



Australian Government
Inspector-General of Taxation

Inquiry into Taxpayer Engagement with the Tax System

A submission to the House of Representatives
Standing Committee on Tax and Revenue

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February 2017

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1. INTRODUCTION

1.1 The Inspector-General of Taxation (IGT) welcomes the opportunity to make a submission to the House of Representatives Standing Committee on Tax and Revenue's (Committee) *Inquiry into Taxpayer Engagement with the Tax System* (Inquiry).

1.2 It is widely acknowledged that the willing engagement of taxpayers in the tax system is a key driver for voluntary compliance:

Contemporary taxation authorities are heavily invested in genuine engagement with the community. Taxation is a complex socio-economic phenomenon that is a great deal more than just economics and fiscal policy. The citizens' willingness to voluntarily comply with their tax obligations is directly related to the salience of their relationship with the revenue authority. Engagement is therefore critical to successful administration as it improves efficiency, reduces the cost of administration and enhances compliance.¹

1.3 The Australian Taxation Office (ATO) has also recognised the importance of the willingness of taxpayers to engage:

Our mission is to contribute to the economic and social wellbeing of Australians by fostering willing participation in our tax and superannuation systems, and our vision is that we are a trusted and respected administrator both here and internationally. Effective client and industry engagement goes to the very core of those things.²

1.4 Within this context, scrutineers, such as the IGT, play a critical role in fostering community trust and confidence in the tax system which in turn enhances voluntary participation and efficient administration. Taxpayers and their advisers take comfort that an independent agency can investigate their complaints or broader systemic issues, provide impartial views and make recommendations for improvement. The availability of such avenues significantly contributes to the perception of fairness in the tax system as a whole.

1.5 This submission seeks to faithfully address the Committee's terms of reference and, in doing so, it has drawn on findings from the IGT's prior reviews and complaints handling function as well as relevant research on current international practices. It is structured around the four themes specified in the terms of reference:

- *the prevalence and impact of the 'cash economy' on the tax system, mechanisms to ensure tax compliance and strategies used by comparable countries' revenue authorities;*

¹ Jo'Anne Langham and Neil Paulsen, 'Effective engagement: Building a relationship of cooperation and trust with the community' (2015) *eJournal of Tax Research* 13:1, pp 378-402 at 378.

² Australian Taxation Office (ATO), 'Our evolving approach to taxpayer engagement' (Speech delivered to the Tax Institute of Victoria Fourth Annual Forum, 5 October 2016) <www.ato.gov.au>.

- *how taxpayers currently interact with the tax and superannuation system, including through tax agents and other intermediaries, and the different compliance burdens of doing so;*
- *the contemporary use of information and communication technology by the Australian Taxation Office and comparative tax administrators to deliver services; and*
- *behavioural insights from other service delivery agencies including possible ways to better inform taxpayers to help them make decisions in their best interests.*³

³ House of Representatives Standing Committee on Tax and Revenue, 'Inquiry into Taxpayer Engagement with the Tax System' (25 November 2016) <www.aph.gov.au>.

2. THE CASH ECONOMY

2.1 There is currently no universally accepted definition of the 'cash economy'. It varies from jurisdiction to jurisdiction and may be referred to by a number of different names, including the 'hidden economy', 'non-observed economy' (NOE), 'underground economy' or 'black economy'.

2.2 In Australia, the ATO has defined the cash economy as those:

...businesses that deliberately hide income to avoid paying the right amount of tax or superannuation. They usually do this by not recording or reporting all their cash or electronic transactions.⁴

PREVALENCE AND IMPACT OF THE CASH ECONOMY ON THE TAX SYSTEM

2.3 In order to develop mechanisms and strategies to combat the cash economy, a clear understanding of its scope and prevalence is needed. However, as the Australian Bureau of Statistics (ABS) has previously noted:

By its very nature, the NOE cannot be directly measured, or it can be very expensive to attempt this measurement. Therefore, estimates of NOE activity must rely on limited indicative information and a variety of indirect methods – all of which can be regarded as contentious. It is likely that an unknown proportion of underground production is already captured in the observable data, owing to the data sources used and the estimation methods employed in collecting the observable data.⁵

2.4 Historically, the prevalence of the cash economy in Australia has been estimated to be between 3 and 15 per cent of gross domestic product (GDP).⁶ However, more recent estimates from the ABS suggest that the figure is closer to 1.5 per cent of GDP or \$24 billion.⁷

2.5 The ATO considers that the cash economy is most prevalent in the small business market segment where approximately 1.6 million small businesses, operating across 233 industries, are likely to have regular access to cash.⁸

⁴ ATO, 'The cash and hidden economy' (2 November 2016) < www.ato.gov.au>.

⁵ Australian Bureau of Statistics, '5204.0.55.008 – Information paper: The Non-Observed Economy and Australia's GDP, 2012' (18 September 2013) <www.abs.gov.au>.

⁶ Senate Economic References Committee, *The structure and distributive effects of the Australian taxation system* (2004), p 62.

⁷ Above n 5.

⁸ Australian National Audit Office (ANAO), *Strategies and Activities to Address the Cash and Hidden Economy* (2016).

2.6 More recently, tax gap methodology has been used by revenue authorities to assist in measuring, amongst other things, the cash economy. The tax gap:

...is an estimate of the difference between what the ATO collects and the amount that would have been collected if every taxpayer was fully compliant....

Tax gaps are, in effect, about measuring what is not visible – what people have not told us about their compliance, whether through misunderstanding, by choice or by taking a tax position that differs from the ATO view of the law.⁹

2.7 In 2014, the Commissioner of Taxation (Commissioner) committed to estimating tax gaps for all taxes and programs that the ATO administers. Whilst the ATO has yet to establish a full set of reliable gaps for income tax, the ATO has published tax gap estimates for goods and services tax (GST), wine equalisation tax, luxury car tax, petrol and diesel excise and duty, pay as you go (PAYG) withholding and fuel tax credits.¹⁰

2.8 The ATO's recent approach to measure tax gap seems to align with processes adopted by other revenue authorities, such as the United Kingdom's (UK) Her Majesty's Revenue and Customs (HMRC). HMRC, who has been measuring tax gap for some time, publishes an annual report of its tax gap analysis. For the 2014-15 financial year, HMRC reported that the tax gap attributable to the hidden economy was £6.2 billion¹¹ which represents approximately 17 per cent of the total tax gap of £36 billion.

2.9 In terms of impact of the cash economy, it is wide-reaching and affects all Australians. As the ATO has stated:¹²

The cash and hidden economy affects all Australians. It affects us by reducing the amount of money available to fund community services such as health, education and other government programs.

Honest businesses face unfair competition when others don't correctly record and report all their income and expenses.

The cash and hidden economy can also hurt you as an individual. Consumers who support it, by paying cash and not obtaining a receipt, risk having no evidence to:

- *support a claim for a refund if the goods or services purchased are faulty*
- *prove who was responsible in cases of poor work quality.*

Those who participate in the cash and hidden economy are disadvantaging the community, honest taxpayers and honest businesses by not competing fairly.

⁹ Commissioner of Taxation, *Annual Report 2015-16* (2016) p 43.

¹⁰ ATO, 'Australian tax gaps 2015-16' (2 November 2016) <www.ato.gov.au>.

¹¹ Her Majesty's Revenue & Customs (HMRC), *Measuring tax gaps 2016 edition* (2016) <www.gov.uk>.

¹² Above n 4.

MECHANISMS TO ENSURE TAX COMPLIANCE

International approaches

2.10 Based on surveys of 26 member countries, in 2012, the OECD delivered its report on combating the cash economy. The report noted that whilst a number of jurisdictions had comprehensive overarching strategies, many did not, 'suggesting that this area of non-compliance may not be receiving adequate attention.'¹³

2.11 The OECD report provided a summary of the core elements of a comprehensive overarching framework for combating the cash economy including that:¹⁴

- *There are arrangements in place for 'whole of revenue body' co-ordination;*
- *Comprehensive research efforts are undertaken;*
- *Enhanced risk detection processes are in place;*
- *A multi-faceted set of risk treatments is undertaken;*
- *Steps are taken to leverage improved compliance through key intermediaries;*
- *There is effective co-operation across Government;*
- *Wide use is made of the media; and*
- *Efforts are made to evaluate the impacts of individual risk treatments and/or the overall strategy.*

2.12 The report also identified a large range of risk detection and risk treatment approaches reported by the revenue authorities in their survey responses or which were highlighted by the OECD research. These approaches included:¹⁵

- *Comprehensive industry benchmarking, coupled with leveraging via tax professionals, media engagement and automated targeting of large numbers of taxpayers (Australia).*
- *Industry-based withholding/third party reporting regimes (Ireland and Canada).*
- *Increased controls over cash transactions (Netherlands, Spain, and Sweden).*
- *Increased record-keeping controls for employees in high-risk industry sectors (e.g. restaurants and hairdressing) (Sweden's staff ledgers).*

¹³ Organisation for Economic Cooperation and Development (OECD), *Reducing opportunities for tax non-compliance in the underground economy* (2012), p 2.

