



Australian Government
Inspector-General of Taxation

Review into the Tax Office's Small Business Debt Collection Practices

Summary of submissions and evidence

Inspector-General of Taxation

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CHAPTER 1: BACKGROUND AND OVERVIEW OF THEMES RAISED IN SUBMISSIONS AND EVIDENCE

INTRODUCTION

1.1 This document provides a summary of the submissions and evidence obtained during the Inspector-General's review of the Australian Taxation Office's (ATO or Tax Office) small business debt collection policies and practices.

1.2 This document has the following objectives:

- to present the evidence received by the Inspector-General, in the form of written and oral submissions, as a contribution to ongoing public discussion of taxation debt collection issues; and
- to present the views expressed during the review, which were explicitly presented as guidance for future changes to the taxation debt collection system.

1.3 Subject to certain confidentiality provisions, the Inspector-General has discretion to make any submission available to the public generally. This would result in publicly identifying the person who made the submission. The Inspector General has not exercised this discretion because it was felt that this would promote an improved flow of information. However, where possible, the particular area of the private sector has been identified to assist readers' understanding. Although this approach may indicate a generalisation applying to all members of a sector, the intention is only to recount the views of those members of the sector that provided submissions.

BACKGROUND

1.4 On 21 April 2004, the Inspector-General announced the terms of reference for his review into the Tax Office's small business debt collection policies and practices. These were:

This review will investigate the fairness of the ATO's small business debt collection policies and practices. It will examine some of the perceptions and concerns raised by stakeholders in the course of the scoping review and prioritisation project. It will evaluate whether the ATO's small business debt collection policies and practices strike an appropriate balance between the competing underlying tensions of efficiently collecting tax debts and recognising the benefits of viable businesses' ongoing trading.

It will focus upon the following matters:

- to identify and determine whether the ATO small business debt collection policies adequately take into account the provision of assistance to small businesses who wish to meet their tax obligations without harming their underlying viability;

- to consider the manner in which the ATO implements its small business debt collection policies;
- to examine the impact of the ATO's small business debt collection policies and practices on aspects of small business tax debt collections, particularly:
 - the impact of the ATO's current approach to payment arrangements in assisting small businesses get out of debt without unduly affecting the viability of the business;
 - the ATO's management of debt collection cases, including their timeliness, co-ordination and commercial approach, with regard to the Taxpayers' Charter and the Compliance Model;
 - whether the Commissioner's policies and practices unnecessarily force small businesses into either bankruptcy or liquidation;
 - the consistency of the Commissioner's exercise of a release from tax debts based on serious financial hardship (Division 340 of Schedule 1 to the *Taxation Administration Act 1953*, previously section 265 of the *Income Tax Assessment Act 1936*) with the legislation's underlying policy; and
 - the ATO's approach to the compromise of tax debts.

1.5 Consultation was conducted with a wide range of individuals and organisations on the Tax Office's small business debt collection policies and practices, and the broad context and approach has been documented in Appendix 2 of the Inspector-General's report, *Review into the Tax Office's Small Business Debt Collection Policies and Practices – Report*.

1.6 The following outlines the broader themes underlying the issues discussed in this document.

THEMES UNDERLYING ISSUES OF CONCERN

1.7 Consultations drew out many issues of concern that the private sector has with the Tax Office's debt collection policies and practices. Behind these issues of concern are broad themes of unease. These themes include:

- uncertainty about the debt collection process, including the perceived lack of clarity, practical guidance and certainty provided by the Tax Office's debt collection policies;
- disquiet about the way in which the Tax Office implements its debt collection policies and the impact of the Tax Office's management of debt collection cases including:
 - the perceived failure by the Tax Office to understand the underlying causes of small business collectable tax debts;
 - the perceived lack of consistency, certainty and transparency in the implementation of its debt collection policies;
 - disquiet about a lack of commercial orientation in aspects of debt collection including the timeliness of response by the Tax Office and approach at creditors meetings;

- the perceived lack of co-ordination with other agencies;
- disquiet about the way in which the Tax Office exercises judgement in determining recovery action including:
 - the perceived Tax Office's lack of appreciation of the pressures faced by small business and the perceived lack of consideration given to the impacts on businesses and their creditors when determining recovery action;
 - the failure by the Tax Office to consider the underlying viability of a debtor business as part of its debt collection practices;
 - the failure by the Tax Office to consider how its actions will affect the underlying viability of the debtor's creditors and competitors;
 - the perceived lack of differentiation between large/small or high risk/low risk or compliant/non-compliant small businesses when determining recovery actions;
 - the perceived reliance and inflexible adherence to processes and procedures rather than judgments designed to manage risks;
- apprehension with the Tax Office's approach to debt collection including:
 - the perceived lack of transparency and accountability in the Tax Office's debt collection systems including the perceived reliance on automated processes and procedures; and
 - the perceived lack of timely and clear communication over debt issues;
- apprehension about the capability of debt collection officers; and
- disquiet about a lack of timeliness and consistency in the Tax Office's approach to legal action with the debt collection policies not promoting a transparent and accountable process.

1.8 These broad themes underlie many of the issues discussed in this document.

SUMMARY OF VIEWS EXPRESSED

Overarching views

1.9 The Commissioner of Taxation signalled an increased auditing of the small business sector this financial year and, as a result, expects higher levels of tax liabilities to be raised in this sector. However, there are general concerns that the Tax Office has still not got the balance right in collecting debt from small businesses.

1.10 Media reports have generally claimed that the Tax Office is too quick to bankrupt or wind up businesses. Insolvency and some tax practitioners have generally claimed that the Tax Office is too lenient in collecting debt. However, representatives of small businesses have stated that they are happy with the Tax Office's flexibility when negotiating their own debt but perceive that they are being treated inequitably where the Tax Office offers the same flexibility to serial defaulters.

1.11 Additionally, representatives for small businesses generally claim that the Tax Office does not understand enough about the factors that impact on small business debt to deliver fair or proportionate debt collection responses in individual cases. The Tax Office generally claims that these criticisms are made by taxpayers who are the subject of legal action and the Tax Office cannot respond publicly to those criticisms because the taxation law secrecy provisions prohibit it from doing so.

1.12 Many submissions pointed to issues of effectiveness or efficiency of recovery actions. However, in the Inspector-General's view these issues are more appropriately considered by Tax Office management and other bodies. The focus for this review is the fairness of judgements exercised by the Tax Office in its debt collection policies and practices.

Specific views

1.13 Specific views were raised in the course of the review. These views and the Tax Office's response are discussed in more detail in following chapters. The Inspector-General has not undertaken a comprehensive analysis of the views and therefore does not evaluate or draw any conclusions from them.

STRUCTURE OF DOCUMENT

1.14 Issues and views expressed during the review have been arranged in the remaining chapters to correspond generally to the terms of reference for this review.

1.15 Chapters 2 to 4 provide general background information. Chapters 5 and 6 outline the views expressed on the Tax Office's small business debt collection policies and practices generally. Chapters 7 to 10 outline the views expressed on particular debt collection practices. The views expressed were sometimes contradictory in nature.

1.16 Chapter 2 provides the context for the review by defining terms, examining the proportion and make-up of the small business sector's collectable debt and outlining the general environment in which small businesses operate.

1.17 Chapter 3 gives an overview of the Tax Office's debt collection system.

1.18 Chapter 4 provides detail on the Tax Office's processes for managing collectable debt. It outlines the processes in a chronological order from before a debt becomes due and payable through to the possible bankruptcy or liquidation of a taxpayer.

1.19 Chapter 5 outlines the views expressed on the Tax Office's main debt collection policy document, the *ATO receivables policy*.

1.20 Chapter 6 outlines the views expressed on the Tax Office's small business debt collection practices generally. These views overlap to some extent with those expressed in the later chapters.

1.21 The remaining chapters outline the views expressed on specific aspects of the Tax Office's small business debt collection practices. Chapter 7, 8, 9, and 10 outline the views on payment arrangements, legal action to recover tax debts, compromise of tax debts and release from tax liabilities, respectively. Chapter 7 also discusses the 'small business debt initiative' announced by the Tax Office.

CHAPTER 2: ESSENTIAL BACKGROUND

INTRODUCTION

2.1 This chapter provides essential background for this review by defining terms, examining the proportion and make-up of the small business sector's collectable debt and outlining the general environment in which small businesses operate.

BACKGROUND

Definition of 'small business'

2.2 The Inspector-General was told that there are as many as 39 different legislative definitions of the term 'small business'.

2.3 Tax practitioner bodies define the term on the basis of the number of employees – for example, in its small business survey CPA Australia defines 'small business' to mean an 'independently-owned and operated business employing fewer than 20 people'.¹

2.4 The standard Australian Bureau of Statistics small business definition generally refers to management units with fewer than 20 employees in all industries except those in the manufacturing industry where they have fewer than 100 employees, and the agricultural industry where they have an estimated value of agricultural operations of between \$22,500 and \$400,000. This definition was also used by the Small Business Deregulation Task Force. The Australian Bureau of Statistics states that in June 2003 there were about 1.2 million small businesses in Australia.² Its data for June 2004 is not available.

2.5 The Australian Bureau of Statistics has also defined small businesses as tax-paying legal entities that operated as trading businesses for at least some time during the financial year and whose total income or expenses were \$10,000 or more, up to a limit of \$5 million.³

2.6 Based on experimental estimates, and using information sourced from the Tax Office, the Australian Bureau of Statistics reported that from 1995-96 to 2000-01 the number of small businesses grew by 3.4 per cent to 1,505,924. Over the same period the increase in total income for small business was 18 per cent, expenditure 18.6 per cent (including wages 29.9 per cent) and profit 13.4 per cent. The average income for small business increased by 14.1 per cent to \$279,270 while average expenses rose 14.7 per cent to \$247,292.⁴

1 CPA Australia, *Small Business Survey Program: Perceptions of Risk*, August 2002, p. 4.

2 Australian Bureau of Statistics, *8127.0 Characteristics of Small Business*, Canberra, April 2004.

3 See Australian Bureau of Statistics, *5675.0 Experimental Estimates, Regional Small Business Statistics*, Australia, Canberra, November 2002, <http://www.abs.gov.au/Ausstats/abs@.nsf/0/c3067c5b705852aaca256e2d00774702>?Open viewed on 16 September 2004.

4 Australian Bureau of Statistics, *5675.0 Experimental Estimates, Regional Small Business Statistics*, Explanatory Notes, Australia, Canberra, February 2004, <http://www.abs.gov.au/Ausstats/abs@.nsf/Lookup/792214F6E8471B03CA256C6FF0077052A> viewed on 8 October 2004.

2.7 For the purposes of this review, the Inspector-General defined 'small businesses' as those businesses with an annual turnover of under approximately \$10 million. This turnover threshold ensures that this review takes into account a very broad base of business taxpayers.

2.8 The Tax Office does not report separately on tax-paying entities with an annual turnover of less than \$10 million. However, within this category would be included businesses classified by the Tax Office as micro-businesses, which are business taxpayers with an annual turnover of less than \$2 million, and small to medium enterprises (SMEs), which are those business taxpayers that have an annual turnover of between \$2 million and \$100 million. The Tax Office has stated that over 85 per cent of the SMEs have a turnover of less than \$10 million, use simple business structures and are typically a single entity.

2.9 The Tax Office states that there were 2.5 million micro-businesses as at 30 June 2003. As at 30 June 2004, there were 2.3 million. The Tax Office reports that these micro-businesses make up 96 per cent of all businesses registered in the revenue system. Micro-businesses also incorporate 300,000 small superannuation funds, the majority of which are self-managed funds. Most micro-businesses are sole traders or family businesses. Most are operated from home. Most have an annual turnover of less than \$200,000.

2.10 For the purposes of identifying the number of micro-businesses reported in the *Compliance Program 2004-05* the Tax Office states that these numbers are sourced from its tax return database for the year ended 30 June 2002.

2.11 The Tax Office advises that this database is based on the lodgment of income tax returns. For example, the Tax Office indicates that where a partnership return is lodged and the partnership has two partners who each lodge an income tax return, three records are counted on the database. Likewise, if a trust return is lodged and each of the five beneficiaries lodge individual income tax returns, six records are counted on the database. On the other hand, where a trust income tax return is lodged and the trustee is assessed and the beneficiaries do not lodge returns, only the one record is counted, that being the trust return.

2.12 For the micro-business segment, the Tax Office reports that there were 3,500,975 taxpayers who completed the business income label in the income tax return. Of that number, 87,999 returned no business income, 1,082,756 returned 'passive' business income and 2,330,220 returned 'active' business income. The Tax Office defines a 'passive' business income taxpayer as an individual whose only business income is a distribution from a partnership or trust of business income with the remainder being considered as 'active'.

2.13 The Tax Office advises that the 2.3 million micro-businesses referred to in the *Compliance Program 2004-05*, relates only to those taxpayers who derived 'active' business income. Table 2.1 sets out the entity types for these 2.3 million micro-business taxpayers.

