where refunds could exceed the charter standards. This facility is being considered for implementation in a subsequent release.

Other observations

7.22 The Inspector-General recommends that the Tax Office further explore whether it could provide a facility for small business taxpayers to expedite their refund by providing the Tax Office with relevant documentation to support their refund claim at the time of lodgment of the refund claim.

Tax Office response made during the review

7.23 The Tax Office does not believe it is a viable option to enable taxpayers to lodge supporting documentation with their BAS. In 2003-04 the Tax Office received and processed around 1.9 million refund BASs. It considers that this option could result in the requirement for supporting documentation to be sent, recorded and stored in a manner that can be rapidly accessible for almost two million BASs. The Tax Office states that this would add significantly to the time to process all refund cases, with little beneficial impact to the small number that are reviewed. It notes that only about 4.3 per cent of the almost two million refund cases are reviewed. Approximately half or less of this number would be called upon to provide supporting documentation.

Inspector-General comments

7.24 The Inspector-General notes that the above suggestion does not contemplate supporting documentation being required for all GST refunds that are subject to verification, only those where such documents are in fact likely to be requested under existing Tax Office procedures. He also notes that this facility is already available to large enterprise taxpayers where they are aware of the identity of their key client manager.

NATURE OF TAX OFFICE REQUESTS FOR INFORMATION

Whether information is requested unnecessarily

7.25 Submissions also raised concerns that, during CVC verification processes for refunds, taxpayers were asked for details about their business that had already been supplied to the Tax Office such as, for example, during the ABN application process.

7.26 The Inspector-General agrees with these concerns. This leads to the following recommendation.

Subsidiary recommendation 10

The Inspector-General recommends that the Tax Office introduce better systems for recording information obtained from taxpayers, for example, on the nature of the taxpayer's industry, and ensure that this information can be accessed by tax officers when required.

Tax Office response

7.27 The Tax Office agrees with this recommendation. The information submitted by taxpayers upon registration is used to construct a profile of the client which sets out likely reporting obligations and activity statement cycles. All of the identity type information is incorporated within the client record to provide basic details of the business and contact details. Some of the data is used to establish an ANZSIC code while other information is used to set up the activity statement generation process.

7.28 The Tax Office does not specifically contact taxpayers to merely verify information. However, the Tax Office recognises that a considerable amount of the data collected at the time of registration may change as the business develops and expands. This is particularly common in areas such as the main business activity, annual turnover values, GST accounting method and bank account details. The information recorded at the time of registration is available to Tax Office staff but they are encouraged to update profile information when in contact with the client as an extra component of the BAS refund verification contact. This is a deliberate practice to ensure currency of the taxpayer's information so that future case selection is appropriate. The Tax Office will improve its systems in this area by continuing to refine the accuracy of taxpayer data without impacting on taxpayers.

Whether Tax Office information is requested all at once

7.29 Concerns were also raised that Tax Office staff, in some cases, did not request at the one time all the relevant information that they needed to verify a GST refund claim, but instead their request was 'drip fed' to the taxpayer or their adviser. This inefficient method was said to result in taxpayers sometimes having to wait up to seven months for their refund.

7.30 The Tax Office has responded to this concern by stating that, wherever possible, officers will request, in the one contact, all information required to make an informed decision in relation to the validity of a refund. In some cases, the information requested by the officer, and provided by a taxpayer, may lead to additional questions being raised and therefore, further information being requested.⁹⁰

Nature of documentation requested

7.31 Taxpayers and advisers were also concerned that taxpayers whose refund claim had been generated by a single large capital purchase were obliged to provide a full list of all revenue expenses in addition to information relating to the large capital purchase. This was especially prevalent during CVC verification procedures.

7.32 The Inspector-General observed during his fieldwork in relation to this review that there appeared to be no written procedures to indicate the circumstances in which a request for details of all revenue expenses would be made.

Tax Office response made during the review

7.33 The Tax Office notes in response that there are written procedures that outline circumstances for requesting details of revenue expenses.

90 ATO Minute No IGT-GST11-2004 at paragraph 4.1 on p. 7.

7.34 It states that tax officers must be satisfied that any acquisition is used for a 'creditable purpose'. Information in relation to revenue expenses will only be obtained where it is not clear to the officer whether the acquisition has been obtained for a creditable purpose.

7.35 The Tax Office also notes that in March 2004, CVCs introduced streamlined procedures to handle GST refund cases. These streamlined procedures included an instruction to staff that they were to request from the client document(s) to substantiate the increased input tax credit claim on the activity statement rather than a review of all credit claimed.⁹¹

Nature of documentation requested for refunds involving large taxpayers

7.36 Similar submissions to those lodged by small business taxpayers were made by large enterprise taxpayers to this review, raising concerns about the nature of the Tax Office's requests for information during a GST refund check.

7.37 In addition large enterprise taxpayers raised the following specific concern about the nature of requests made by the Tax Office for information. This was that, in some situations involving large refunds, taxpayers with very large turnovers have been required to provide randomly selected tax invoices for extremely minor acquisitions.

7.38 Going through vast quantities of records for a single tax invoice of an inconsequential value in order to justify a large refund was claimed to represent a significant burden for large companies.

Tax Office comments

7.39 The Tax Office has informed the Inspector-General that where a refund is to be verified, the focus should be on the major transactions that relate to the refund but that these types of requests may be made in a full audit in order to test the integrity of the taxpayer's accounting system.

⁹¹ *ibid* at paragraphs 3.1 to 3.4 on pp. 6-7.