¹⁴ Ibid.

¹⁵ Ibid, p 3.

- *Initiatives aimed at reducing the use of cash transactions (Norway and Turkey).*
- *The use of monetary incentives to encourage proper record-keeping and deter unrecorded cash payments (Canada's and Norway's home renovation tax credit, Korea's lottery and incentive for obtaining receipts).*
- *Increased revenue body use of suspicious transactions reports collected by a separate government agency (Australia and France).*
- *Educating new/potential taxpayers (Austria's schools initiative, Canada's trade school initiative).¹⁶*

2.13 Turning to approaches of comparable jurisdictions, in 2007, the United States' (US) National Taxpayer Advocate (NTA) undertook a review of the revenue forgone because of the cash economy. The report indicated that the difference between the tax payable and the amount voluntarily paid by taxpayers was approximately US\$345 billion in 2001, with US\$100 billion per year being attributable to the cash economy.¹⁷ The major recommendation from the NTA was that a Cash Economy Program Office should be established¹⁸ as a means of implementing and coordinating the overall strategies of the Internal Revenue Service (IRS) in this area. It appears that the IRS declined to do so and the NTA had expressed concerns that without such an office, 'ad hoc measures will not get the job done'¹⁹.

2.14 In New Zealand, the Inland Revenue Department (IRD) had indicated in 2011 that it had adopted a range of strategies to target different industries in which the risk had been identified. These strategies included raising awareness of obligations, enforcing penalties, prosecuting serious offenders, increasing data matching and partnering with industry associations and other government agencies on education, information sharing and investigations.²⁰

2.15 In 2016, the HMRC published a number of consultation papers in relation to proposals to assist in tackling the cash economy.²¹ These new proposed strategies follow on from earlier initiatives in which the HMRC made use of extensive educational campaigns to improve taxpayer compliance behaviour.²² The current proposed strategies are three-pronged and include extending the data-gathering powers to 'money service businesses',²³ the need for new penalties and sanctions²⁴ as well as conditional registration.²⁵ The latter point requires 'tax registration as a condition of access to some essential business services or licences'.²⁶ As part of its

¹⁶ Ibid, p 3.

¹⁷ National Taxpayer Advocate (NTA), *2007 Annual Report to Congress Volume 2* (2008) <www.irs.gov>, p 4.

¹⁸ Ibid, p 13.

¹⁹ Internal Revenue Service, 'National Taxpayer Advocate Delivers Report to Congress' (IR-2008-4, 9 January 2008) <www.irs.gov>.

²⁰ New Zealand Inland Revenue Department, *The Hidden Economy* (2011) <www.ird.govt.nz>.

²¹ HMRC, 'Proposals to tackle the hidden economy' (26 August 2006) <www.gov.uk>.

²² HMRC, *New campaign against tax evasion* (November 2012) <www.gov.uk>.

²³ HMRC, 'Tackling the hidden economy: extension of data-gathering powers to money service businesses' (26 August 2016) <www.gov.uk>.

²⁴ HMRC, 'Tackling the hidden economy: Sanctions' (26 August 2016) <www.gov.uk>.

²⁵ HMRC, 'Tackling the hidden economy: Conditionality' (26 August 2016) <www.gov.uk>.

²⁶ Ibid, p 9.

strategy, the HMRC is also seeking to identify points at which businesses tend to enter the cash economy by failing to register for certain taxes (such as Value Added Tax when certain thresholds are met) and making it as easy as possible for taxpayers to register.

Australian approach

2.16 In 1998, the Government stated that the 'taxes and collection systems allow too much scope for taxpayers to participate in the cash economy'.²⁷ The Government at the time proposed and implemented a number of strategies including the introduction of the Australian Business Number (ABN) as a single business identifier for dealing with the whole-of-government, simplifying payment and reporting systems (the PAYG system) as well as other law and administrative changes to promote certainty and make compliance simpler and fairer.²⁸ The improvements included the requirement for all businesses to register for ABNs with the consequence that unregistered businesses would have a significant proportion of their payment withheld by trade partners and remitted to the ATO.

2.17 Notwithstanding the legislative improvements, the risk of non-compliance still remains within the tax system. Dealing effectively with the cash economy can present many challenges, including:²⁹

- difficulties in detecting underreported income due to the 'hidden' and dispersed nature of the economic activities concerned;
- challenges in identifying the most revenue-productive targets due to the relatively large number of participants, each with small amounts of tax which in aggregate can be sizable;
- many participants having poor records and in some cases may not even be registered with the ATO;
- ascertaining the full extent of a taxpayer's unreported income for a fiscal period may necessitate exhaustive and often time-consuming inquiries by the ATO;
- collecting the tax, interest and penalties may be difficult even after assessments have been issued;
- detecting and dealing with such non-compliance provides no guarantee that it will not be repeated into the future; and
- compliant taxpayers may become less compliant where they feel that the underground economy is not being properly addressed and that, as a result, they bear an unfair share of the tax burden.

²⁷ Peter Costello MP, *Tax Reform: Not a new tax, a new tax system* (August 1998) <archive.treasury.gov.au>.

²⁸ Ibid, pp-132-134.

²⁹ Above n 13.

2.18 Given the challenges above and its resources, the ATO has applied a number of different strategies and initiatives to combat these risks over the years. One such strategy is the use of benchmarks which are financial ratios that assist businesses to compare their performance with other businesses within the same industry. The ATO uses such benchmarks to identify businesses, in particular industries, which may incorrectly report their business income and expenses. Businesses significantly outside of the benchmarks can expect a form of ATO engagement to better understand their specific position.³⁰

2.19 The ATO also uses other risk-based approaches to identify taxpayers or transactions which it considers represent a higher risk of non-compliance. It currently publishes material about specific industries in which it is seeing disproportionate numbers of businesses that:

- indicate unrealistic income relative to the assets and lifestyle of the business and owner;
- fail to register for GST or lodge activity statements or tax returns;
- underreport transactions and income according to third-party data;
- fail to meet super or employer obligations;
- operate outside the normal small business benchmarks for their industry;
or
- are reported to the ATO by the community for potential tax evasion.³¹

2.20 In 2015-16, the ATO committed approximately 400 staff and a budget of \$39.5 million to further combat the risk posed by the cash economy.³² The ATO adopted a range of different strategies including computerised risk models and specific data matching which used information from other agencies, business suppliers and banks to target its compliance strategies.³³

2.21 In 2016, the Australian National Audit Office (ANAO) undertook an independent performance audit of the ATO's approach to the cash and hidden economy.³⁴ As part of its review, the ANAO noted that in 2014-15, the ATO's approach to the cash economy shifted from:

...focusing primarily on audit activities...to a broad omitted income focus on registration, lodgment and correct reporting by small businesses as part of an overarching community participation and assurance framework. The strategies comprise two elements: community participation and engagement, using a range of

³⁰ IGT, *Review into the Australian Taxation Office's use of benchmarking to target the cash economy* (2012) p 7.

³¹ ATO, 'Working with industry' (11 January 2017) <www.ato.gov.au>.

³² Above n 8, p 7.

³³ ATO, 'Michael Hardy discusses the cash economy with David Koch - transcript' (12 February 2014) <www.ato.gov.au>

³⁴ Above n 8.

*media and social media channels; and compliance activities, including taxpayer audits and reviews.*³⁵

2.22 The ANAO concluded that the ATO's current strategies and activities 'are consistent with international approaches' and that 'the ATO's planning, liaison and reporting arrangements have been sound, and risk management activities and case selection processes have supported increasingly cost-effective compliance cases being conducted with taxpayers in recent years'.³⁶ In addition to the compliance and enforcement initiatives, the ANAO also examined the ATO's help and education activities, through its website and targeted communications. The ANAO commented that the ATO needed to evaluate the effectiveness of such activities.³⁷

2.23 It should be noted that the above matters may be further considered by the Black Economy Taskforce which has been recently established to develop 'an overarching whole of government policy framework and detailed proposals for action'.³⁸ It is due to deliver an interim report in March 2017 and a final report in October 2017.³⁹

IGT OBSERVATIONS

2.24 The IGT has previously undertaken two reviews which are relevant to the ATO's approach to the cash economy.

2.25 Firstly, in 2012, the IGT reviewed one of the ATO's main initiatives to address the cash economy risks, namely, the use of benchmarks.⁴⁰ The IGT's review found that of over 7,600 benchmarking audits, the ATO made adjustments in only 24 per cent of cases. Whilst the IGT acknowledged that 24 per cent may be higher than a random sampling of audit cases, there was scope for the ATO to improve its current approach to better exclude compliant taxpayers. In all, the IGT made 11 recommendations to which the ATO agreed in full or in part. Following the implementation of these recommendations, the ATO's strike rate increased from 24 per cent to over 50 per cent.⁴¹

2.26 The above improvement in strike rate also reduced the compliance burden on otherwise compliant taxpayers. In that report, the IGT had noted:

*...the ATO needs to strike a balance between reducing compliance costs for taxpayers, whilst at the same time collecting enough information about those taxpayers to make an informed risk assessment.*⁴²

³⁵ Above n 8, p 16.