Table 2.1: Entity types within micro-business segment based on tax return database figures

Entity type	Number
Company	617,710
Individual	874,644
Partnership	413,657
Superannuation fund	222,852
Trust	201,357
Total	2,330,220

Source: Tax Office

2.14 Given that the 2.3 million figure reported by the Tax Office as the number of micro-businesses excludes individuals whose only business income is a distribution from a partnership or a trust of business income, it suggests that the 874,644 individuals reported in Table 2.1 are likely to be operating as sole traders or contractors.

2.15 The Tax Office states that there are approximately 82,000 SMEs (consisting of 108,000 business entities). Based on Tax Office information, this would mean that, as at 30 June 2004, there were approximately 69,000 SMEs (consisting of 91,000 business entities) that have a turnover of less than \$10 million. Aggregated Tax Office figures suggest that, as at 30 June 2004, there were approximately 2.4 million small businesses that had a turnover of less than \$10 million.

2.16 For the purposes of identifying the number of SMEs reported in the *Compliance Program 2004-05* the Tax Office states that these numbers are not sourced from the tax return database. Rather, this is determined by starting with the number of active entities which are classified as SMEs and then adjusting for grouped entities. The Tax Office advised that an 'active' entity does not mean that the entity is deriving active business income but rather that client activity is reported to the Tax Office.

2.17 Table 2.2 provides a reconciliation of the number of SME entities reported in the *Compliance Program 2004-05* on the basis of client activity.

Table 2.2: Entity types within SME segment based on client activity

Entity type	Number
Company	73,371
Individual	23,486
Partnership	9,845
Superannuation fund	3,202
Trust	712
Sub-total	110,616
Less grouped entities	39,053
Plus number of groups	11,133
Total of SMEs	82,696

Source: Tax Office

2.18 The Tax Office also advises that when using numbers sourced from its tax return database, it arrives to a similar figure to that reported in the *Compliance Program 2004-05*.

Table 2.3 sets out the entity type for SME taxpayers for both the 2002 and 2003 income years using tax return information.

Table 2.3: Entity types within SME segment based on tax return database figures

Entity type	2002	2003
Company	58,499	56,228
Individual	2,051	2,173
Partnership	6,204	6,286
Superannuation fund	786	726
Trust	16,879	16,959
Total	84,419	82,372

Source: Tax Office

2.19 The Tax Office publication *Taxation Statistics 2001-02* reports that based on 2002 annual income tax returns there were a total of 1.7 million taxpayers that were classified as a company, partnership, trust or superannuation fund. However, included in this figure would be entities that have an annual turnover of greater than \$10 million.

2.20 In trying to develop a clearer understanding of the characteristics of a small business from an entity perspective, these numbers must be treated with some caution.

2.21 First, a business may involve more than one entity, for example, a business may operate through a trading trust with a corporate trustee and also have a self managed superannuation fund as part of its business structure. A micro-business may also include dependent contractor arrangements. The figures provided by the Tax Office may include other entities closely related to the small business deriving active income—such as other companies, trusts, partnerships and dependent contractors—notwithstanding that these closely related entities are part of the one economic unit.

2.22 Second, these figures may also include entities closely related to, or a part of, businesses with annual turnovers of more than \$10 million—such as partners of large firms where they derive 'active' income from another source.

2.23 Although the issue may seem academic, it does mean that the Tax Office's figures will also include other entities that are not the focus of this review.

Review focus on collectable debt

2.24 This review focused on collectable debt owed by small businesses to the Tax Office. Collectable debt is that component of tax debt with no legal impediment to recovery. It does not include debt arising from a liability that is disputed. Disputed debt generally means outstanding tax for which taxpayers have lodged an objection to their assessment or an appeal to the Administrative Appeals Tribunal or a court.

2.25 Many representations were made to the Inspector-General in relation to the Tax Office's manner of collecting disputed debt. In the Inspector-General's view, this concern is another potential systemic tax administration issue that may be one he chooses to review in the future.

Focus on fairness not efficiency

2.26 The Inspector-General's review is focused on the fairness of the debt collection policies and practices. It is not focused on the efficiency or effectiveness of those policies and practices. Issues of efficiency and effectiveness are matters which the Inspector-General considers are more appropriate considered by Tax Office management and other bodies.

2.27 However issues of efficiency, effectiveness and fairness overlap. Submissions raised issues of efficiency and effectiveness that also had a direct impact on the fairness of the policies and practices. Therefore, these issues have been canvassed but only to the extent that they impact on fairness.

Amount and proportion of small business collectable debt

Primary sources of debt figures

2.28 The primary sources for the debt figures used in this document are the Tax Office's June 2004 Operations, *Debt and Lodgment Debt Report* prepared as an internal Operations Business Line document, the Commissioner of Taxation's *Annual Report 2003-04* and material provided in mid-September 2004 specifically requested in relation to higher debt level cases. In addition, information was sourced from longitudinal analysis developed by the Tax Office for the purposes of their ongoing analysis only and not intended by the Tax Office for reporting purposes.

2.29 Some figures provided by the Tax Office have been adjusted to reflect the definition of "small business" used for the purposes of this report. These adjustments are made on the basis that 85 per cent of businesses within the SME segment have an annual turnover of less than \$10 million. Adjustments are as at 30 June 2004 and these adjusted figures are included throughout the report.

As at 30 June 2002

2.30 The Commissioner of Taxation reported that the Tax Office collected a total of \$168 billion in taxes, including the goods and services tax (GST) and excise, in the 2001-02 income year.

2.31 As at 30 June 2002, the value of debt on hand was \$13.89 billion, an increase of 35.6 per cent on the previous income year. Of this amount, \$5.49 billion was collectable debt with a reported 1.168 million cases on hand. Cases on hand are taken to represent the number of taxpayers including entities that have a collectable debt owed to the Tax Office.

2.32 Collectable debt increased by 51 per cent, or \$1.8 billion, on the previous year, with a 68 per cent increase in the number of collectable debt cases on hand.

As at 30 June 2003

2.33 The Commissioner of Taxation reported that the Tax Office collected a total of \$185 billion in taxes, including the GST and excise, in the 2002-03 income year.

2.34 As at 30 June 2003, \$17.21 billion remained outstanding of which \$6.9 billion was collectable debt owed by 1.285 million taxpayers. Seven billion dollars is one per cent of Australia's gross domestic product and 4 per cent of the Commonwealth's total revenue.

2.35 The Commissioner reported that the \$6.9 billion of collectable debt had increased from the previous year by 25 per cent. The Tax Office states that this increase was due to an increased liability raised through lodged activity statements. However, during this same period there was only a 9.9 per cent increase in the number of collectable debt cases on hand.

2.36 Of this \$6.9 billion figure, the Tax Office reported that approximately 810,000 small businesses owed approximately \$5.5 billion, or about 80 per cent, of that overall collectable debt. Approximately 500,000 small businesses owed less than \$25,000 with approximately 140,000 small businesses owing less than \$100. As at 31 January 2004, 62 per cent of the small business debt cases involved less than \$2500 of collectable debt.

2.37 In 2003, although the small business sector owed about 80 per cent of the overall collectable debt it only contributed 10 per cent of the total Commonwealth revenue and remitted 16 per cent of all employees' Pay As You Go and superannuation withholdings.

As at 30 June 2004

2.38 The Commissioner of Taxation reported that the Tax Office collected a total of \$198 billion in taxes, including the GST and excise, in the 2003-04 income year.

2.39 The Commissioner's annual report states that as at June 2004, \$16.93 billion remained outstanding of which \$7.53 billion was collectable debt. This collectable debt is owed by 1.395 million taxpayers.

2.40 The Tax Office provided the Inspector-General with a break-up of 2003-04 debt figures for the 2003-04 income year which stated that 1.395 million taxpayers owed \$8.343 billion in collectable debt as at June 2004.

2.41 There is some discrepancy, totalling \$813 million or 11% of the total adjusted collectable debt amount, between the debt figures the Commissioner has reported in his 2003-04 annual report and the debt figures the Tax Office provided to the Inspector-General during the course of this review.

2.42 In respect to this discrepancy the Commissioner's annual report states that the collectable debt figures have been adjusted to reflect account posting corrections.⁵ The Tax Office advises that:

... adjustments account for components of debt that report as collectable but due to timing or other issues have not had the appropriate actions undertaken as yet (e.g. 'dispute' indicator not input). Given the manual nature of the adjustment process it is only undertaken by the Tax Office at the overall level, not at segment level.

2.43 There was also some discrepancy in the number of collectable debt cases on hand as at 30 June 2004. The figure provided to the Inspector-General of 1.395 million taxpayers includes approximately 175,000 cases that had nil or credit balances and therefore no collectable debt.

⁵ The Tax Office has stated that collectable debt amounts provided to the Inspector-General, which have been used for the purposes of this analysis and discussion, are 'unadjusted' and will differ from overall debt on hand.

2.44 It is not clear whether the collectable debt figures and number of taxpayers used in the Commissioner's previous annual reports have also included taxpayers with nil or credit balances.

2.45 The following, unless otherwise noted, is based on the break-up of figures provided by the Tax Office; collectable debt of \$8.343 billion (unadjusted) owed by 1.224 million taxpayers.

2.46 On the basis of the break-up provided by the Tax Office, the overall collectable debt rose to \$7.53 billion (adjusted), or \$8.343 billion (unadjusted), with 1.224 million cases. On adjusted figures, this represents a 9 per cent increase in collectable debt on the previous year. On unadjusted figures (\$7.59 billion in 2002-03) this marks a 10 per cent increase in collectable debt on the previous year. However, during this period there was a 4.7 per cent decrease in the number of collectable cases on hand.

2.47 The Tax Office reports that approximately 838,000 small businesses owe approximately \$6.69 billion.⁶

2.48 Of this total, approximately 787,342 small business collectable debt cases, or 94 per cent of the total small business collectable debt cases, owe less than \$25,000, approximately 505,537 cases owe less than \$2500 (60 per cent) and about 147,152 cases (17 per cent) owe less than \$100.

2.49 Table 2.4 shows the overall debt collection results for the past six years. It indicates an upward trend in the collectable debt on hand over the past six years. It also indicates that the total number of collectable debt cases has continued to steadily increase. The value of cases on hand appears to have eased.

Table 2.4: Debt collection results, 1998-99 to 2003-04

	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04
Value of cases on hand at 30 June (\$ billion)	7.37	8.55	10.24	13.89	17.21	16.93
Collectable debt on hand at 30 June (\$ billion)	2.81	3.07	3.58	5.49	6.9 (7.59) ^(a)	7.53 (8.34) ^(a)
Number of collectable debt cases on hand at 30 June	332,309	502,921	694,091	1,168,726	1,285,283	1,395,491 (1,224,232) ^(b)

Source: Commissioner of Taxation Annual Reports 2001-02 and 2002-03 and 2003-04. These figures have been adjusted to reflect 'account posting corrections'.

(a) This figure represents the unadjusted collectable debt amount on hand at 30 June.

(b) This number of cases represents the unadjusted debt cases and excludes those cases that have nil or credit balances.

2.50 Table 2.5 summarises the collection of debt as a percentage of total collections. It indicates an upward trend in the collectable debt on hand as a percentage of total collections over the past six years.

⁶ Note that this figure assumes that 85 per cent of businesses within the SME segment have an annual turnover of less than \$10 million, as reported in the Tax Office's *Compliance Program 2004-05*, at p. 18.

Table 2.5: Collectable debt compared with total collections, 1998-99 to 2003-04

	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04
Collectable debt on hand at 30 June (\$ billion)	2.81	3.07	3.58	5.49	6.9	7.53 (8.34) ^(a)
Total collections (\$ billion)	122.52	151.31	165.8	168.8	185.04	198.63
Collectable debt on hand/total collections (%)	2.05	2.03	2.16	3.25	3.74	3.79 (4.2) ^(b)

Source: Commissioner of Taxation Annual Reports 2001-02 and 2002-03.

(a) This \$8.34 billion figure represents the unadjusted collectable debt amount on hand at 30 June 2004.

(b) This figure represents the unadjusted collectable debt on hand as a percentage of total collections for the 2003-04 income year.

2.51 In respect to the amount of collectable debt on hand reported in the Commissioner of Taxation's annual reports for 2001-02 and 2002-03, the Tax Office states that collectable debt has been adjusted to 'reflect account posting corrections' and 'accounting modifications and extraordinary collection factors that increased the level of collectable debt reported'. The Tax Office further states that the adjustment allows for a direct historical comparison with the percentage of collectable debt to total debt for previous years.

Nature of the collectable debt

Background

2.52 As at 30 June 2004, \$8.343 billion of unadjusted collectable debt remained outstanding with a total of 1.224 million cases.⁷

2.53 Of the \$8.343 billion of collectable debt, \$4.866 billion related to debt level 4 (cases with \$25,000-\$49,999 outstanding), debt level 5 (\$50,000-\$99,999 outstanding) and debt level 6 (\$100,000 or more outstanding) amounts. By value, this represents 58.32 per cent of the total collectable debt and, by cases, 4.76 per cent of total collectable debt cases.