³⁶ Ibid, p 7.

³⁷ Ibid, p 45.

³⁸ Kelly O'Dwyer MP, 'Black Economy Taskforce' (Media Release, 14 December 2016) <jkmo.ministers.treasury.gov.au>.

³⁹ Ibid.

⁴⁰ Above n 30.

⁴¹ ATO, 'Commissioner and Minister Senate estimates briefing' (October 2012) <<http://foi.iorder.com.au>>.

⁴² Above n 30, p 67.

and

*To ensure compliance costs are minimised, the IGT considers that the ATO should use a staged approach in its information gathering as part of its risk identification process. The approach should also accommodate less formal means where possible. Information gathering that occurs in a less formal context than that of a formal audit may also reduce taxpayer stress given its lower intensity.*⁴³

2.27 Secondly, the ATO's use of compliance risk assessment tools more generally was examined in another review where the IGT had stressed the importance of clearly articulating the risk hypothesis to ensure that risk inputs, both qualitative and quantitative, are appropriate to detecting and addressing those risks.⁴⁴ The IGT also discussed the use of representative random audits as a means of assessing the underlying levels of non-compliance which in turn may be used for assessing the effectiveness of the ATO's risk assessment tools.⁴⁵ The use of random audits would also assist the ATO in measuring the tax gap and potentially act as a deterrent against non-compliance.⁴⁶

2.28 The IGT supports the ATO's current work to measure the scope and impact of the cash economy and it is pleasing that the ATO has undertaken some work to measure the tax gap. An important factor in this task would be for the ATO to identify which component of the tax gap is in fact attributable to the cash economy and which components are due to other reasons, such as lack of knowledge of tax laws or taxpayers adopting positions that are different to the ATO's view of the law. In doing so, the ATO could engage with the academic community as well as revenue agencies of comparable jurisdictions, such as the HMRC.

2.29 In respect of enforcement and compliance activities, as mentioned above, the ANAO has found the ATO's strategies and activities to combat the cash economy are generally working well. In addition, the ANAO has noted that more can be done to measure the effectiveness of help and education programs.

2.30 The IGT believes that the ATO's enforcement activities should be further augmented by educational programs and campaigns along similar lines to recommendations made by the ATO's 1998 Cash Economy Taskforce⁴⁷. Such programs should be aimed at the community as a whole and may have more long term effect when focused on the young or new arrivals to Australia. It should be noted the Commissioner has requested the IGT to conduct a review into improving willing participation in the tax and superannuation systems by targeting these demographics.⁴⁸

2.31 Education and appropriate campaigns can be very effective. For example, 'drink driving campaigns' have transformed the way Australians view drink driving such that it is now socially unacceptable as well as being illegal. As mentioned above,

⁴³ Above n 30, p 67.

⁴⁴ IGT, *Review into aspects of the Australian Taxation Office's use of compliance risk assessment tools* (2014), p 142.

⁴⁵ *Ibid*, p 145.

⁴⁶ *Ibid*, p 147.

⁴⁷ Cash Economy Taskforce, *Improving tax compliance in the cash economy* (April 1998), pp ii and iii.

⁴⁸ IGT, 'IGT Work Program 2017' (31 January 2017) <www.igt.gov.au>.

similar educative campaigns have been used by the HMRC to improve taxpayer compliance behaviour.⁴⁹

2.32 The IGT is also looking forward to the findings and recommendations of the Committee as well as the Black Economy Taskforce. The IGT would be pleased to offer assistance and expertise in relation to any identified measures to combat the significant risks posed by the cash economy.

⁴⁹ Above n 22.

3. TAXPAYER INTERACTIONS WITH THE TAXATION AND SUPERANNUATION SYSTEMS

3.1 Generally, taxpayers interact with the tax and superannuation systems in order to meet their statutory obligations such as registering, reporting, withholding and paying their tax liabilities. Taxpayers may choose to do so through intermediaries, such as tax practitioners, or directly through services and channels provided by the ATO.

USE OF TAX PRACTITIONERS AND OTHER INTERMEDIARIES

3.2 Tax practitioners, including lawyers and business activity statement (BAS) preparers, have played a fundamental role in the tax system particularly since the shift from full assessment to self assessment in 1986. The shift to self assessment transferred to taxpayers the responsibility of applying the tax laws to their affairs with the consequence that incorrect application would result in taxpayers being exposed to additional primary tax, penalties and interest.

3.3 Within the self assessment system, taxpayers have increasingly come to depend on tax practitioners who perform a broad range of tax related activities such as preparing and filing tax returns, providing advice and representation when dealing with the ATO. They may also provide non-tax related services such as audit, assurance and financial advisory services. As a result of their activities, tax practitioners are an invaluable source of knowledge and practical experience which may be drawn upon to develop more effective and efficient tax laws and administrative practices.⁵⁰

3.4 The OECD has also acknowledged the crucial intermediary role of tax practitioners between taxpayers and the revenue authorities. In this tripartite relationship, tax practitioners contribute to the smooth functioning of the tax system and facilitate tax compliance.⁵¹ In particular, the OECD has also noted:

The importance of the role tax advisers play in a tax system can be tested by answering a simple question: would compliance with tax laws improve if tax advisers did not exist? The Study Team found no country where the answer to that question is yes. Across the whole range of taxpayers, taxes and circumstances, the vast majority of tax advisers help their clients to avoid errors and deter them from engaging in unlawful or overly-aggressive activities.⁵²

3.5 The Productivity Commission has noted that 'small businesses are much more likely than large businesses to rely on third parties, including industry and professional associations and intermediaries such as tax agents, to receive information

⁵⁰ OECD, *Together for Better Outcomes: Engaging and Involving SME Taxpayers and Stakeholders* (2013) pp 16-18.

⁵¹ OECD, *Increasing Taxpayers' Use of Self-Service Channels* (OECD Publishing, 2014) p 35.

⁵² OECD, *Study into the Role of Tax Intermediaries* (2008) p 14.

on regulatory requirements.⁵³ This should not detract from the important role that tax practitioners across all market segments, including the large business market, play in the effective administration of the tax system.

3.6 As noted by the IGT in his 2015 review into the ATO's services and support for tax practitioners,⁵⁴ taxpayer reliance on tax practitioners in Australia has gradually increased since the implementation of self assessment, due to a number of factors including:

- complexity of the business operations and related regulations;
- individual taxpayers involvement in investment activities and income sources others than personal exertion;
- scope and complexity of tax law and related compliance; and
- use of the tax system to deliver social policies as well as to collect revenue.⁵⁵

3.7 Australia has some of the highest levels of reliance on tax practitioners of any OECD country.⁵⁶ In 2015-16, the ATO reported that 74.2 per cent of all individuals and over 95 per cent of business taxpayers used the services of a tax practitioner.⁵⁷

3.8 In addition to the traditional tax intermediaries noted above, there are increasingly new players providing services and products within the tax sphere. Most notable of the new intermediaries are software developers whose products are being developed to feed directly into ATO systems to align with initiatives, such as Standard Business Reporting (SBR) and Single Touch Payroll (STP). The customer support from these providers and the associated cost will no doubt influence the experience of taxpayers and their advisers in managing their affairs.

3.9 Similarly, as the ATO continues to roll out technology to enable taxpayers to effectively manage their own tax affairs, sufficient take-up depends on ready access to adequate hardware, software and robust internet connections. Accordingly, other software and hardware developers as well as telecommunications entities also necessarily play an important role.

SELF-SERVICE CHANNELS

3.10 In line with the whole-of-government digital transformation initiative, the ATO has adopted a digital-by-default policy which aims to 'deliver a simpler, easier,

⁵³ Productivity Commission, *Regulatory Engagement with Small Business* (2013) p 141.

⁵⁴ Above n 9, p 46.

⁵⁵ IGT, *The Australian Taxation Office's services and support for tax practitioners* (2015) p 2; see also: ANAO, *The Australian Taxation Office's Management of its Relationship with Tax Practitioners* (2002) p 12.

⁵⁶ OECD, *Tax Administration 2015 Comparative Information on OECD and other Advanced and Emerging Economies* (2015) p 267.

⁵⁷ Above n 9, p 46.

more flexible and adaptable way of interacting digitally' with ATO services.⁵⁸ The ATO has noted that:

*The proposed initiative will require most of the community to use digital services to send and receive information and payments to the ATO. The ATO is seeking feedback from all sectors of the community to understand the range of support needed to transition fully to digital services.*⁵⁹

3.11 The ATO has previously,⁶⁰ and continues to deliver, a range of online services which are available to individuals, businesses and tax practitioners, examples of which include:⁶¹

- lodging tax returns electronically using myTax;
- finding and managing superannuation;
- managing PAYG instalments and other activity statements;
- receiving ATO communication electronically via myGov; and
- managing business reporting and transactions via the Tax Agent Portal, BAS Agent Portal and Electronic Lodgment Service (ELS).

3.12 As part of the ATO's move towards a digital environment, it called for submissions from the general public regarding its *Digital by default consultation paper*. The consultation paper yielded 1003 responses with more than half of the respondents acknowledging the benefits for the entire community from a digital-by-default concept.⁶²

3.13 At the same time, the ATO also noted that a key theme emerging from the consultation was that the community expects digital-by-default to be more than digital only. It was accepted that while digital services will be the primary way to interact with the ATO, alternative options needed to be available for users for whom this was not an option.⁶³ Specifically, more information was needed about the availability of alternative modes of interaction and to whom they would be available.⁶⁴

3.14 The ATO has noted the community's views that access to alternative service channels should be available for the following reasons:

- *advanced age, serious health issues and physical or cognitive disabilities*

⁵⁸ ATO, 'Digital by default' (undated) <lets-talk.ato.gov.au/>.

⁵⁹ Ibid.

⁶⁰ Above n 53, p 164.

⁶¹ ATO, Online services: Individuals and sole traders' (9 August 2016) <www.ato.gov.au>; ATO, Online services: Tax agents' (13 May 2016) <www.ato.gov.au>; ATO, Online services: BAS agents' (30 March 2016) <www.ato.gov.au>.

⁶² ATO, 'Digital by Default - Findings report' (undated), <lets-talk.ato.gov.au >.

⁶³ Ibid, page 2.

⁶⁴ Ibid, page 5.

- *inability to access the internet due to extreme costs*
- *the internet not being available or extremely unreliable in remote or metropolitan areas*
- *limited financial capacity and financial hardship; and*
- *limited computer literacy.*⁶⁵

COMPLIANCE COSTS

3.15 For many businesses, tax and superannuation are amongst a much broader spectrum of regulatory requirements⁶⁶ and concerns about the level of cumulative burdens have been raised by businesses across a range of activities and regulatory areas.⁶⁷

3.16 It is important to acknowledge that all taxpayers are expected to bear a 'baseline' level of tax compliance costs. Additional costs may be imposed on taxpayers where further engagement with the ATO is required, for example when the ATO undertakes compliance activities.⁶⁸ Stakeholders believe that such costs may be unnecessarily imposed where the ATO's risk assessment is inaccurate, its communication inadequate or its actions are disproportionate to the mischief or identified risks.⁶⁹

3.17 There have been a number of studies which have examined the compliance burden. These include a Productivity Commission research paper⁷⁰ as well as a number of academic papers which have examined compliance costs and their impact on both small and large taxpayers⁷¹. Some of these studies suggest that compliance costs represent a higher percentage of sales and income for small and medium enterprises when compared with larger businesses.⁷² For example, a 2012 comparative study found that 'while medium and large businesses usually spend less than 1/10th of 1% of their turnover on TCC [tax compliance costs], small businesses often face TCC of 5% or more of turnover, which can be compared to an extra tax burden'.⁷³

3.18 It should also be noted that large businesses are increasingly concerned about the growing compliance costs arising from a range of initiatives being implemented by

⁶⁵ Ibid.

⁶⁶ Above n 53, p 293.

⁶⁷ Ibid.

⁶⁸ Above n 44, p 81.

⁶⁹ Above n 44, p iii.

⁷⁰ Productivity Commission, *Compliance Costs of Taxation in Australia* (1996) <<http://www.pc.gov.au>>.

⁷¹ Chris Evans, Phil Lignier and Binh Tran-Nam, *Tax Compliance Costs for the Small and Medium Enterprise Sector: Recent Evidence from Australia* (26 September 2013) <<https://tarc.exeter.ac.uk>>; Chris Evans, Phil Lignier and Binh Tran-Nam, 'The Tax Compliance Costs of Large Corporations: An Empirical Inquiry and Comparative Analysis' *Canadian Tax Journal* (2016) 64:4, 751-93.

⁷² OECD, *Taxation of SMEs in OECD and G20 Countries*, *OECD Tax Policy Studies* (2015), p 13; Productivity Commission, *Regulator Engagement with Small Businesses* (2013) pp 72-73.

⁷³ Jacqueline Coolidge, (2012), 'Findings of tax compliance cost surveys in developing countries' (2012) *eJournal of Tax Research*, 10(2), pp. 250-287.

the ATO in the last few years. These concerns were raised with the IGT during the development of his 2017 Work Program.⁷⁴

IGT OBSERVATIONS

3.19 The IGT supports the ongoing use of technology where such technology makes it easier and cheaper for taxpayers to effectively interact with the system to discharge their obligations. However, notwithstanding the increased use of technology and digital channels, it is necessary to appreciate that tax practitioners and other intermediaries continue to play a crucial role in the tax system. The ATO's ongoing service delivery should not detract or dissuade taxpayers from seeking independent tax and legal advice on their tax affairs. The ATO cannot and should not be the sole source of advice for taxpayers.

3.20 The IGT has previously examined the role of tax practitioners and the ATO's support and services for them in 2015.⁷⁵ In that report, the IGT noted that tax practitioners face a number of challenges including 'new technology, globalisation, client demand for a wider range of services, future changes arising from 'disruptive' technology and an impending generational change'.⁷⁶ Moreover, the IGT observed the strain on the relationship between tax practitioners and the ATO which was, in part, due to dissatisfaction with some of the ATO services and the communication between them.⁷⁷

3.21 The ATO has been working to improve its relationship with tax practitioners as it is critical for the efficient administration of the tax system. Furthermore, the IGT has announced that, in response to a request from the Commissioner, a review will be conducted into the future role of the tax profession. The aim of the review is to consult widely with tax practitioners, taxpayers and their representative bodies as well as with the ATO and TPB to ensure all major issues are addressed and to chart the best way forward for the efficient and effective administration of the tax system. In particular, the increased use of digital technology and ATO service delivery initiatives will be explored.

3.22 As technology continues to develop, the role of tax practitioners and their business models will necessarily transform.⁷⁸ The OECD has already observed some changes in this regard, noting that tax service providers (TSPs) are moving from:

...a reactive model of fulfilling customer demand with a more proactive one. Whereas many TSPs are used to executing more operational tasks, based on legal obligations, they are gradually acquiring a more strategic role when it comes to financial planning and business advice.⁷⁹

⁷⁴ Above n 48.

⁷⁵ IGT, Above n 55.

⁷⁶ IGT, Above n 55, p 10.

⁷⁷ IGT, Above n 55, pp iii-iv.

⁷⁸ OECD, *Rethinking Tax Services: The Changing Role of Tax Service Providers in SME Tax Compliance* (2016) p 58.

⁷⁹ Ibid.

3.23 The OECD foreshadows the increasing use of data analytics, predictive modelling and advanced decision support systems as a means for TSPs to more comprehensively understand their clients' circumstances which would provide a basis for more tailored advice.⁸⁰

3.24 Technological developments may also necessitate greater reliance on third party software providers in future. Whilst the IGT may tangentially consider the role of these new intermediaries as part of the above review, the Committee may also wish to examine how they are currently interacting with the ATO and the community in providing their services and any improvements that may be required.

3.25 In addition to the concerns raised by tax practitioners about digital delivery of services, the IGT has also received complaints from taxpayers directly. These concerns have tended to focus on the difficulties of some taxpayers to use such channels for service delivery. For example, one case concerned a local church's inability to engage with the SuperStream system electronically due to the remoteness of their location and their limited access to the online services. Other complaints have noted the limited availability of paper forms and guidance and the channels through which these may be requested. The IGT has also received similar feedback through submissions made to the development of his Work Program for 2017⁸¹.