2.54 As at 13 September 2004, the Tax Office reports that \$3.936 billion of collectable debt classified as debt level 4, 5 or 6 amounts was owed by businesses with an annual turnover of less than \$10 million. This amount includes activity statement, income tax and superannuation debt.

2.55 The Tax Office was not able to produce a break-up of the total collectable debt for debt level 4, 5 and 6 amounts into the value of primary tax, interest and penalty amounts. This is because:

The Tax Office's accounting system operates on a running account balance account. Liabilities are posted and credits (payments) are applied to the balance of the account rather than matched to individual liabilities. Categories of primary tax, interest and penalty amounts cannot be readily identified.

2.56 The Tax Office was also not able to provide the total value of collectable debt trends for debt level 4, 5 and 6 amounts over the last 12 months:

[The Tax Office is] unable to present this information where it has not been gathered over time. This is because the data in [the Tax Office's] data warehouse is regularly refreshed.

⁷ Cases on hand are taken to represent the number of taxpayers including entities that have a collectable debt owed to the Tax Office.

2.57 Table 2.6 provides a summary of the small business collectable debt by debt levels.

Table 2.6: Small business collectable debt by debt levels

	Value (\$m)	% of total collectable debt	Cases ^(a)	% of total collectable cases
Total collectable debt	8,343	100	1,224,232	100.00
Total small business collectable debt	6,694	80.23	838,155	68.46
Total micro collectable debt	5,725	68.62	818,685	66.87
Total SME collectable debt	1,141 (970) ^(b)	13.68 (11.62)	22,906 (19,470)	1.87 (1.59)
Total debt level 4-6 collectable debt	4,866	58.32	58,242	4.76
Total small business debt level 4-6 collectable debt	4,002	47.97	50,812	4.15
Micro debt level 4-6 collectable debt	3,088	37.01	45,211	3.69
SME segment debt level 4-6 collectable debt	1,075 (914) ^(b)	12.88 (10.95)	6,590 (5,601)	0.54 (0.46)

Source: Tax Office. Information provided by the Tax Office as at 30 June 2004.

(a) Case numbers exclude credit/zero balance cases.

(b) Figures in parentheses represent proportion of SMEs with an annual turnover of between \$2 million and \$10 million and have been calculated as 85 per cent of \$2 million to \$100 million entities.

2.58 Table 2.7 provides a summary of the small business collectable debt by revenue type

Table 2.7: Small business collectable debt by revenue type

		Value (\$m)	% of total collectable debt	Cases ^(a)	% of total collectable debt cases
Total collectable debt(b)	Total for all segments	8,343	100	1,224,232	100
	Total activity statement	4,415	52.90	633,551	51.75
	Total income tax	3,187	38.20	531,739	43.40
Micro-business segment (<2 million annual turnover)	Total micro	5,725	68.62	818,685	66.87
	Micro activity statement	3,255	39.01	582,276 ^(c)	41.64
	Micro activity statement debt levels 4-6 ^(d)	2,095	25.11	37,265	3.04
	Micro income tax	1,967	23.58	304,268 ^(c)	21.76
	Micro income tax debt levels 4-6 ^(d)	966	11.58	11,034	0.90
	Total SME	970	11.62	19,470	1.59
SME segment (\$2 million-\$10 million annual turnover)*	SME activity statement	653	7.82	16,384 ^(c)	1.17
	SME activity statement debt levels 4-6 (d)	611	7.33	5,018	0.41
	SME income tax	192	2.31	4,679 ^(c)	0.33
	SME income tax debt levels 4-6	121	1.45	812	0.07

Source: Tax Office

(a) Unless specifically mentioned, case numbers exclude zero/credit balance cases.

(b) Information current as at 30 June 2004.

(c) Case numbers include zero/credit balance.

(d) Information current as at 13 September 2004. Percentages calculated using figures from different periods of time.

* Total SME figures are calculated as 85 per cent of the \$2 million to \$100 million annual turnover entities.

Age of collectable debt

Income tax collectable debt

2.59 As at 13 September 2004, the Tax Office reports that for small business, \$666.74 million of income tax collectable debt, classified as debt level 4, 5 or 6 amounts, was outstanding for a period greater than 12 months. This represents 61.3 per cent of the total income tax collectable debt classified by the Tax Office as debt level 4, 5 or 6 amounts, which totalled \$1.087 billion.

2.60 Table 2.8 provides a break-up of the income tax collectable debt within debt levels 4, 5 and 6 as at 13 September 2004.

Table 2.8: Small business income tax collectable debt levels 4, 5 and 6 by age of debt

Income Tax Collectable debt	Debt Level 4 (\$m)	Cases	Debt Level 5 (\$m)	Cases	Debt Level 6 (\$m)	Cases
Less than 1 month	9.88	282	9.23	131	23.05	87
Between 1 and 2 months	14.90	437	15.12	221	31.21	118
Between 2 and 3 months	11.82	353	8.37	119	30.68	73
Between 3 and 6 months	43.95	1294	28.41	418	66.04	272
Between 6 and 12 months	18.42	529	14.25	204	95.39	194
Greater than 12 months	149.04	4401	106.02	1553	411.68	1160
Total	248.01	7296	181.40	2646	658.05	1904

Source: Tax Office

2.61 The Tax Office indicates that the above figures may not accurately represent the amount of time a collectable primary tax debt has remained outstanding:

Income tax debt is aged by case based on time when a debt first established. Small amounts of General Interest Charge often remain on the account. This impacts the accuracy of the age profile. Amounts in dispute that subsequently become collectable also add to the overall age of debt holdings.

2.62 However, the Tax Office did not provide the Inspector-General with any further information as to the impact that these factors have on the age profile of income tax collectable debt or provide any other age profiling of debt undertaken by the Tax Office.

Integrated instalment account (or activity statement) collectable debt

2.63 As at 13 September 2004, the Tax Office reports that for small business, \$1.603 billion of activity statement collectable debt, classified as debt level 4, 5 or 6 amounts, was outstanding for a period greater than 12 months. This represents 59.2 per cent of the total activity statement collectable debt classified by the Tax Office as debt level 4, 5 or 6 amounts, which totalled \$2.707 billion.

2.64 Table 2.9 provides a break-up of the activity statement collectable debt within debt levels 4, 5 and 6 as at 13 September 2004.

Table 2.9: Small business activity statement collectable debt levels 4, 5 and 6 by age of debt

Activity Statement Collectable debt	Debt Level 4 (\$m)	Debt Level 5 (\$m)	Debt Level 6 (\$m)
Less than 1 month	50.71	43.30	95.08
Between 1 and 2 months	22.77	22.10	45.56
Between 2 and 3 months	21.61	21.04	35.83
Between 3 and 6 months	108.90	92.11	136.28
Between 6 and 12 months	119.40	112.50	176.97
Greater than 12 months	592.69	437.63	573.06
Total	916.08	728.68	1062.78

Source: Tax Office

Revenue type

2.65 Of the \$8.343 billion in outstanding collectable debt, the Tax Office reports that \$4.415 billion related to activity statement collectable debt while \$3.187 billion related to income tax collectable debt.

2.66 Integrated instalment account debt includes the GST, Pay As You Go withholding and Pay AS You Go instalment amounts but excludes fringe benefits tax (FBT) and superannuation-related debts.

2.67 Table 2.10 shows the total collectable debt levels 4, 5 and 6 for businesses with annual turnovers of less than \$10 million by revenue type as at 13 September 2004.

Table 2.10: Small business collectable debt levels 4, 5 and 6 by revenue type

Revenue type	Debt Level 4 (\$m)	% of all revenue types	Debt Level 5 (\$m)	% of all revenue types	Debt Level 6 (\$m)	% of all revenue types
Income tax	248.01	20.5	181.39	19.2	658.05	37.0
Integrated instalment account	916.08	75.5	728.68	77.0	1062.79	59.8
Superannuation surcharge	11.57	1.0	8.25	0.9	18.25	1.0
Superannuation Guarantee	37.06	3.0	27.32	2.9	38.63	2.2
Total	1212.72	100.0	945.64	100.0	1777.72	100.0

Source: Tax Office

Income tax collectable debt

2.68 As at 30 June 2004, \$3.187 billion of collectable debt classified as income tax remained outstanding with a total of 531,739 cases. By value, this represents 38.2 per cent of the total collectable debt and, by cases, 43.4 per cent of all collectable debt cases.

2.69 As at 13 September 2004, the Tax Office reports that \$1.087 billion of income tax collectable debt relating to debt level 4, 5 and 6 amounts was owed by businesses with an annual turnover of less than \$10 million. This \$1.087 billion is owed by 11,846 cases.

2.70 The Tax Office is not able to provide a break-up of the income tax collectable debt, for debt level 4, 5 and 6 amounts, into the value of primary tax, interest and penalty amounts or trends for those debts over the last 12 months. It provides the same reasons as for its inability to provide similar break-ups and trends for the total collectable debt amounts.

Integrated instalment account (or activity statement) collectable debt

2.71 As at 30 June 2004, \$4.415 billion of integrated instalment account collectable debt remained outstanding with a total of 633,551 cases. By value, this represents 52.9 per cent of the total collectable debt and, by cases, 51.8 per cent of all collectable debt cases.

2.72 As at 13 September 2004, the Tax Office reports that \$2.707 billion of activity statement collectable debt classified as debt level 4, 5 or 6 amounts was owed by businesses with an annual turnover of less than \$10 million. This \$2.207 billion is owed by 42,283 cases.

2.73 As for income tax collectable debt and the total collectable debt, the Tax Office is not able to provide a break-up of the activity statement collectable debt, for debt level 4, 5 and 6 amounts, into the value of primary tax, interest and penalty amounts or trends for those debts over the last 12 months.

2.74 By value, 91.1 per cent of all integrated instalment account (activity statement) collectable debt is within the micro-business and SME segments, with \$3.255 billion and \$768 million respectively out of a total of \$4.415 billion in integrated instalment account collectable debt. These represent 48.22 per cent of all collectable debt.

2.75 Information provided by the Tax Office also indicates an upward trend for outstanding integrated instalment account debt within both the micro-business and SME segments for the July 2003 to June 2004 period.

2.76 By cases, 85.41 per cent of all integrated instalment account cases are within the micro-business and SME segments, with 582,276 cases and 19,276 cases respectively out of a total of 704,367 integrated instalment account cases. These represent 43.02 per cent of the total number of collectable debt cases.

Micro-business segment

Background

2.77 As at 30 June 2004, \$5.724 billion of collectable debt remained outstanding within the micro-business segment.

2.78 Of that, \$3.088 billion was classified as debt level 4 (\$1.017 billion), debt level 5 (\$0.704 billion) or debt level 6 (\$1.367 billion) amounts. This represents 53.94 per cent of the micro-business segment collectable debt or 37.01 per cent of the total collectable debt.

2.79 Within debt level 6, as at 13 September 2004, there were 97 cases where a micro-business had a collectable debt greater than \$1 million, totalling \$251.07 million. There were also 4932 cases with a collectable debt between \$100,000 and \$499,999, totalling \$855.82 million, and 170 cases with a collectable debt between \$500,000 and \$999,999, totalling \$114.73 million.

2.80 As at 30 June 2004, the number of cases relating to the debt level 4, 5 and 6 amounts totalled 45,211, which represented 5.52 per cent of the micro-segment cases and 3.69 per cent of the total collectable debt cases.

By revenue type

2.81 Income tax debts and integrated instalment account debts comprise 91.22 per cent of the collectable debt within the micro-business segment and represent 94.99 per cent of the micro-business segment cases.

2.82 Within the micro-business segment, 56.86 per cent of the collectable debt (\$3.255 billion) was characterised by the Tax Office as integrated instalment account debt. This amount also represents 39.01 per cent of the total collectable debt.

2.83 By cases, 62.39 per cent of cases within the micro-business segment (582,276 cases) were classified by the Tax Office as integrated instalment account cases. These represent 41.64 per cent of the total number of collectable debt cases.

2.84 Integrated instalment account debt includes GST and Pay As You Go withholding amounts. Tax Office longitudinal analysis of additional debt cases for February 2004 indicates that for the micro-business segment, 72.04 per cent of additional integrated instalment account debt comprised of Pay As You Go withholding while 22.17 per cent related to GST.

2.85 Table 2.11 shows the micro-business segment collectable debt levels 4, 5 and 6 by revenue type as at 13 September 2004.

Table 2.11: Micro-business collectable debt levels 4, 5 and 6 by revenue type

Revenue type	Debt Level 4 (\$m)	% of all revenue types	Debt Level 5 (\$m)	% of all revenue types	Debt Level 6 (\$m)	% of all revenue types
Income tax	235.02	20.7	167.28	20.8	563.84	46.2
Integrated instalment account	854.62	75.4	611.60	75.8	629.58	51.5
Superannuation surcharge	10.73	1.0	6.7	0.8	9.84	0.8
Superannuation Guarantee	32.90	2.9	21.01	2.6	18.36	1.5
Total	1133.27	100	806.59	100	1221.62	100

Source: Tax Office

2.86 Within the micro-business segment, 64.4 per cent of the total integrated instalment account debt (\$2.095 billion) related to debt level 4, 5 and 6 amounts. Of that amount, approximately 74.3 per cent of the debt level 4, 5 and 6 cases related to integrated instalment account debt. Overall, these debt level 4, 5 and 6 cases represent 6.4 per cent of all integrated instalment account debt cases (37,265 cases out of 582,276).