3.26 As noted above, the ATO has also received feedback on the need for alternatives to digital interaction in certain cases and has published information on its website which outlines the types of services it provides for people with a disability.⁸² Through the IGT's complaints handling function, we have also become aware that ATO officers seek to assist taxpayers where they can by, for example, providing printed copies of sections of the website and other digital information.

3.27 The lack of access to digital channels has also been explored in other jurisdictions, such as the US where the NTA recently undertook a survey on broadband and internet access. The NTA found that more than 33 million taxpayers in the US did not have access to broadband and 14 million had no internet access at home which significantly limited their online activities.⁸³ Taxpayers who were low income, elderly or disabled were found to be less likely to have internet access when compared with survey participants who were classified as 'not low income'.⁸⁴

3.28 In addition to lack of access to the internet or digital technology, there may be unforeseen technological outages such as the one which occurred in late 2016 and which the Commissioner has referred to as the 'worst unplanned system outage in recent memory'⁸⁵. A second system-wide ATO outage has also occurred in early February 2017. Large-scale systems upgrades may also have a similar effect, such as

⁸⁰ Above n 78.

⁸¹ Above n 48.

⁸² ATO, 'Our services for people with disability' (7 January 2016) <www.ato.gov.au>.

⁸³ NTA, *2016 Annual Report to Congress* (2017), p 20.

⁸⁴ *Ibid.*

⁸⁵ ATO, 'Commissioner of Taxation, Chris Jordan AO on system outages' (Media Statement, 16 December 2016) <www.lets-talk.ato.gov.au>.

those experienced during the ATO's Change Program which led to significant delays in tax return processing.⁸⁶

3.29 In the light of the NTA's research in the US, taxpayer requests to the IGT and the ATO for alternatives to digital interactions as well as the potential for technological outages, the Committee may wish to consider whether there is a need to formally establish alternative methods of interaction with the ATO, at least as a contingency measure.

3.30 In relation to the recent ATO outages, the IGT has been informed that the ATO is undertaking a number of internal reviews into their causes and consequences. At the same time, it has also commissioned PwC to externally review the matter.⁸⁷ To the extent that outages or disruptions continue and concerns persist, the IGT will consider whether to independently investigate the matter.

3.31 Finally, in relation to issues concerning compliance costs, the IGT believes that a greater understanding of the costs imposed on all taxpayers when interacting with the tax system would assist to inform both tax policy design and administrative practices. The IGT has previously supported the idea of an independent body, such as the Productivity Commission, 'undertaking a study to measure tax related compliance costs and their impact on the administrator, the taxpayer, tax practitioners and the Australian economy as a whole.'⁸⁸ Such a study would also be useful in determining whether the increased use of digital interaction has lessened the compliance burden for the various taxpayer groups.

⁸⁶ See for example, IGT, *Review into the ATO's Change Program* (2010).

⁸⁷ ATO, 'ATO systems update' (24 January 2017) <lets-talk.ato.gov.au>.

⁸⁸ IGT, *Review into improving the self assessment system* (2013) p 63.

4. USE OF INFORMATION AND COMMUNICATIONS TECHNOLOGY

4.1 The previous chapter of the IGT submission examined a number of ways in which taxpayers interacted with the tax system, including through electronic and digital channels offered by the ATO. The use of electronic and digital channels is supported internally by the ATO's own Information and Communication Technology (ICT) platform.

4.2 As part of its Capability Review of the ATO in 2013, the Australian Public Service Commission (APSC) stated that:

...ICT is the lifeblood of the ATO. It underpins most, if not all, of the work the ATO performs and has an impact on its ability to be agile, responsive and ultimately perform to meet service delivery and stakeholder expectations.⁸⁹

4.3 Following the APSC's review, the ATO released its Information Technology (IT) Strategy to guide its design of IT services, focusing on the client experience and includes initiatives such as increasing its use of third party data.⁹⁰

4.4 The IGT has previously examined a number of ATO initiatives aimed at enhancing its technological services through data collection and use as well as the ATO's communications. These discrete initiatives are separately discussed below and include the IGT's view and observations.

USE OF DATA MATCHING AND PRE-FILLING

4.5 Each year, the ATO receives large amounts of taxpayer data from a number of third party sources including from other government agencies, financial institutions and foreign revenue authorities. Some are required to be provided by legislation whilst others are provided by less formal means.⁹¹ The ATO validates and refines such data before comparing them to taxpayers' reported information to identify potential discrepancies. The cases which contain discrepancies undergo a selection process to identify those suitable for further scrutiny and potentially lead to audits.

4.6 In addition to using its data holdings to identify potential discrepancies in reported income, the ATO also uses it to pre-fill electronic income tax returns where the data can be appropriately matched to a specific taxpayer. Pre-fill is designed to improve accuracy and ease the preparation of tax returns. Information that may be

⁸⁹ Australian Public Service Commission, *Capability Review Australian Taxation Office* (2013) p 9.

⁹⁰ ATO, *ATO IT Strategy Summary* (July 2014) pp 3-7.

⁹¹ Data may also be received by the ATO through memoranda of understanding with other government agencies, through use of its information gathering powers or under various treaties and double tax agreements with foreign revenue authorities.

pre-filled include items such as salary and wages, taxes withheld by employers and bank interest.

4.7 In 2015, the OECD reported that almost half of revenue bodies that it surveyed made use of pre-filing.⁹² Australia's use of pre-filing is similar to Canada's⁹³ and was considered by the OECD to be 'substantial' and in line with other jurisdictions such as the Netherlands, Portugal, France and Singapore.⁹⁴ In contrast, the OECD noted a number of other jurisdictions had the capability to generate fully completed tax returns.⁹⁵

4.8 Other research has noted different regimes to pre-filing, such as the concept of reduced filing that has been used by HMRC in the UK and IRD in New Zealand.⁹⁶ Reduced filing systems:

*...feature comprehensive withholding mechanisms and little or no deductibility for expenses and result in a situation where the majority of taxpayers are not required to annually reconcile their tax.*⁹⁷

4.9 In Scandinavian countries, revenue agencies have a vastly different approach. Digitisation has been a key objective of the whole of the public sector in Sweden, Norway and Denmark for some time.⁹⁸ Denmark was the first Scandinavian country to introduce pre-filled tax returns in the 1990s, followed by Sweden and Norway.⁹⁹ In Sweden, taxpayers can accept a pre-filled return by internet, phone, SMS or paper. Since 2009, Norway has adopted a silent acceptance approach whereby if taxpayers do not respond to the pre-filled income tax return, it is treated as final and binding. Similarly, in Denmark a 'no response' is deemed to be acceptance of the return. The OECD has reported that, the Scandinavian countries experienced a 50 to 75 percent rate of returns not requiring adjustment by taxpayers.¹⁰⁰

4.10 The use of data for pre-filing purposes, whether to partially or fully complete a return depends on the receipt of timely and accurate data. In this regard, the ANAO has suggested that the reliance of the goodwill of data providers to deliver data earlier might not be sufficient to optimise the implementation and efficiency of the pre-fill initiative.¹⁰¹ The OECD has also expressed the need for timely data in relation to pre-fill.¹⁰²

⁹² Above n 56, p 256.

⁹³ Canada Revenue Agency (CRA), 'About Auto-fill my return' (2 February 2017) <www.cra-arc.gc.ca>.

⁹⁴ Above n 56, p 256.

⁹⁵ Ibid, p 255.

⁹⁶ Jason Kerr, 'Tax return simplification: risk key engagement, a return to risk?' *eJournal of Tax Research* (2012) vol 10, no 2, pp 465-482.

⁹⁷ Ibid, p 466.

⁹⁸ OECD, *Third Party Reporting Arrangements and Pre-filled Tax Returns: The Danish and Swedish Approaches* (2008), p 4.

⁹⁹ Ibid, p 9.

¹⁰⁰ OECD, *Using Third Party Information Reports to Assist Taxpayers Meet Their Return Filing Obligations – Country Experiences with the Use of Pre-Populated Personal Tax Returns* (2006).

¹⁰¹ ANAO, *The Australian Taxation Office's Use of Data Matching and Analytics in Tax Administration* (2008) 85.

¹⁰² OECD, *Tax repayments: Maintaining the Balance Between Refund Service Delivery, Compliance and Integrity* (2011) p 9.