2.87 Information provided by the Tax Office indicates an upward trend for outstanding integrated instalment account debt within the micro-segment for the July 2003 to June 2004 period. In particular, debt level 4, 5 and 6 activity statement collectable debt within the micro-segment all showed an upward trend for the July 2003 to June 2004 period.

2.88 The Tax Office states that it has identified additional debt as an area of concern, with a need to identify strategies to manage additional debt cases. In its latest longitudinal analysis study, it estimates an average of 39.5 per cent of cases will be finalised with 60.5 per cent of additional debt cases becoming bad or doubtful.

2.89 The Tax Office's *Longitudinal Study - New and Additional Debt 2003-04* indicates that 775,885 additional debt cases, which totalled \$15.4 billion, were referred for collection. Of this total, 606,268 cases related to micro-business, with a value of \$8.8 billion.

2.90 The Tax Office's longitudinal study estimates that an average of 41.5 per cent of additional debt cases within the micro-business segment were finalised within 12 months. The Tax Office's study observed that this was the lowest finalisation rate of additional debt cases across all segments.

2.91 With respect to new debt cases, the Tax Office's longitudinal study estimates that 76.1 per cent of new debt cases within the micro-business segment finalised within 12 months. The Tax Office's study observed that this was the lowest finalisation rate of new debt cases across all segments.

Small to medium enterprise (SME) segment

Background

2.92 As at 30 June 2004, \$1.141 billion of collectable debt remained outstanding within the SME segment.

2.93 Of that, \$1.075 billion related to debt level 4 (\$83 million), debt level 5 (\$136 million) and debt level 6 (\$856 million) amounts. This represents 94.22 per cent of the SME segment debt or 12.88 per cent of the total collectable debt.

2.94 As at 30 June 2004, approximately 6,590 cases related to debt level 4, 5 and 6 amounts. This represented 28.77 per cent of the SME segment cases and 0.54 per cent of the total collectable debt cases.

By revenue type

2.95 As at 30 June 2004, income tax debts and integrated instalment account debts comprised 87.12 per cent of the collectable debt within the SME segment and represented 84.49 per cent of the SME segment cases.

2.96 Within the SME segment, 67.27 per cent of the collectable debt (\$768 million) was characterised by the Tax Office as integrated instalment account debt. This amount also represents 9.21 per cent of the total collectable debt.

2.97 By cases, 65.72 per cent of cases within the SME segment (19,273 cases) were classified by the Tax Office as integrated instalment account cases. These represent 1.38 per cent of the total number of collectable debt cases.

2.98 Tax Office analysis of new debt cases for February 2004 indicates that for the SME segment, 67.33 per cent of new integrated instalment account debt comprised of Pay As You Go withholding while 31.64 per cent related to GST.

2.99 Within the SME segment, 79.65 per cent of the total integrated instalment account debt (\$611.74 million) was classified as debt level 4, 5 or 6 amounts.

2.100 Table 2.12 shows the SME segment collectable debt levels 4, 5 and 6 by revenue type as at 13 September 2004.

Table 2.12: SME segment collectable debt levels 4, 5 and 6 by revenue type

	Debt Level 4 (\$m)	% of all revenue types	Debt Level 5 (\$m)	% of all revenue types	Debt Level 6 (\$m)	% of all revenue types
Revenue type						
Income tax	13.00	16.4	14.12	10.2	94.21	17.0
Integrated instalment account	61.45	77.3	117.08	84.2	433.21	77.9
Superannuation surcharge	0.84	1.1	1.55	1.1	8.42	1.5
Superannuation Guarantee	4.16	5.2	6.30	4.5	20.26	3.6
Total	79.45	100.0	139.05	100.0	556.10	100.0

Source: Tax Office

2.101 Approximately 80.68 per cent of the debt level 4, 5 and 6 cases related to integrated instalment account debt. Overall, these cases represent 8.72 per cent of all SME segment integrated instalment account debt cases (1680 cases out of 19,276).

2.102 Information provided by the Tax Office indicates an upward trend for outstanding integrated instalment account debt within the SME segment for the July 2003 to June 2004 period. In particular, debt level 4, 5 and 6 activity statement collectable debt within the SME segment all showed an upward trend for the July 2003 to June 2004 period.

2.103 As previously discussed, the Tax Office has stated that it has identified additional debt as an area of concern with a need to identify strategies to manage additional debt cases.

2.104 The Tax Office's *Longitudinal Study - New and Additional Debt 2003-04* indicates that 34,116 additional debt cases relating to SMEs, with a value of \$3.2 billion, were referred for collection.

2.105 The Tax Office's longitudinal study estimates that an average of 59.6 per cent of additional debt cases within the SME segment were finalised within 12 months.

2.106 With respect to new debt cases, the Tax Office's longitudinal study estimates that 86.1 per cent of new debt cases within the SME segment finalised within 12 months.

Small business environment

2.107 During the course of the review, submissions drew attention to a number of factors that, in the opinion of the authors of the submissions, influence the small business sector's compliance with tax payment obligations. Generally, these factors can be said to be inherent to running a small business. Submissions indicate that these factors are more pronounced in businesses that have an outstanding tax debt. Submissions are of the view that these factors are:

- difficulties with cash flow management;
- limited access to finance;
- dealing with big business;
- competition with non-compliant businesses; and
- the regulatory burden on small businesses.

Difficulties with cash flow management

Cash flow a major concern

2.108 Without sufficient cash flow a business is unable to meet debts when due and payable and may technically be trading while insolvent.

2.109 In submissions, small business representatives and tax practitioners commented that difficulty with cash flow was one of the primary factors affecting payment of tax liabilities. The February 2004 Sensis Business Index reports that, behind finding quality staff and lack of work/sales, cash flow is the third most important concern for small and medium businesses.⁸

Factors affecting cash flow

2.110 The factors which adversely affect a small business's cash flow range from those outside a business's control—such as, increasing unemployment, an economic downturn or collapse of a key supplier or client⁹—to those entirely within a business's control, such as business decisions and lack of sufficient financial competence.

2.111 Tax practitioners also comment that the nature of a business may affect the cash flow cycle. For example, certain industries may generate larger cash flows during periods of increased demand—such as the retail sector during the lead-up to Christmas.

Provision for and awareness of tax debt

2.112 A feature of the current taxation system is that there is a delay between the business activity that accrues a future tax liability and the liability to pay the tax. For income tax debts this delay may be up to 25 months where a business derives profit at start of the financial year and is on a tax agent's income tax return lodgment program. Therefore, a business needs to be aware of the taxation liabilities that its activities accrue and make provision for future tax debts.

2.113 Tax practitioners indicate that small businesses are normally undercapitalised from the commencement of the business and lack the planning of larger businesses which have management tools such as business plans and regular reporting. The consequence of this is that small businesses often lack sufficient cash flow and find it difficult to borrow the funds required to enable continued trading or expansion.

2.114 Tax practitioners observe that despite using the tax withheld or collected from employees and sales as working capital, small businesses find it difficult to make provision for future tax debts. Generally, tax practitioners observe that small businesses micro-manage on a cash flow basis and make provision to meet liabilities on a 30 to 60 day basis. Examples provided indicate that rather than determining their tax liability on a periodic basis and putting money aside for that liability, small businesses generally try to find the money for a tax debt when they become aware of their tax liability. This awareness may be either when the business's income tax return or business activity statement is prepared, or the Tax Office amends or adjusts the business's previously lodged forms or statements. The observed result is generally that the business needs to find a larger amount of money in a shorter period of

8 Sensis, *Sensis® Business Index – small and medium enterprises*, February 2004, http://www.sensis.com.au/media/pdf/sensis_bizindex_feb2004.pdf viewed on 4 May 2004, p. 11.

9 See CPA Australia, *Small Business Survey Program: Perceptions of Risk*, August 2002, p. 5.

time where it waits until its income tax return or business activity statement is prepared before making provision for the tax liability.

2.115 Tax practitioners also state that despite advice to do so, many of their small business clients do not have separate accounts for tax liabilities and do not have management systems in place to determine their tax liability on a periodic basis. There are commercial products available that assist small businesses to identify their taxation liabilities and make provision for them. However, a survey of 3000 small businesses by MYOB found that 80 per cent of those small businesses did not have a separate account for their tax liabilities and only 54 per cent of those businesses were aware of the amount needed to pay their tax liability when their business activity statement was to be lodged.¹⁰

2.116 Tax practitioners state that the need to have management systems in place is even more important where the taxpayer is required to remit tax on behalf of others. This would include Pay As You Go amounts withheld from employee wages and GST amounts collected from sales. Tax practitioners argue that these amounts are effectively being held on trust by the small business and that there is a greater need to ensure that a small business does make provision for the payment of these amounts to the Tax Office.

2.117 Tax practitioners put forward a number of possible ways to ensure that a small business makes provision for their tax liabilities. Some suggest that it should be a requirement when starting up a small business to have a separate account for their tax liabilities. Others suggest that government needs to provide incentives to small business taxpayers, especially during the start-up period, to encourage them to make provision for their tax liabilities. This could be similar to the approach adopted in New Zealand and briefly discussed later in this document. However, tax practitioners state that together with the measures suggested above there is a real need for greater assistance to be provided to small business in managing their cash flow and understanding their responsibilities in business.

2.118 Even if a small business makes provision for future tax liabilities, in difficult financial circumstances, it may not have enough available cash to pay all creditors and may need to choose whom they will pay first and whom they will pay later. Where small businesses are required to choose between paying the Tax Office or a supplier, small businesses indicated that they were more likely to pay a supplier. Where suppliers were not paid, they could immediately stop supply of goods and services necessary for the continuing operation of a business. However, the time lag between non-payment of a tax debt and recovery action would not immediately affect the continuing operation of a business.

Access to finance

2.119 Small businesses and tax practitioners also generally state that small businesses are undercapitalised, highly geared and may have business borrowings using private assets as collateral. Small businesses argue that they are generally unable to borrow more money to pay tax debts as they have borrowed up to their credit limit in running their business.

2.120 Representatives of small businesses also state that small businesses have little capital that financial institutions will lend against. For example, the business's goodwill, chattels and fixtures may have a particular book value but not have a realisable value in the event of foreclosure.

¹⁰ 'Minnows struggling with cash', *Sydney Morning Herald*, 4 May 2004, p. 21.

Dealing with big business

2.121 One tax practitioner commented that the real reason for small business debts was the onerous terms and conditions that big businesses impose on small businesses and the minimal profit margins small businesses obtain in dealing with big businesses. They stated that small businesses must deal with big businesses to survive and that the law does not allow small businesses to contract with big business with equal bargaining power.

2.122 CPA Australia's 2002 survey of small businesses reports that a significant proportion of small businesses are not paid promptly by big business:

Forty per cent of small businesses say they wait more than 30 days for payment from large business customers.

CPAs say an average of 51 per cent of businesses are not paid promptly by big business and slow payment impacted either a great deal or a fair amount on 83 per cent of businesses.¹¹

2.123 Small businesses may obtain finance to bridge the period between paying a tax liability and receiving payment from clients. This borrowing will incur interest and add to the business's running costs. For those operating in an accrued accounting system, they may face the further burden of being required to pay their business activity statement before being paid by their business debtors.

Competition with non-compliant businesses

2.124 The Tax Office has observed that in some industries competition with non-compliant businesses may in fact influence businesses not to comply themselves. For example, suppliers may move away from businesses that endeavour to improve compliance with their taxation obligations.

2.125 Also, representatives for small businesses stated that non-compliant businesses have reduced operating costs and therefore are able to undercut compliant businesses' prices.

Regulatory burden

2.126 Small businesses have to comply with a variety of ongoing government regulatory obligations. These may include:

- Commonwealth requirements, such as industrial awards, corporate governance and taxes;
- State government requirements, such as environmental protection, payroll tax and worker insurance; and
- professional association obligations, such as professional indemnity insurance and continuing professional development.

2.127 Representatives for small businesses comment that the cumulative complexity of these different obligations creates a significant burden on small businesses. They state that this reduces the time and resources that small businesses could direct towards entrepreneurial activities. Third party surveys have concluded that compliance with taxation

11 CPA Australia, *Small Business Survey Program: Perceptions of Risk*, August 2002, pp. 5-6.

laws is one of the most costly regulatory burdens on small businesses.¹² The Inspector-General has identified the cost of complying with taxation obligations as a potential separate issue for review.

12 Small Business Deregulation Task Force, *Time For Business Report of the Small Business Deregulation Task Force*, November 1996; Senate Employment, Workplace Relations and Education Committee References Committee, *Small business employment*, February 2003; Chittenden, Kauser and Poutziouris, *Regulatory Burdens of Small Business: A Literary Review*, University of Manchester, 2002, p. 9; CPA, *Small business survey program: Compliance burden*, April 2003, p. 4; Senate Employment, Workplace Relations and Education Committee References Committee, *Small business employment*, February 2003, pp. 126-127 in quoting the WA Small Business Development Corporation; and OECD, *Businesses' views on red tape – administrative and regulatory Burdens on small and medium enterprises*, OECD, Paris, 2001, p. 21.

CHAPTER 3: OVERVIEW OF THE TAX OFFICE'S SMALL BUSINESS DEBT COLLECTION SYSTEM

INTRODUCTION

3.1 This chapter gives an overview of the Tax Office's debt collection system.

TAX OFFICE'S ROLE IN THE SYSTEM

3.2 The Tax Office is the main Commonwealth revenue collection agency. It collects over 90 per cent of the Government's revenue. Its principal role is to administer the taxation, superannuation and excise laws and address those broader issues affecting the revenue system.

3.3 The Tax Office finalised approximately 1.6 million debt cases—including debt cases not attributable to small businesses—for the 2002-03 income year.

3.4 The Tax Office states that it is an organisation that must operate unlike other debt recovery organisations. Firstly, it states that it is not a typical creditor and secondly, it has obligations that require it to depart from operating on a purely commercial basis.

Tax Office is not a typical creditor

3.5 Unlike other creditors, the Tax Office cannot choose not to deal with non-compliant debtors nor can it refuse to provide supplies to these debtors until they resolve their existing debts. This means that the Tax Office's debt collection policies and practices encompass a range and variety of taxpayers from those who are fully compliant to those who are deliberately avoiding detection or are avoiding payment of liabilities.

3.6 The Tax Office comments that its challenge is to design a system which encourages voluntary compliance through balancing collection from compliant taxpayers with focusing its resources on those areas which will achieve a broader outcome.

3.7 Additionally, the Tax Office has powers that other creditors do not.

- The Tax Office may issue an equivalent to a garnishee notice (see below) without a court order, without obtaining judgment and without the third party holding any money at the time of issue of the notice.
- The Tax Office may pursue directors of companies without needing to have formal guarantees in place.

Laws administered by the Commissioner

3.8 The Tax Office states that it must conduct itself materially differently from a commercial organisation because various laws impose obligations on it that require it to do

so. There are no laws that require the Commissioner to treat small businesses differently from other classes of taxpayers when recovering tax debts.

3.9 The Tax Office administers a range of laws which affect the Commonwealth's and States' revenues—for example:

- revenue laws, such as income tax, excise, and the GST;
- laws delivering benefits in areas such as family assistance, private health insurance and equalisation deposits; and
- laws aimed at achieving other policy objectives, such as private health insurance, retirement savings and research and development.

3.10 There are various laws which influence the way in which the Tax Office manage tax debts—for example, the *Public Service Act 1999* prescribes a code of conduct for all Commonwealth employees and the *Financial Management and Accountability Act 1997* (FMAA 1997) places obligations on Commonwealth officers in dealing with Commonwealth money and property and the recovery of debt.

3.11 Further guidance on the Tax Office's management of debt is set out in several Tax Office policy documents. These are outlined further below.

TAX OFFICE RESOURCES

Tax Office organisational structure and staffing

3.12 The Tax Office includes the debt collection function within its definition of 'receivables management'. This includes:

all the processes, interactions, products and activities involved in managing the primary obligations (i.e. lodge and pay) of a known client, from before the liability arises to collection of the debt, for example, advising tax liabilities, managing debts, collecting money, securing lodgment of returns, chasing outstanding debts. Managing receivables also includes the supporting business systems.

3.13 Of the Tax Office governance documents, the Operations sub-plan sets objectives for the Tax Office's receivables management functions. In relation to tax debts, the sub-plan states that the Tax Office aims to maintain collections and reduce debt holdings.

3.14 The Tax Office's internal organisational structure in dealing with debt is located within the Operations business line headed by a Deputy Commissioner. An Assistant Deputy Commissioner assisted by six senior executives and approximately 3170 staff manages the debt and lodgment process.

They are organised into teams of approximately 15 staff, located in 27 sites around Australia. Team leaders are normally APS 6 level, and teams have 1 or 2 coaches at APS 4 level, and a technical adviser at APS 5 level.

3.15 Most tax officials involved in debt recovery are also involved in managing taxpayers' lodgment obligations. The Tax Office is of the view that its debt recovery function is entwined with its lodgment management function. Under the tax laws, taxation liabilities

are raised on lodgment of certain electronic and paper forms, such as the Business Activity Statement and income tax return form.

3.16 Approximately 500 of the total staff above are dedicated to managing lodgment compliance. This means that approximately 2,600 staff are involved in directly managing debt recovery or involved in supporting those directly involved.

TAX OFFICE POLICIES

3.17 The Tax Office publishes numerous documents to provide guidance to staff on the exercise of its powers and fulfilment of its role. In relation to tax debt collection, the most important documents are the *ATO receivables policy*, the *Chief Executive Instructions on debt management*, the *Taxpayers' Charter* and the *Compliance Model*.

ATO receivables policy

3.18 The Commissioner of Taxation is required by legislation to recover taxation liabilities from those required by law to pay. The Commissioner is assisted in exercising his powers by public servants, collectively called the Australian Taxation Office or Tax Office. To provide guidance to these officials in the exercise of these powers, the Commissioner publishes policy documents and requires these officials to follow them.

3.19 The primary policy document for the collection of debt is the *ATO receivables policy*. This document sets out the Tax Office's approach to debt collection and lodgment matters. It is made up of 123 chapters and is available electronically from the Tax Office's website.

Principles in the ATO receivables policy

3.20 The *ATO receivables policy* sets out the underlying principles of the Tax Office's receivables management and their application to specific aspects of debt management. Application to specific aspects of debt management is discussed in the following chapters of this document. The *ATO receivables policy* identifies the following underlying principles:

- taxpayers should pay debts when due;
- the Tax Office is not a credit provider;
- officials must adopt the most appropriate remedy in dealing with non-compliant taxpayers;
- actions are to be perceived as equitable by those taxpayers who do comply with their obligations;
- debt is to be managed on a risk management basis; and
- officials must be empathetic to viable businesses that have made a genuine attempt to implement the new tax system.

Taxpayers to pay debts when due

3.21 In the *ATO receivables policy*, the Tax Office states that all taxpayers should pay taxation debts as and when they fall due. This is because:

[t]axpayers are expected to take responsibility for their taxation obligations, and to organise their affairs in such a way as to be able to discharge those responsibilities when required. The Commissioner expects that taxpayers will give the same priority to taxation obligations as their other responsibilities.¹³

3.22 The Government relies on the revenues collected from taxation liabilities to fund public programs. Paying tax debts on time may reduce interest on public debt. If the taxes are paid late then the Government may need to borrow amounts to cover the shortfall in funding.

3.23 The Tax Office is of the view that the general interest charge (GIC) is a means to cover expenses incurred by late payment of tax debts. However, the Explanatory Memorandum to the Bill which introduced a separate interest charge regime in 1992 described this charge as being 'compensation to the Revenue for the time value of money'.

3.24 Following the introduction of the new GIC regime in 1999 it was noted that:

the Government considers that a 7 percentage point margin is sufficient to support the policy objectives that taxpayers should pay their tax liabilities on time and not use the Commonwealth as a lending authority.¹⁴

3.25 Under section 204 of the *Income Tax Assessment Act 1936*, a person is liable to pay a GIC if an amount of tax assessed remains outstanding after the date it is due and payable.

3.26 The GIC is calculated in accordance with section 8AAC of the *Taxation Administration Act 1953* (TAA 1953) on any amounts outstanding after the date it is due and payable. Currently this rate is set at a 12.43 per cent annual compounding rate made up of a rate reflecting short term lending rates – the monthly average yield of 90-day Bank Accepted Bills published by the Reserve Bank of Australia – plus an 'uplift' factor of 7 percentage points.

Tax Office is not a credit provider

3.27 The Tax Office states that it is not a lending institution or credit provider. However,

[i]n limited, genuine circumstances, the Commissioner is prepared to ... permit payment [of the tax debts] by instalments...¹⁵

3.28 One could say that the intention of Parliament in introducing the 'uplift' factor of the GIC was to serve as a disincentive to taxpayers and effect compliance by discouraging taxpayers from using the tax system as an unsecured mechanism for borrowing.¹⁶

13 Commissioner of Taxation, *ATO receivables policy*, April 2003, available from www.ato.gov.au viewed on 4 April 2004, paragraphs 1.3.1 and 4.2.1.

14 Explanatory Memorandum accompanying the Taxation Laws Amendment (No. 3) Bill 2001, at paragraph 4.6.

15 Commissioner of Taxation, *ATO receivables policy*, April 2003, available from www.ato.gov.au viewed on 4 April 2004, paragraph 1.2.2.

3.29 The Tax Office considers the GIC's automatic imposition as not only compensating the government for late payment of liabilities but also as encouraging taxpayer compliance with future liabilities:

[The GIC] denies late payers an advantage over those who do pay on time. The knowledge that GIC is accruing should encourage debtors to organise their affairs in such a way as to enable them to pay on time.¹⁷

Most appropriate remedy adopted in dealing with non-compliant taxpayers

3.30 The Tax Office states that in dealing with taxpayers who do not comply with their obligations it will 'adopt the most appropriate remedy, i.e. the remedy that, based on the taxpayer's compliance history, will most likely result in both current and future compliance'. The Tax Office has indicated that it will give considerable weight to the taxpayer's compliance history when deciding the manner in which to deal with the taxpayer.

3.31 The range of non-compliant taxpayers runs from those who want to pay but cannot to those who can pay but do not or evade the taxation system altogether.

3.32 The Tax Office considers that the onus is on the taxpayer to contact it at the earliest opportunity to discuss alternative arrangements where they are not able to meet their taxation obligations or expect not being able to do so.

Perceptions of equity

3.33 The Tax Office states that:

A fundamental principle in taxation administration is that any alternative arrangements should also be perceived as equitable by those taxpayers who do comply with their obligations. A decision to enter into an alternative arrangement will take into account the particular circumstances of the taxpayer, including:

- the taxpayer's compliance history;
- whether the reasons for the potential non-compliance were beyond the taxpayer's control, and the steps taken to mitigate the effects of those circumstances;
- the ability of the taxpayer to meet the obligation within a reasonable timeframe; and
- the steps taken to ensure future taxation obligations are met on time.¹⁸

16 The Inspector-General further discusses the underlying policy of the general interest charge in his report, *Review of the Remission of the General Interest Charge for Groups of Taxpayers in Dispute with the Tax Office*, Canberra, November 2004; see also *Explanatory Memorandum to the Taxation Laws Amendment Act (No. 3) 2001*, paragraph 8.7.

17 Commissioner of Taxation, *ATO receivables policy*, April 2003, available from www.ato.gov.au viewed on 4 April 2004, paragraph 91.3.2.

18 *ibid*, paragraph 1.3.10.

Risk management

3.34 As the Tax Office cannot select which people it is to deal with like other suppliers, it develops strategies to maximise the likelihood that taxpayers will voluntarily comply with the taxation laws:

The risk managed by those responsible for securing outstanding tax returns and statements, or for collecting outstanding tax debts (including all additional charges for late lodgment/payment imposed by legislation) is that the returns and statements will not be lodged or debts will not be paid within time frames acceptable to the Commissioner, if at all.

For those dealing with the collection of outstanding amounts, risk is about making decisions to do something in the most cost effective and timely manner, based on an evaluation of all the circumstances.¹⁹

3.35 The *ATO receivables policy* sets out the three main elements that tax officials must evaluate: the nature of the risk; the risk probability; and the risk exposure.²⁰ Generally, the overall compliance risk of the taxpayer is assessed by reference to the taxpayer's individual circumstances.

Effect of the new tax system

3.36 The Tax Office states that it has a 'clear expectation that ... individuals and businesses would take reasonable steps to implement the new [tax] system'.²¹ However, it recognises that small businesses were affected during the transitional period and needed considerable support and assistance from the Tax Office:

During this transitional period, the Commissioner was empathetic to viable businesses that have made a genuine attempt to implement the new tax system. If those businesses made a mistake for example miscalculated their cash flows, the Commissioner considered all their circumstances, and adopted an empathetic approach to payment arrangements to ensure that the debt with the Tax Office was not, of itself, the reason for a viable business to founder.²²

3.37 Views on the *ATO receivables policy* are outlined in Chapter 5.

Chief Executive Instructions on debt management

3.38 Section 47 of the FMAA 1997 requires a Chief Executive of an agency to recover debts for which it is responsible. In effect, section 47 places a positive duty on the Commissioner of Taxation to pursue recovery of all tax debts due to the Commonwealth. However, section 47 provides the Commissioner with a discretion not to pursue recovery where either:

- the debt has been written off, as authorised by the FMAA 1997; or

¹⁹ *ibid*, paragraph 3.2.2.

²⁰ *ibid*, paragraphs 3.5.1 to 3.5.6.

²¹ *ibid*, paragraph 1.3.2.

²² *ibid*, paragraph 1.3.12.

- the Commissioner is satisfied that the debt is not legally recoverable; or
- the Commissioner considers that it is not economical to pursue recovery of the debt.