IGT observations

4.11 In 2013, the IGT undertook a review into the ATO's approach to data matching.¹⁰³ Overall, the ATO's data matching was found to be effective, however, a number of recommendations were made which included some aimed at ensuring the relevant data is accurate before being used in compliance activities and raising awareness of channels for review where taxpayers disagreed with the ATO's decisions.¹⁰⁴

4.12 The IGT's review also considered the ATO's use of its available data to assist taxpayers and tax practitioners in lodging income tax returns. Despite the support for the ATO's pre-filing program, concerns were raised with the IGT regarding the ATO's processes for correcting errors in pre-filled data.¹⁰⁵

4.13 While the use of pre-filled information has been welcomed suggestions have been made to the IGT that the ATO could do more to collect additional data to assist taxpayers. However, challenges do exist in this regard:¹⁰⁶

- a) timeliness – the legislated deadlines for the provision of third-party information to the ATO are potentially too late for taxpayers who want to submit their income tax returns early;
- b) comprehensiveness – the pre-filled information could be more comprehensive and often because of technical problems, some supposedly available pre-fill information may not be available;
- c) availability – the availability of systems could be improved; and
- d) reliability and accuracy – in some instances, pre-filing information may not be reliable. However, the ATO website does caveat that taxpayers bear the onus of confirming the veracity of any information reported in their tax return.

4.14 Some submissions to the IGT's 2017 Work Program have suggested that the ATO could do more to bolster its pre-filing program. One example was collecting data on deductible charitable donations and pre-filing those as a means of both assisting taxpayers and fostering greater giving. Any such moves to expand the pre-filing program will necessarily require the ATO to have robust processes for obtaining the data. As mentioned above the ANAO has asserted that it is not sufficient to simply rely on the good will of data providers. Where necessary, the ATO may require legislative changes mandating the provision of relevant data.

¹⁰³ IGT, *Review into the Australian Taxation Office's compliance approach to individual taxpayers – use of data matching* (2014).

¹⁰⁴ *Ibid*, p vii.

¹⁰⁵ *Ibid*, pp 43-47.

¹⁰⁶ Fraser Institute, *Prefilled Personal Income Tax Returns A Comparative Analysis of Australia, Belgium, California, Québec, and Spain* (2011) p 13.

4.15 However, in the above review, the IGT has noted that although the use of data is helpful, where the ATO requests large amounts of information which are ultimately not used, this creates costs for the third party providers and administrative costs for the ATO.¹⁰⁷ To reduce these impacts the IGT recommended that the ATO needs to identify the areas in which its data matching work is effective and those in which it is less effective.¹⁰⁸ Moreover, the IGT also recommended that the ATO work closely with potential data providers to consider their 'natural business systems' and the options available to the ATO to support or subsidise any necessary changes to improve the provision of data.

4.16 The ATO has recognised the importance of data collection and use and is implementing a strategic Smarter Data program to make smarter, unified use of data to improve decisions, services and compliance. It is a whole-of-ATO approach to risk assessment, intelligence, analytics, data management and technology. This framework will seek to deliver value by 'making it easy to comply and hard not to' in line with the ATO's reinvention program.¹⁰⁹ The IGT has not had an opportunity to review this program and it may be an area which may benefit from the Committee's consideration.

4.17 Whilst the ATO continues to improve the accuracy of the pre-filled information, it is important that taxpayers and their advisers do not rely solely on it in completing their tax returns. Any inaccuracies are not desirable for the integrity of the system and may also result in subsequent compliance action which would impose an additional burden on both the ATO and the taxpayer.

4.18 In progressing pre-filling further in this country, it may be useful to consider the approaches of different jurisdictions as outlined above. In this regard, whilst it may be attractive to reach the ultimate goal of relieving taxpayers of the need to lodge annual tax returns, it is necessary to consider the different socio-economic and legal frameworks that vary between such jurisdictions. For example, in many countries where tax returns are fully completed by the revenue authority, there may not be as comprehensive a regime for claiming deductions for work-related expenses as there is in Australia.¹¹⁰

4.19 The Committee may wish to consider the extent to which pre-filling of tax returns should be further progressed in Australia and the legislative and administrative means which would facilitate such a goal.

STANDARD BUSINESS REPORTING

4.20 Many jurisdictions are currently progressing whole-of-government strategies to provide a single portal for citizens to access government information and services including an authentication mechanism.¹¹¹ Such strategies rely on the sharing and

¹⁰⁷ Above n 103, p 42.

¹⁰⁸ Above n 103, p 43.

¹⁰⁹ ATO, *Smarter Data Program reinventing data and analytics – the ATO experience* (Presentation delivered to SAS, May 2015) <www.sas.com>.

¹¹⁰ Above n 96, p 466.

¹¹¹ Above n 51 (2014).

reuse of reported data, implying a need for standardisation of required data.¹¹² In Australia, SBR is one such strategy.¹¹³

4.21 Since 2010, Australia has pursued the adoption of SBR which aims to simplify business reporting obligations through a standard approach to online or digital record-keeping, collection of electronically reported information and distribution of that information to the appropriate government agency.¹¹⁴ As such, SBR is not an information technology system but a 'collection of core services, data and message standards that uses a hub or mail centre.'¹¹⁵

4.22 SBR is intended to yield a number of benefits including a reduction of data entry, increased productivity, information sharing, greater certainty, real-time validation and security.¹¹⁶

4.23 In line with the SBR initiative, the ATO intends to upgrade its current online platform, including the ELS through which tax practitioners lodge their clients' returns. As a result of this development, practitioners will need to upgrade their current practice management software to one that is SBR-enabled. Taxpayers will also be encouraged to implement SBR-enabled software. In both cases, initial cost outlays are expected for both tax practitioners and their clients.

IGT observations

4.24 The IGT considered SBR in his 2015 review into services and support for tax practitioners.¹¹⁷ It was found that stakeholders have generally supported the SBR's aim of streamlining reporting requirements for government departments such as the ATO.¹¹⁸ However, at the time the review was conducted, the main impediment to SBR's success was its low adoption rate by businesses and tax practitioners.¹¹⁹ To address the issues related to SBR-adoption, the IGT set out a number of steps that the ATO could take.

4.25 First, closely working with tax practitioners is required to better understand and respond to causes of tax practitioner and taxpayer resistance to adopting SBR-enabled software. The IGT noted that co-operation would be difficult if tax practitioners are pushed towards products which may not provide full functionality and may expose the ATO to the risk of lower practitioner engagement and satisfaction.¹²⁰

4.26 Secondly, co-operation with software developers as well as tax practitioners and taxpayers would be necessary to enhance the user experience of SBR-enabled

¹¹² Ibid, p 26.

¹¹³ IGT, Above n 55.

¹¹⁴ Ibid, p 64.

¹¹⁵ Ibid.

¹¹⁶ Ibid.

¹¹⁷ Ibid.

¹¹⁸ Ibid, p 65.

¹¹⁹ Ibid, p 68.

¹²⁰ IGT, Above n 55, p 68-69.

accounting software. Such improved user experience as well as other benefits of adopting SBR could be better communicated to all the relevant parties.¹²¹

4.27 Thirdly, targeted financial incentives could be considered to reduce set up or upgrade costs for tax practitioners. It could also adopt concessional treatment during the transition period, such as allowing the deferral of certain payments or lodgment obligations without penalties being incurred – as was done in the UK in broadly similar circumstances. Tax practitioners and taxpayers could be made aware of such treatment well in advance of the transition period.¹²²

4.28 Lastly, the IGT was of the view that SBR education and training for tax practitioners will be needed to reduce the risk of incorrect reporting and demand on the ATO's telephony channel from taxpayers and tax practitioners seeking assistance. The ATO could provide educational materials such as online tutorials delivering practical guidance that would assist tax practitioners with the transition to SBR.¹²³

4.29 The Committee may wish to further examine the ATO's implementation of SBR, given the passage of time since the ATO commenced this task and the above IGT review.

SINGLE TOUCH PAYROLL

4.30 STP aims to 'cut red tape' for employers by 'simplifying tax and superannuation reporting obligations'.¹²⁴ Employers who are required to comply with STP requirements will need to report PAYG withholding and superannuation guarantee (SG) information to the ATO every payroll cycle.

4.31 Employers with 20 or more employees will be required to comply with STP requirements from 1 July 2018.¹²⁵ However there are options for early uptake from 1 July 2017.¹²⁶ Employers who are required to comply with STP will incur some initial set-up costs in either purchasing new software, upgrading existing software or using the services of an external intermediary to comply with their obligations.

4.32 The introduction of STP will not only relieve complying employers of a range of reporting obligations,¹²⁷ the 'real time' nature of STP data should enable the ATO to more proactively address PAYG Withholding and SG risks. As the Explanatory Memorandum to the STP legislation states:

More timely information will allow the Commissioner to engage with employers earlier to address cases of non-compliance. This could potentially prevent more

¹²¹ Ibid.

¹²² Ibid.

¹²³ Ibid.

¹²⁴ Josh Frydenberg MP, 'Cutting red tape for employers through Single Touch Payroll' (Media Release, 28 December 2015) <jaf.ministers.treasury.gov.au>.

¹²⁵ *Budget Savings (Omnibus) Act 2016* sch 23 pt 1 div 3.

¹²⁶ ATO, 'Simpler reporting with Single Touch Payroll' (1 December 2016) <www.ato.gov.au>.

¹²⁷ *Taxation Administration Act 1953* Sch 1 s 389-20.

*punitive outcomes for such employers which would apply under the SG charge regime where non-compliance is identified further down the track.*¹²⁸

4.33 In addition to exempting employers with fewer than 20 employees, the STP legislation allows the Commissioner to exempt particular employers or classes of employers from meeting those requirements in appropriate circumstances.

4.34 The ATO is currently conducting a pilot of STP to ascertain the level of 'deregulation benefits' for the 710,000 small employers who have less than 20 employees and 'test support and education tools'.¹²⁹ Following the pilot, the Government will make a decision, by the end of the 2017 calendar year, as to whether employers with less than 20 employees will also be required to comply with STP.¹³⁰

IGT observations

4.35 There are clear benefits in the introduction of STP, both for the reduction of reporting burdens on employers as well as enhancing the availability of timely data to enable the ATO to act quickly and address any compliance risks in relation to PAYGW and SG as they arise.

4.36 Whilst appropriate exemption would be of considerable relief for affected employers, the regulation impact statement states that the benefits and efficiencies anticipated from the successful implementation of STP can only be realised through 'full participation by all businesses'.¹³¹

4.37 Therefore, the IGT believes that, whilst exemptions are important, particularly for smaller or regional employers who may not have the same level of digital access, it is important to examine alternatives to encourage, as opposed to mandate, full participation. Such encouragement or support may include alternative forms of accessing STP and low or no cost options associated with its adoption. The Committee may wish to consider these matters further.¹³²

DIGITAL COMMUNICATION

4.38 In addition to using its ICT platform to assist taxpayers, the ATO has also made use of digital communications, including social media channels, as a means of quick and cost effective communication with taxpayers.

¹²⁸ House of Representatives, Revised Explanatory Memorandum, *Budget Savings (Omnibus) Bill 2016*, p 265.

¹²⁹ The Treasury, *Regulation Impact Statement: Single Touch Payroll* (October 2015) p 39.

¹³⁰ Ibid.

¹³¹ Above n 128, p 283.

¹³² The IGT has examined STP as part of his *Review into the Australian Taxation Office's employer obligation compliance activities*. The report has been transmitted to the Minister but has not yet been publicly released.

Email and SMS

4.39 Prior to 2014, the ATO used digital communication channels for sending ad hoc news and information. In 2014, the ATO launched its Digital Outbound Release (DOR) project to enable sending client-specific correspondence via email and SMS. Within three weeks of the DOR being released, more than 76,500 pieces of ATO correspondence were sent digitally rather than by post.¹³³

4.40 The ATO currently uses SMS and emails for promotional and information purposes. General email and SMS messages promote services the ATO offers such as myTax and myGov. Specific email and SMS messages may request actions be taken by using the ATO's services, such as to verify changes made to an ATO online account.¹³⁴

Social media

4.41 The OECD has said that social media technologies have the potential to 'bridge access and take-up gaps still faced by many traditional online government services'.¹³⁵ It has also stated that 'social media have the potential to make policy processes more inclusive and thereby rebuild some confidence between governments and citizens. But there are no "one size fits all" approaches and government strategies need to seriously consider context and demand factors to be effective'.¹³⁶

4.42 The ATO currently uses social media to share the latest information on tax and superannuation changes, initiatives, products and services as well as reminders.¹³⁷ They can be found on Facebook, Twitter, LinkedIn and YouTube. For example, the ATO used a combination of social media messaging to promote online lodgment options during the 2016 tax time period.¹³⁸

4.43 As social media sites become more pervasive, they allow governments to use new sources of information to better understand the needs and behaviours of individuals and small businesses.¹³⁹ This has led to the public perception that governments are using social media in an intrusive way, leading to concerns regarding privacy breaches and perceived surveillance.¹⁴⁰ For example, in November 2016, an Australian Broadcasting Corporation article warned that the ATO is using Facebook, Instagram and other social media to confirm the accuracy of information that is reported to it.¹⁴¹

¹³³ Accenture Consulting, 'Australian Taxation Office - How the Australian Taxation Office is driving digital communication to Australian Taxpayers' (undated) < www.accenture.com >.

¹³⁴ ATO, 'Current ATO SMS and email activities' (17 October 2016) < www.ato.gov.au >.

¹³⁵ OECD, *Social Media Use by Governments: A Policy Primer to Discuss Trends, Identify Policy Opportunities and Guide Decision Maker* (2014) p 3.

¹³⁶ *Ibid.*

¹³⁷ ATO, 'Find us on social media' (1 March 2016) < www.ato.gov.au >.

¹³⁸ ATO, 'Social media' (7 March 2016) < www.ato.gov.au >.

¹³⁹ *Above n 135*, p 4.

¹⁴⁰ *Ibid.*, pp 4-5.

¹⁴¹ Brett Williamson, 'Tax Office Trawls Facebook, Instagram and other social media to catch out dodgers, cheats' (17 November 2016) < www.abc.net.au >.

4.44 Several OECD member countries such as Ireland, Malaysia, the Netherlands, New Zealand and Singapore are now utilising advanced analytics to carry out social network analysis to help detect certain types of Valued Added Tax fraud.¹⁴²

IGT observations

4.45 The IGT recognises that new means of communication provide different opportunities for the ATO to engage directly with the community at very low cost. However, care must be taken to respect the role of intermediaries, such as tax practitioners. As noted in the previous chapter, the advent of platforms such as myTax and myGov has caused concerns for tax practitioners who feel they are being circumvented. This is particularly true in instances where taxpayers who rely on tax practitioner services are receiving correspondence directly from the ATO through the myGov inbox without the tax practitioner being necessarily informed.

4.46 The IGT has received a number of complaints on the above issue and has facilitated conversations between the ATO and some affected tax practitioners to ensure appropriate outcomes are achieved and to foster a closer working relationship between the two parties.

4.47 In relation to the use of emails and SMS, security issues need to be addressed before their use is extended beyond its current limits, particularly given their use in scams and phishing schemes to obtain taxpayer information or to assume their identities. The ATO is cognisant of these risks and has sought to manage them through website information on current ATO SMS and email activities as well as providing a free telephone line for verifying the authenticity of correspondence.¹⁴³

4.48 In respect of using social media as a means of detecting non-compliance, whilst the IGT believes that the ATO should use all information at its disposal to combat non-compliance, care must be taken to ensure that information relied upon is accurate and verifiable and that privacy laws are not breached. This is particularly important in the context of social media or other uncontrolled sources of information in which there is significant scope for inaccuracy and exaggeration.

4.49 The Committee may wish to consider any further use of digital communications, particularly social media, by the ATO and in doing so address any security and privacy concerns.

OTHER USES OF ICT

4.50 In addition to the above, the IGT has also examined other ICT improvements that the ATO could implement to assist taxpayers. In the 2015 review into services and support for tax practitioners, the IGT recommended that the ATO increase its use of modern modes of communication.¹⁴⁴ Other recommendations considered the

¹⁴² OECD, *Advanced analytics for better tax administration: Putting data to work* (2016) pp 21-22.

¹⁴³ Above n 134.

¹⁴⁴ IGT, Above n 55, p 51.

publication of practical online user guides in relation to certain ATO platforms, simplifying proof of identity through the use of unique identifiers or voice recognition and developing a 'web chat functionality' to provide tax practitioners with useful information.

4.51 The ATO has undertaken some work in relation to the above. For example, it is making some use of voice recognition for taxpayers¹⁴⁵ and has developed a 'virtual assistant' on its website called 'Alex' that 'understands conversational language and can clarify what you want and answer your questions.'¹⁴⁶ The IGT has not had opportunity to examine the effectiveness of these new technologies. The Committee may wish to consider current ATO endeavours in this regard and explore any additional measures to enhance its service delivery to the community.

¹⁴⁵ ATO, 'ATO launches voice authentication' (8 April 2014) <www.ato.gov.au>.

¹⁴⁶ ATO, 'Introducing Alex, our new web assistant' (15 September 2015) <www.ato.gov.au>.