3.39 The Chief Executive Instructions provide guidance to Tax Office staff on the exercise of the discretion not to pursue recovery of debts.

Taxpayers' Charter

3.40 Generally, the Taxpayers' Charter sets out taxpayers' rights and obligations and the service standards taxpayers can expect from the Tax Office:

The Taxpayers' Charter commits the Tax Office to treating taxpayers fairly and reasonably under the law, a commitment that implies that individual circumstances are recognised and taken into account.²³

3.41 Amongst other rights, the Tax Office tells taxpayers that they can expect it to:

Treat you fairly and reasonably.

Treat you as being honest in your tax affairs unless you act otherwise.

Offer you professional service and assistance to help you understand and meet your tax obligations ...

Give you advice and information you can rely on.

Explain to you the decisions we make about your tax affairs ...

Administer the tax system in a way that minimises your costs of compliance.

Be accountable for what we do.²⁴

3.42 The Tax Office also tells taxpayers that it expects them to:

Be truthful in your dealings with us ...

Pay your taxes and other amounts by the due date.

Be cooperative in your dealings with us.²⁵

²³ Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection-interim report*, June 2001, p. 37.

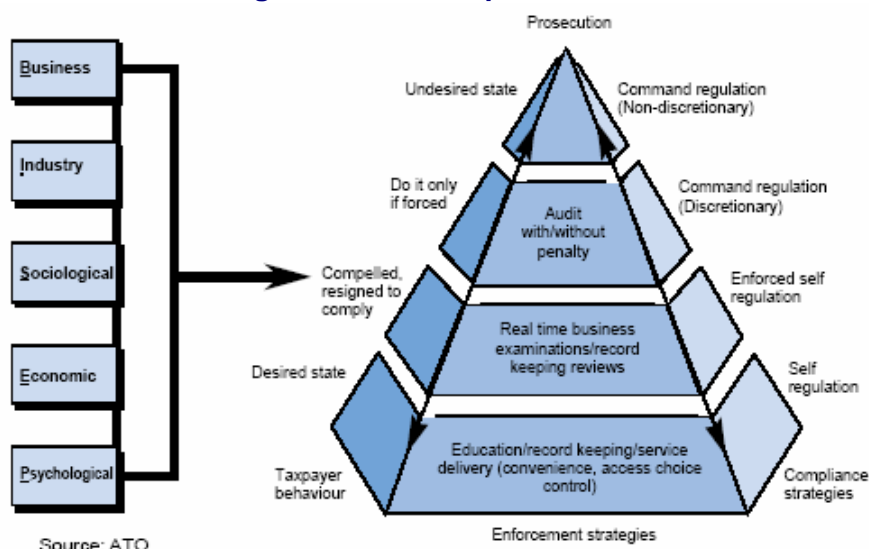
²⁴ Australian Taxation Office, *Taxpayers' Charter – what you need to know*, Canberra, November 2003, p. 2.

²⁵ *ibid*, p. 3.

Compliance Model

3.43 The Compliance Model is a concept which seeks to determine the most appropriate compliance response to achieve desired taxpayer behaviour. It was developed by the Cash Economy Task Force based on knowledge about the reasons why people function the way they do with the institutional arrangements of societies.²⁶

Figure 1: The Compliance Model



The diagram is reproduced from the Auditor-General's report on the management of tax debt collection.²⁷

3.44 Generally, the Compliance Model comprises four parts: the factors that influence taxpayers' decisions and behaviour (BISEP); taxpayers' attitudes to compliance; the Tax Office's compliance strategies; and the Tax Office's enforcement strategies.

BISEP

3.45 The left hand side of the Model specifies different types of factors that may influence a particular taxpayer's behaviour in respect to their compliance with taxation obligations.

Taxpayer behaviour

3.46 The left hand face of the pyramid provides a continuum of taxpayers' attitudes towards compliance ranging from the 'desired state' of a taxpayer 'willing to do the right thing' to the 'undesired state' of a taxpayer's 'disengagement from the tax system' or wilful non-compliance.

Compliance strategies

3.47 The right hand face of the pyramid provides a continuum of compliance strategies that correspond to a taxpayer's attitude towards compliance.

²⁶ Second Report of the Cash Economy Task Force, *Improving Tax Compliance in the Cash Economy*, April 1998.

²⁷ Australian National Audit Office, *Audit Report number 23 of 1999-2000: The Management of Tax Debt Collection*, 20 December 1999, pp. 119-120.

Enforcement strategies

3.48 The middle face of the pyramid indicates the Tax Office's most appropriate enforcement strategy to achieve compliance in relation to the taxpayer's attitude. For example, for those taxpayers who are in the 'desired state' of being 'willing to do the right thing', the most appropriate Tax Office compliance response may be to educate those taxpayers in what needs to be done to comply.

3.49 Essentially, the Model urges tax officials to consider a taxpayer's attitude towards compliance when choosing a compliance response towards that taxpayer. One aim is that tax officials choose compliance responses that have a future effect of moving a taxpayer towards the bottom of the pyramid away from the most severe compliance strategies:

[the Compliance Model] illustrates that the individual circumstances of a taxpayer contribute to his or her underlying attitudes to compliance and to the subsequent behaviour. Accordingly, the Tax Office's strategies, including its approach to the imposition of penalties, are designed to improve that behaviour and in the long term, the underlying attitude to compliance.²⁸

3.50 Additionally, this Model requires the Tax Office to be aware of the factors that influence taxpayers' decisions and behaviour.

²⁸ Commissioner of Taxation, *ATO receivables policy*, April 2003, available from www.ato.gov.au viewed on 4 April 2004, paragraph 91.3.2.

CHAPTER 4: TAX OFFICE PROCESSES IN MANAGING DEBT

INTRODUCTION

4.1 A number of submissions complained of the lack of publicly available information on the Tax Office's debt collection process.

4.2 This chapter provides an overview of the Tax Office's debt collection processes. It is based on Tax Office information.

BEFORE DEBT DUE AND PAYABLE

Timeframe from activity to liability

4.3 Australia's tax system is based on self-assessment of the tax liability for activities giving rise to an obligation to report. Reporting those activities in turn gives rise to a legal liability to pay an amount assessed by reference to the amounts reported.

4.4 Inherent in this system is a time delay between the initial activity and the legal liability to pay a tax amount.

4.5 Generally, the Tax Office is unaware of a taxpayer's tax liability until the taxpayer lodges a particular document or notifies an amount, whether through an activity statement or annual return.

AFTER DEBT DUE AND PAYABLE—AUTOMATED PROCESSES

4.6 A taxation liability becomes a collectable debt once it becomes due and payable, there is no dispute as to the liability for the tax and the debt remains unpaid. Generally, the Tax Office may commence debt recovery action if the amount due and payable is not paid within an acceptable time to the Tax Office.

4.7 The potential actions the Tax Office use to recover the debt may consist of automated computer processes and those involving direct human action.

4.8 The Tax Office has automated processes in place to stream cases to the relevant areas in the Tax Office for a debt recovery response. Depending on the taxpayer, the type of debt and amount of the debt, these will initially involve an automatically generated letter or a phone call from a tax official.

Type of taxpayer or debt

4.9 The Tax Office states that it has established specialist 'project teams' to focus on and manage specific areas of risk depending upon debt or taxpayer type. The relevant debt types or taxpayers are automatically sent to the relevant project team for debt recovery action.

4.10 These project teams are established to enable the Tax Office to pull out from the mainstream processes for special attention those cases concerning identified areas of risk. Examples of these areas include scheme participants, superannuation debts and phoenix companies. The project teams have their own process for debt recovery action that is tailored to that identified risk area.

Amount of debt

4.11 The Tax Office classifies debt cases into six categories, or 'debt levels', according to the amount of debt owing.

Table 4.1: Classification of debt levels

Debt level	Amount of debt
1	<\$2500
2	\$2500 - \$7499
3	\$7500 - \$ 24,999
4	\$25,000 - \$49,999
5	\$50,000 - \$99,999
6	>\$100,000

Source: Tax Office

4.12 The Tax Office uses the term 'lower debt levels' to refer to debt levels 1 to 3. The term 'higher debt levels' refers to debt levels 4 to 6.

Lower debt levels

4.13 The Tax Office advises that, in relation to the lower debt levels, it may send out an automatically generated letter where it has not received payment within a specific timeframe. The Tax Office calls this letter a 'soft' letter. The Tax Office states that the tone of the letter is non-threatening and aimed at reminding the taxpayer that they may have forgotten that they have a debt and that it is outstanding. The Tax Office states that 60 per cent of cases will pay immediately following this letter.

4.14 If no payment is received within a period of time following the soft letter, another automatically generated letter may be sent out. The Tax Office calls this letter a 'firm' letter.

4.15 If no payment is received within a period of time following the firm letter, a third automatically generated letter is sent out. The Tax Office calls this letter a 'hard' letter.

4.16 For the cases with higher amounts in the lower debt levels, where no response is received, the case is sent to an outbound call centre (see below) for prioritisation and possible follow up action.

Higher debt levels

4.17 For the higher debt levels, if no payment is received within 24 hours to 7 days following the date due and payable, the case is sent to an outbound call centre (see below) for prioritisation and possible follow-up action.

Payment arrangement interactive voice phone line

4.18 On its letters sent to debtors, the Tax Office provides details of a phone line through which a debtor may propose a payment arrangement—the payment arrangement interactive voice response (IVR) phone line.

4.19 This IVR phone line is linked to an automated program that prompts debtors to provide identifying information, proposed repayment amounts and frequency of repayments. The program uploads the recorded information to the Tax Office's mainframe systems overnight. The mainframe systems checks that the data is valid and that the proposal meets the Tax Office's business rules for accepting payment arrangements.

4.20 The Tax Office advises that these business rules are not absolute as debtors with extraordinary circumstances may contact the Tax Office's call centre staff to discuss alternative arrangements.

4.21 The Tax Office reports:

Approximately 60,000 taxpayers with debts totalling \$24 million have used the service to establish a payment arrangement since July 2003.

4.22 The Tax Office did not provide a break up of this figure into number of small businesses or number of recurrent debtors.

AFTER DEBT DUE AND PAYABLE—MANUAL PROCESSES

4.23 The Tax Office has a number of business areas that focus on different aspects of the debt recovery process. These areas are discussed below.

4.24 However, the Tax Office states that it does not have enough resources to action manually every debt case each year. Therefore, it must prioritise cases for attention by tax officials.

Net Risk

4.25 The Tax Office has implemented an automated system, Net Risk, which was designed to select those cases for human response that posed the greatest risk of non-payment without tax official intervention. The Net Risk system is based on a two-stage process: determining 'likelihood' and 'consequence'.

Likelihood

4.26 'Likelihood' indicates the likelihood that a particular debt case will require 'high-end' debt recovery action through some human intervention. This is calculated by comparing the case with a risk matrix of 46 characteristics that have been identified as historically indicating that likelihood. The Tax Office contracted academic mathematicians to develop an algorithm based on this matrix of characteristics.

4.27 Once this algorithm is applied to a particular debt case it is given a numerical score and allows a comparison against other cases.

4.28 However, a case's likelihood score is disregarded when considering which cases should receive 'high-end' debt recovery action through some human intervention. The Tax Office states that the function was providing results which were inconsistent with the Tax Office's allocation of resources.

4.29 The Tax Office prioritises its recovery resources on the basis of the value of the debt outstanding—that is, the larger the debt the more likely the case will receive 'high-end' debt recovery action through some human intervention. The exception to this are the cases referred to the Tax Office's 'project teams'.

Consequence

4.30 'Consequence' generally refers to determining the appropriate response that will achieve recovery of the debt. Examples of responses include garnishing bank accounts, entering into payment arrangements and issuing Director Penalty Notices.

4.31 The Tax Office is not using the consequence function of Net Risk as it states that the function was providing results which were inconsistent with the Tax Office's allocation of resources. It states that it is aiming to incorporate a similar function into the Tax Office's 'Change Program' to be implemented by December 2008. The Tax Office states that this new system will enable the Tax Office to better filter those cases requiring human intervention and better indicate appropriate responses.

4.32 Effectively, Net Risk does not determine either a debt case's priority or indicate an appropriate compliance response. In the meantime, the Tax Office uses its computerised Receivables Management System (RMS) to:

- stream debt cases to different business areas based on internal business rules; and
- prioritise debt cases for action by those business areas based on the case's debt levels.

4.33 Concerns were raised in relation to the Tax Office's effectiveness in case selection and methods of risk assessment. In the Inspector-General's view these issues would be more appropriately considered by other bodies. However, these issues do affect the equitable treatment of taxpayers. This aspect of these issues is considered further in chapters 5 and 6.

Main business areas

4.34 The following are the main business areas of the Tax Office that are tasked to manage debt:

- call management centres;
- outbound call centres;
- arrangement management teams;
- pre-legals teams;
- legals and complex case teams; and
- insolvency teams.