5. USE OF BEHAVIOURAL INSIGHTS

5.1 Behavioural insights may be defined as drawing:

*...on research into behavioural economics and psychology to influence choices in decision-making. By focusing on the social, cognitive and emotional behaviour of individuals and institutions it suggests that subtle changes to the way decisions are framed and conveyed can have big impacts on behaviour.*¹⁴⁷

5.2 In recent years, there has been significant interest in the use of behavioural insights amongst government agencies around the world, particularly those engaged in service delivery such as revenue agencies. The UK Government's Behavioural Insights Team (BIT) has undertaken significant work in this area. It is focused on:¹⁴⁸

- *making public services more cost-effective and easier for citizens to use;*
- *improving outcomes by introducing a more realistic model of human behaviour to policy; and wherever possible,*
- *enabling people to make 'better choices for themselves'.*

5.3 Central to the behavioural insights research is the use of randomised controlled trials (RCT) which involve:

*...dividing the study population into two or more groups and randomly assigning individuals to each of these groups. By giving the intervention (for example the modified letter, the changed process, the new text message) to one of these groups while continuing to treat the other group as business per usual, we can determine the difference in effectiveness of each of the interventions. The key ingredient to this approach is the randomisation of individuals to groups, which enables us to assume that any difference in outcomes is attributed to the intervention rather than other factors.*¹⁴⁹

5.4 In 2012, BIT partnered with the NSW Government's Department of Premier & Cabinet to create a centrally staffed Behavioural Insights Unit (BIU) in Sydney and to obtain insights which would work in the Australian context. The BIU's latest report, *Behavioural Insights in NSW 2016* showcases the major projects over the previous two years. Some of these projects included the use of text reminders to assist tenants to exit arrears, patient attendance at hospital appointments to save on healthcare costs and reminder letters to increase women's attendance at cervical cancer screenings.¹⁵⁰

¹⁴⁷ NSW Premier and Cabinet, 'Behavioural Insights Community of Practice' (undated) <bi.dpc.nsw.gov.au>.

¹⁴⁸ UK Cabinet Office Behavioural Insights Team, 'Who are we' (undated) <www.behaviouralinsights.co.uk>.

¹⁴⁹ UK Cabinet Office Behavioural Insights Team, *Applying behavioural insights to reduce fraud, error and debt* (2012), p 21.

¹⁵⁰ NSW Premier and Cabinet, 'Behavioural Insights in NSW 2016' (19 December 2016) <bi.dpc.nsw.gov.au>.

5.5 Similar teams to the NSW BIU have since been established in the Federal Government and the Victorian Government. On 1 February 2016, the Behavioural Economics Team of the Australian Government (BETA) started work in the Department of Prime Minister and Cabinet. BETA works with partner agencies, such as the ATO, to:¹⁵¹

- *build the APS capability needed to support greater use of behavioural economics in policy-making;*
- *provide behavioural economics expertise on a number of projects that apply and test policy programme and administrative designs; and*
- *establish links between the APS and the behavioural economics research and practitioner community, here and overseas.*

5.6 BETA is in its very early stages and the IGT is not aware of any projects it may have conducted with the ATO. However, the ATO has undertaken some work which have utilised behavioural insights. For example, in January 2014, the ATO commissioned an external consultant to conduct a project called 'Attitudinal and Behavioural Research on the Prevention of Aged Debt' (BRP):¹⁵²

The key outcomes of the BRP are to understand the drivers for the accumulation of tax debt by small businesses and subsequently develop better services and compliance strategies which, amongst other things, encourage willing payment of taxes and prevent debt accumulation.

Some of the key areas the project will consider include how small businesses make decisions concerning the payment of tax debt and relative payment priorities as well as how small business taxpayers form views about the behaviour of others. Furthermore, key characteristics of taxpayers likely to fall into tax debts were investigated, including the type of taxpayer entity, number of employees, turnover, the age of the entity and the industry within which they operate. The project will also consider the ATO's role in the prevention of tax debts and specifically whether its interventions 'promote, limit or prevent tax debt'.

Toward the end of this review, the ATO advised that they have commenced working with the IRD to compare the results of their respective research to provide 'new ideas on how to prevent the accumulation of aged debt by small businesses'. Additionally, the ATO expressed an intention to strengthen its corporate research capability more broadly to provide evidence which supports improved decision making.

5.7 The ATO has used behavioural insights to develop its communications to improve payments. In doing so, the ATO examined the language, structure and layout of a number of debt letters to increase payment compliance by being clearer about what taxpayers need to do and the consequences of not paying.¹⁵³

¹⁵¹ Department of the Prime Minister and Cabinet, 'Behavioural Economics' (undated) <www.dpmc.gov.au>.

¹⁵² IGT, *Debt Collection* (2015) p 51.

¹⁵³ ATO, 'Better communication to improve payment compliance' (7 March 2016) <www.ato.gov.au>.

5.8 The ATO is also using behavioural insights in developing a 'Debt Engagement Framework' which focuses on re-engagement with taxpayers to help them understand and manage their payment obligations. During conversations with taxpayers, ATO staff are directed to:¹⁵⁴

- (a) Seek to understand why the taxpayer is in debt;
- (b) Emphasise the need for the taxpayer to take quick action to pay debts by using 'behavioural insights'; and
- (c) Arrive at a constructive solution that results in a greater likelihood of resolving the debt, such as requesting larger initial payments with next payment within a week.

5.9 Behavioural insights may also be useful in assessing the impact of pre-filling on taxpayer compliance. The concept of pre-filling was discussed in the previous chapter. Broadly, research in this area suggests that when taxpayers are presented with completed tax returns, they are more likely to lodge them without disputing the pre-filled data.¹⁵⁵ The OECD has come to a similar view based on the Danish and Swedish experience where two thirds of recipients of fully completed income tax returns have lodged such returns without dispute or request for changes.¹⁵⁶ A positive consequence is a 'dramatic reduction in the administrative burden' for those taxpayers.¹⁵⁷

IGT OBSERVATIONS

5.10 As noted in previous chapters, various jurisdictions have adopted a range of different approaches to assist their citizens comply with tax obligations. The approach to be adopted in each country has to be suited to the particular social, economic and legal environments in that jurisdiction. Therefore, a key consideration in adopting any initiative would be whether it would yield fair and equitable outcomes, in an Australian context, for both the government and the community. As the APSC has noted:¹⁵⁸

One of the key learnings from international experience is that public sector agencies need to be mindful that behavioural change policy goals have to be reasonably congruent with a particular society's views on the right balance between individual responsibility and government responsibility. These views vary according to policy area and over time.

5.11 The IGT has for many years championed the increased use of behavioural insights in various aspects of tax administration and much of the work that the ATO has undertaken in this area has been as a result of IGT reviews. For example, in the

¹⁵⁴ Above n 152, p 133.

¹⁵⁵ Above n 96.

¹⁵⁶ Above n 98, p 7.

¹⁵⁷ Ibid, p 5.

¹⁵⁸ Australian Public Service Commission, 'Changing behaviour: A public policy perspective' (14 December 2015) <www.apsc.gov.au>.

Review into the ATO's compliance approach to individual taxpayers – income tax refund integrity program (ITRIP), the IGT considered applied research from the UK BIT. Having regard to that research, recommendations were made for the ATO to assess the effectiveness of the ITRIP letters to generate the intended behavioural response from individual taxpayers through the use of RCTs in correspondence design.¹⁵⁹ The IGT also reiterated that support through a range of other reviews including those examining data matching,¹⁶⁰ the ATO's use of risk assessment tools,¹⁶¹ debt collection,¹⁶² excess contributions tax¹⁶³ and penalties¹⁶⁴.

5.12 In addition to the above work, the IGT believes that the ATO could further benefit from insights arising out of projects conducted by BETA with other comparable service delivery agencies and learnings from the BIU and BIT. In respect of implementing significant new changes, the ATO should continue to make use of RCTs which have been strongly supported by the BIT.

5.13 The Committee may wish to examine the ATO's current initiatives involving behavioural insights, in particular any work being done outside of the debt area, and how it is assisting taxpayers to make decisions in their best interest. In doing so, the Committee could consider the taxpayer's best interest, how it varies across different taxpayer groups and how it is determined. In this regard, the Committee may find learnings from the UK in relation to practising mindfulness by public policy makers particularly useful.¹⁶⁵

¹⁵⁹ IGT, *Review into the Australia Taxation Office's compliance approach to individual taxpayers – income tax refund integrity program* (2013).

¹⁶⁰ Above n 103, pp 55-56 .

¹⁶¹ Above n 44, pp 148-149.

¹⁶² Above n 152, pp 51, 86, 133.

¹⁶³ IGT, *Review into the Australian Taxation Office's compliance approach to individual taxpayers – superannuation excess contributions tax* (2014) p 60.

¹⁶⁴ IGT, *Review into the Australian Taxation Office's administration of penalties* (2014) pp 5-6.

¹⁶⁵ Rachel Lilley, Mark Whitehead, Rachel Howell, Rhys Jones and Jessica Pykett, 'Mindfulness Behaviour Change and Engagement in Public Policy – An evaluation' (October 2014) <www.sps.ed.ac.uk> p 4.