Call management centres

4.35 Various debt- and lodgment-related letters and publications contain a telephone number, 13 1142, through which taxpayers may contact the Tax Office to discuss debt- and lodgment-related matters. Calls on this number are directed to the call management centres. Other areas of the Tax Office may also direct calls to the call management centre where debt and lodgment issues are raised by external callers.

4.36 Approximately 400 tax officials staff call management centres in six sites across Australia.

4.37 Staff in the call centre management centres have the delegation and authorisation to:

- remit the general interest charge on the grounds of a Tax Office error;
- defer the date due and payable for tax debts;
- suspend debt collection activity; and
- agree to arrangements to pay a tax debt by instalments.

4.38 Staff record notes of their calls with taxpayers in electronic 'narrations' recorded on the RMS.

4.39 Representatives of staff from these areas indicated that the focus of their work in relation to debtors was to 'keep the taxpayer engaged in the tax system' by entering arrangements. Generally, this focus is an application of a compliance strategy based on the compliance model (see Chapter 3). It seeks to change a debtor's compliance behaviour from paying only if forced to resigned self-enforced compliance with payment obligations. These staff rely on the taxpayer's assessment of their own capacity to repay.

4.40 Staff receive guidance through a number of documents, team and national support networks. The guiding documents include the *ATO receivables policy*, call centre scripting and practice notes.

4.41 Staff deal with work on a transactional basis. They do not have ongoing contact with particular taxpayers and finish their involvement with the taxpayer's case once the purpose of the call is fulfilled.

Outbound call centres

4.42 Outbound call centres are the areas which initiate contact with those debtors in identified areas of risk who have not contacted the Tax Office. This centre's workload is generated by the RMS identifying cases selected for Tax Office-initiated contact. Approximately 240 tax officials staff the outbound call centres in six sites across Australia.

4.43 The RMS allocates cases for staff to action. Allocation is made on the basis of level of debt, available resources and identified skills. Staff undertake preliminary work to establish the debt then contact the debtor to determine the reason for non-payment of the debt. Their aim is to achieve payment of the debt either in full or by instalments, rectify non-compliant behaviour and case manage, to a limited extent, the debtor. The outbound call centres aim either to agree and monitor the initial payment of an acceptable payment arrangement or to escalate the matter to the pre-legals team when negotiations break down.

4.44 The Tax Office states that in circumstances where debtors have defaulted on a previous payment arrangement with the Tax Office, outbound call centres attempt to keep the taxpayer engaged by entering into another payment arrangement. The telephone conversations are noted and recorded by staff on the RMS.

Arrangement management teams

4.45 The arrangement management teams deal with defaulted payment arrangements and provide a focus of Tax Office expertise in payment arrangements. This centre's workload is generated by the RMS identifying cases selected for Tax Office-initiated contact. Approximately 333 tax officials staff the arrangement management teams in five sites across Australia.

4.46 The RMS allocates cases for staff to action. Allocation is made on the basis of level of debt, available resources and identified skills. Lower debt level cases are sent automatically generated letters asking the debtor either to pay or call the call centre management teams.

4.47 Staff undertake preliminary work to familiarise themselves with the case and determine a process of negotiation. The Tax Office states that staff will call the debtor to clarify facts and issues, determine the reasons for default, seek to understand the business pressures and negotiate for another payment arrangement. Staff aim at keeping the taxpayer engaged in the system. They obtain financial information and determine the taxpayer's capacity to repay.

4.48 The Tax Office states that the arrangement management teams recognise that small business operators may be fearful of Tax Office debt collection activity. Such taxpayers may try to agree to further payment arrangements to get off the phone quicker without fully considering their capacity to make the instalments. Therefore the teams seek to determine these taxpayers' other debts and due dates, and income or ability to pay.

4.49 In the event that a payment arrangement is not entered into, staff will consider whether legal action is worthwhile. Chapters 21 and 26 of the *ATO receivables policy* set out the principles to be applied in making this decision. If legal action is determined to be worthwhile, the case will be prepared for legal action and referred to the legals area. If it is not worthwhile, the debt will be written-off as uneconomical to pursue (see 'Write off' below). However, the written off amount may be re-raised at a later date if the circumstances change.

4.50 The Tax Office states that approximately 4 per cent of arrangement management team cases are referred to the legals teams for legal action.

4.51 The arrangement management teams also seek to determine systemic reasons for taxpayer payment arrangement defaults.

Pre-legals teams

4.52 The pre-legals teams receive cases referred to them by the outbound call centres. They also focus on areas of identified risk. Approximately 150 tax officials staff pre-legals teams in five sites across Australia.

4.53 The RMS allocates cases for staff to action. Allocation is made on the basis of level of debt, available resources and identified skills. Staff initially review cases to ensure that the

taxpayer understood they had been given a reasonable opportunity to enter into a payment arrangement. Cases where taxpayers either did not understand or were not given a reasonable opportunity are contacted by either the outbound call centres or the pre-legals teams.

4.54 Failing the agreement of a payment arrangement, staff will investigate options for recovery of funds from debtors. Notices of intended legal action will be sent to the debtor. Depending on the type of debt and debtor, the notices may refer to possible garnishee action, Director Penalty Notices and statutory notices for winding up. The notices have the direct contact details of the staff member who is managing their case.

4.55 Taxpayers who contact the staff member have the option to enter a payment arrangement. Representatives from the pre-legals area stated that this does not happen often because their cases often involve a history of defaulted arrangement without reasonable evidence of a change in financial circumstances. The reasons for declining to accept a payment arrangement proposal are given in writing. If a suitable payment arrangement is not negotiated, staff will consider whether legal action is worthwhile in the same manner as the arrangement management teams (see above).

4.56 The Tax Office states that staff will also seek to educate the debtor as to why this action is occurring, what further steps the Tax Office will take and what the debtor's obligations are.

4.57 Cases that involve complex issues, such as possible insolvency, are referred to the complex case area of the legals teams.

Legals and complex case teams

4.58 The legals and complex case teams deal with those matters where there is a significant risk to revenue or some issue involving significant sensitivity or complexity. Cases referred to this area are either from a legals referral or a non-Tax Office initiated winding-up letter. Approximately 215 tax officials staff legals and complex case teams in 16 sites across Australia.

4.59 In the event of a matter of significant complexity or sensitivity, a legals team leader may be contacted by the compliance areas of the Tax Office for advice before the tax liability is determined. Following the determination of liability, the complex case team will be responsible for debt collection activities concerning that entity.

4.60 In the event of non-Tax Office initiated winding-up proceedings, the complex case area will determine, in accordance with chapters 18, 20 and 26 of the *ATO receivables policy*, whether the Tax Office will support the action.

4.61 In the event of a legals referral, staff will undertake preliminary work to assess whether all alternative debt collection action has been taken and that the proposed legal action is appropriate in the circumstances. Once satisfied, staff will instruct the Tax Office Legal Services Branch to commence legal proceedings to obtain a sequestration order or winding-up notice. If not satisfied, staff will either refer the case back to the referring area for further action or write off the case as uneconomical to pursue (see below).

4.62 Where the taxpayer is a corporate entity, the *ATO receivables policy* outlines a number of factors that should be considered before initiating liquidation action, including:

- the asset position of the company;
- the nature of the debt;
- the future income of the company;
- the risk to the revenue;
- the potential to recover from directors;
- whether there are matters that may warrant an examination by a liquidator; and
- whether there is evidence of fraudulent or criminal activities on the part of the directors.

4.63 Where satisfied, tax officials will serve a notice in terms of section 459E of the *Corporations Act 2001* and if payment is not made within 21 days or if suitable payment proposals are not agreed within that time, they will apply to the court to have the company wound up. If the company fails to comply with the demand to pay, it is presumed to be insolvent and its presumed insolvency may be used as a ground for winding up the company by the creditor who made the demand or by any other creditor or any other applicant for winding up.

4.64 The Tax Office indicates that action to wind up a company will be taken in circumstances where the company has failed to pay its debts and there has been no agreement on payment proposals. This action will also be taken in circumstances where it is considered a company is insolvent and there will be a detrimental effect on the revenue if it is allowed to continue to trade.

4.65 Liquidation occurs where a corporate debtor's affairs are placed into the hands of a liquidator. A liquidator will take steps to dispose of the debtor's assets to raise funds to meet the proven debts of all creditors.

4.66 Where the taxpayer is an individual, tax officials must be satisfied that the debtor is in fact insolvent. The *ATO receivables policy* outlines a number of factors that should be considered before initiating bankruptcy action, including:

- the asset position of the debtor;
- the nature of the debt;
- the future income of the debtor;
- the risk to the revenue;
- the cost of bankruptcy and the likely return;
- whether special circumstances exist; and
- whether the debtor is divesting himself or herself of assets.

Insolvency teams

4.67 The insolvency teams deal with cases where a debtor is declared bankrupt, is proposing to appoint an administrator, or is in liquidation. In relation to individuals, Insolvency and Trustee Services Australia notifies the insolvency teams on a weekly basis of those declared bankrupt and those who have been discharged from bankruptcy. Where the Tax Office is a creditor of a company in liquidation or administration, the administrator or liquidator is required by corporations law to notify the Tax Office of the liquidation or administration. Approximately 150 tax officials staff insolvency teams in seven sites across Australia.

4.68 In relation to bankrupts, the insolvency teams will consider any Part IX or Part X (of the *Bankruptcy Act 1966*) arrangement. The insolvency teams monitor the progress of the trustee-in-bankruptcy's work and write off the debt as irrecoverable in law (see below) once distribution of the bankrupt's property is completed.

4.69 In relation to companies in liquidation, the insolvency teams will provide the liquidator with the proof of debt, meet with the liquidator if the liquidator decides investigation is warranted and receive the liquidator's annual and final reports.

4.70 In relation to companies proposing voluntary administration, the insolvency teams are the proxy holders for the creditors' meetings and decide how the Tax Office will vote at these meetings.

4.71 The insolvency teams determine whether to support a proposal to appoint particular administrators. They also determine whether to support an administrator's recommendations. Preliminary work is undertaken to establish the debt, to trace assets, to investigate business relationships and to determine consistency of information. Also, insolvency teams determine if information divulged by creditors at meetings is inconsistent with the company's claims.

Quality assurance, professional accreditation and knowledge network

4.72 Through a system of quality assurance, professional accreditation, skilling and a knowledge network, the Tax Office states that it assures itself that staff meet certain technical standards and that faults are identified.

Quality assurance

4.73 The Tax Office states that it has three methods of assuring itself of the consistent and accurate application of rules to specific circumstances by tax officials involved in debt collection: technical quality review, functional analysis and team-based analysis.

Technical quality review

4.74 The technical quality review process assesses written interpretive advice to identify faults in policy, procedure and skilling. It does not identify faults in the balance that the *ATO receivables policy* strikes to achieve between the collection of the outstanding debt and ensuring a fair and equitable outcome. Where faults are identified the individual and their manager are notified and, if serious, senior tax officials as well. The results are collated and put on a register from which some qualitative analysis is undertaken and remedial strategies developed.

Functional analysis

4.75 There are two types of functional analysis: analysis in an area of risk identified by senior tax officials on an ad hoc basis; and analysis of a specific debt function over a period of time. Functional analysis provides feedback to the head of the functional area reviewed – for example, feedback has been provided to the head of the arrangements management area on a monthly basis since August 2003.

Team-based analysis

4.76 Team-based analysis is done within a team environment and tied to the performance of the tax official. Teams each have a team coach, a technical adviser and a team leader. Generally, performance is actively monitored by the team coach.

Professional excellence and accreditation

4.77 The professional excellence and accreditation process was initiated as a response to the Sherman report findings.²⁹ This process requires technical advisers at a senior level – the APS5 to EL1 level – to obtain and maintain professional accreditation.

4.78 Professional accreditation workshops assess staff's capabilities in decision-making. This assessment is based on historical information comprising a portfolio of previous decisions and an interview-like discussion, interview questions and a process check comprising a scenario and negotiation with colleagues and a 'taxpayer' to reach agreed outcomes.

4.79 From this process, training package development may be recommended for staff. If there is a deficiency, a report may be made to a staff member's team leader to recommend steps to address that deficiency in the staff member's learning plan.

Debt and Lodgment Learning Network

4.80 The Debt and Lodgment Learning Network is a forum of tax officials at the APS 4 and 5 levels in regional areas who meet to discuss issues of concern with a view to identifying steps and changes for improvement.

Debt recovery responses available to Commissioner

4.81 The Commissioner is empowered with a variety of responses to recover tax debts. These responses are outlined below. Responses that raise issues of concern are discussed in more detail in the following chapters.

Offset

4.82 Under Part IIB of the *Taxation Administration Act 1953* (TAA 1953), the Commissioner may offset a refund or credit owing to a taxpayer against a debt owed by the same taxpayer. The process is generally automatic but is subject to rules which except certain categories of taxpayers and circumstances in connection with the timing of establishment of some liabilities.

²⁹ Sherman, *Report of an Internal Review of the Systems and Procedures relating to Private Binding Rulings and Advance Opinions in the Australian Tax Office*, August 2000.

GIC remission

4.83 Generally, the general interest charge (GIC) is a charge for unpaid taxes calculated on a daily balance. The rate of the GIC is set at the monthly average yield of 90-day Bank Accepted Bills published by the Reserve Bank of Australia plus an additional 7 percentage points.

4.84 Section 8AAG of the TAA 1953 provides that the Commissioner may remit all or part of the GIC where the Commissioner is satisfied that either:

- the circumstances that contributed to the delay in payment were not due to, or caused directly or indirectly by, an act or omission of the person and the person has taken reasonable action to mitigate, or mitigate the effects of, those circumstances; or
- the circumstances that contributed to the delay in payment were due to, or caused directly or indirectly by, an act or omission of the person and the person has taken reasonable action to mitigate, or mitigate the effects of, those circumstances and having regard to the nature of those circumstances, it would be fair and reasonable to remit all or a part of the charge; or
- there are special circumstances because of which it would be fair and reasonable to remit all or a part of the charge; or
- it is otherwise appropriate to do so.

4.85 Chapters 91 and 93 of the *ATO receivables policy* provide further guidance to tax officials exercising the Commissioner's discretion to remit the GIC.

Circumstances beyond taxpayer control

4.86 The Tax Office indicates that it may remit the GIC where a taxpayer demonstrates that their cash flow difficulties were due to factors beyond their control and clearly could not be predicted. Examples provided include natural disasters, industrial action, collapse of a major debtor and sudden ill health of key personnel.

4.87 Taxpayers need to show that the circumstances had a specific impact on their ability to pay the tax debt. The Tax Office states that merely arguing an economic downturn, adverse business conditions or fluctuations in currency exchange rates are not sufficient to demonstrate a specific impact.

Acts or omissions of a taxpayer

4.88 The Tax Office indicates that it may remit the GIC where the non-payment of the debt is caused by the direct involvement of the taxpayer but non-payment was not the intended outcome. The policy indicates that the Tax Office may remit where the taxpayer can demonstrate that plans were in place to ensure the payment of tax on time, but that as a result of the unforeseen circumstances, payment on time was not possible:

A soundly advised or well considered decision which results in unforeseen severe consequences affecting a debtor's ability to pay might otherwise gain some remission.³⁰

³⁰ Commissioner of Taxation, *ATO receivables policy*, April 2003, available from www.ato.gov.au viewed on 4 April 2004, paragraphs 93.5.8 and 93.5.10.

4.89 The Tax Office indicates that it will not remit the GIC where non-payment of a tax debt is caused by an extended credit policy which adversely affects their cash flow, by using available funds to acquire assets or by paying other creditors.

Fair and reasonable to remit

4.90 Remission on fair and reasonable grounds must not result in an unfair advantage:

a debtor who pays late should not be given any advantage over those taxpayers who organise their affairs to ensure they can pay on time. Debtors will need to demonstrate that it is fair and reasonable to remit the GIC, having regard to the nature of the specific event or decision.³¹

Otherwise appropriate to remit the GIC

4.91 The policy sets out specific examples of when it would otherwise be appropriate to remit the GIC—for example, where recovery of the GIC would cause hardship. Discretion to remit on this ground is limited to senior tax officials.

Relevant factors

4.92 The Tax Office indicates that in exercising the discretion to remit the GIC it will consider as relevant factors a taxpayer's payment history, the steps they have taken to mitigate the circumstances leading to the non-payment of the tax debt and the effect of the debt.

4.93 Section 8AAG of the TAA 1953 empowers the Commissioner with a wide discretion to remit all or part of the GIC payable by taxpayers. The Commissioner will generally not exercise his discretion to remit GIC payable on outstanding debt as a part of a payment arrangement.

Payment arrangement

4.94 Section 255-15 of Schedule 1 of the TAA 1953 provides the Commissioner with power to accept payment arrangements for the repayment of tax liabilities. A tax liability is defined in section 255-1 as a pecuniary liability to the Commonwealth arising directly under a taxation law.

4.95 A payment arrangement will not vary the time at which the amount is due and payable. Therefore, the GIC or any other applicable penalty for the unpaid amount will continue to accrue after the date the debt is due and payable.

4.96 Where the Commissioner accepts a payment arrangement and the taxpayer meets that arrangement, the Commissioner will generally not exercise his power under subsection 255-5(2) to sue and recover the outstanding debt.

4.97 Debtors may also contact the call management centres to enter payment arrangements. Tax officials in the outbound, pre-legal and legal areas will seek to initiate contact with debtors with a view to recovering payment either in full or by way of a payment arrangement.

³¹ *ibid.*, paragraph 93.5.13.

4.98 The legal instrument conferring legal authority to exercise powers on behalf of the Commissioner, the *Instrument of Authorisation – Operations Program*, indicates that staff at every level in the Operations Program may enter payment arrangements on behalf of the Commissioner without limitation on amount or time period. However, under the *Taxation Authorisation Guidelines*, a document that guides Tax Office staff on what powers they may exercise, staff have authority to enter agreements according to the limitations set out in the following table.

Table 4.2: Tax officials' authority to negotiate terms of payment arrangements

Officer level	Limit of period	Monetary limit
APS 1	Not authorised	Not authorised
APS 2	6 months	\$50,000
APS 3	12 months	\$150,000
APS 4	18 months	\$500,000
APS 5	24 months	\$1,000,000
APS 6	No limit	\$2,500,000
EL 1, EL 2 and SES	No limit	No Limit

Source: Tax Office

4.99 The Commissioner's policy in exercising his discretion to enter into payment arrangements is set out in the *ATO receivables policy*. Chapter 5 outlines general principles expressed in the *ATO receivables policy*. Further elucidation of these principles in relation to payment arrangements is given in Chapter 10 of that policy. The Tax Office also provides further guidance to staff in the form of self-paced electronic training modules and procedures.

Write-off

4.100 A 'write-off' effectively means that the Tax Office will not pursue the debt because it is either not legally recoverable or it is not cost-effective to pursue the debt. A write-off will not extinguish the debt. The Tax Office will continue to pursue the debt where it becomes apparent that the taxpayer has available funds to meet the debt. The *ATO receivables policy* indicates that where a written off debt is eventually re-raised the 'additional charges for late payment' should be imposed.

4.101 Section 47 of the *Financial Management and Accountability Act 1997* (FMAA 1997) places a positive duty on the Commissioner of Taxation, among other chief executives, to pursue recovery of all debts due to the Commonwealth for which the Commissioner is responsible. However, section 47 allows the Commissioner not to pursue recovery where, amongst other factors, the Commissioner considers that it is not economical to pursue recovery of the debt.

4.102 The Commissioner has delegated this power to certain other tax officials. The Commissioner's *Chief Executive Instruction on debt management* and chapter 26 of the *ATO receivables policy* provide further guidance to Tax Office staff.

4.103 The Tax Office interprets 'uneconomical to pursue' as a combination of:

uneconomical to pursue and irrecoverable because a debtor is without assets/funds and there was little chance of the financial circumstances improving.

4.104 For a debt to be uneconomical to pursue, a delegate must be satisfied that on all the facts it is probable that the total costs of recovery action will exceed the return to the Commonwealth. This is to be decided on a case-by-case basis.

4.105 In relation to the assets and funds of a debtor, the *ATO receivables policy* asks delegates to consider alternative action before a write-off such as bankruptcy, garnishee notices, payment arrangement and section 255 notices.³²

Compromise

4.106 A compromise is an arrangement in which the Commissioner accepts an amount less than the primary tax outstanding in full settlement of an *undisputed* debt. It is made in circumstances where a taxpayer does not have the capacity to pay a debt in full. By contrast, an arrangement in which the Commissioner accepts less than the primary tax in full settlement of a disputed debt is called a 'settlement' by the Tax Office.

4.107 The Commissioner has the power to compromise an undisputed debt in respect of a range of taxation debts including income tax, GST, fringe benefits tax and superannuation surcharge.

4.108 The general administrative power to compromise each type of taxation debt is provided for in a range of Acts. For instance, section 8 of the *Income Tax Assessment Act 1936* in combination with section 255-5 in Schedule 1 of the TAA 1953 allows the Commissioner to compromise an undisputed income tax debt. A list of the range of sections and Acts under which the Commissioner has the power to compromise an undisputed taxation debt can be found at paragraph 27.2.1 of the *ATO receivables policy*. However, as previously discussed, section 47 of the FMAA 1997 imposes certain qualifications to the general administrative power the Commissioner may have to compromise a tax debt.

4.109 Chapter 27 of the *ATO receivables policy* deals with the Commissioner's ability to resolve undisputed taxation debts by compromise. Its intention is to provide guidance for deciding what is an appropriate case for compromise and considers the following:

- cases where the Commissioner will not compromise a debt;
- cases where the Commissioner may compromise; and
- the procedures that need to be followed to implement a decision to compromise a debt.

Release

4.110 Division 340 of Schedule 1 to the TAA 1953 confers a discretion on the Commissioner to release taxpayers from tax-related liabilities on the grounds of the taxpayer suffering serious hardship. A 'release' is a term used in taxation law to mean the extinguishment of a taxpayer's tax liability.

Waiver

4.111 The Minister for Finance and Administration may permanently waive a taxation liability. This means the taxpayer would not be required to pay the amount to the

³² A section 255 notice relates to a resident with control of a non-resident's money.

Commonwealth. The most common condition under which a waiver may be granted is that where, due to the particular circumstances of the case, the decision-maker concludes that there is a moral obligation, rather than a legal obligation, on the Government to extinguish the debt due to equity or ongoing financial hardship considerations.

Departure prohibition orders

4.112 Another debt recovery response is for the Tax Office to obtain a departure prohibition order. Generally, a departure prohibition order is an order by the Commissioner that a taxpayer with outstanding tax liabilities is prohibited from leaving Australia without making arrangements to discharge those liabilities.³³ The penalty for contravening such an order is \$5000, 12 months imprisonment or both.

Garnishee notices

4.113 A garnishee notice requires a person who owes, or holds on account, money payable to the taxpayer to pay it to the Tax Office instead.

4.114 The Tax Office states that it uses garnishee notices where it considers it to be the most effective method of resolving the debt, in particular where the taxpayer is not cooperating to bring their taxation obligations up to date.

Director Penalty Notices

4.115 Directors of companies are personally liable to pay, by way of penalty, amounts equal to any unpaid amounts of Pay As You Go withholding tax. The Tax Office will issue Director Penalty Notices to a director where the company has failed to respond to previous opportunities to bring their obligations up-to-date or enter into alternative arrangements, such as the payment of arrears by instalment.

4.116 When a Director Penalty Notice is issued, the directors of the company can take any of the four options listed below within 14 days of the service of the notice to avoid personal liability for the unpaid tax:

- pay the liability;
- appoint an administrator to the company;
- commence winding-up proceedings; or
- enter into an agreement under section 222ALA of the ITAA 1936.³⁴

4.117 If the directors do not respond within 14 days, then recovery action can be taken against them individually for the total liability. Each director is jointly and severally liable for the debt.

³³ For examples, see 'Departures can prove taxing', *Canberra Times*, 9 May 2004, p. 33.

³⁴ This is generally an agreement in which a company director undertakes to ensure that the company remits amounts that the company has withheld under the Pay As You Go system, or amounts that the Commissioner reasonably estimates to have been withheld by the company, but were not remitted to the Tax Office.

4.118 The Tax Office indicates that the decision to issue a Director Penalty Notice is based on the compliance history of the taxpayer company and the nature of the tax outstanding. As it only relates to certain types of tax, the Tax Office states that it is often necessary to issue these notices in conjunction with other actions, such as winding-up proceedings.

Bankruptcy and liquidation

4.119 Bankruptcy occurs when a debtor's property is placed under the control of a trustee in bankruptcy for the benefit of creditors. A debtor may declare themselves bankrupt (a voluntary bankruptcy) or the court may order the sequestration of the bankrupt's estate (a creditor's petition).

4.120 Liquidation occurs where a corporate debtor's affairs are placed into the hands of a liquidator. A liquidator will take steps to dispose of the debtor's assets to raise funds to meet the proven debts of all creditors.

4.121 A notice under section 459E of the *Corporations Act 2001* can be used to establish evidence of corporate insolvency. The notice is a formal document which requires a company to pay, secure or compound its debt within 21 days of service.

4.122 A judgement or court order is not required before liquidation is commenced. If the company fails to comply with the demand to pay, it is presumed to be insolvent and its presumed insolvency may be used as a ground for winding up the company by the creditor who made the demand or by any other creditor or any other applicant for winding-up.

CHAPTER 5: THE TAX OFFICE'S DEBT COLLECTION POLICIES

INTRODUCTION

5.1 The first focus for the terms of reference for this review asks the Inspector-General to identify and determine whether the Tax Office's small business debt collection policies adequately take into account the provision of assistance to small businesses who wish to meet their tax obligations without harming their underlying viability. A number of submissions dealt with this issue and focused on the Tax Office's *ATO receivables policy*. This document is the Tax Office's primary policy document on the collection of debt and sets out the Tax Office's approach to debt collection and lodgment matters. Other policies which affect debt collection activities are outlined in Chapter 3.

5.2 This chapter will present the views expressed to the Inspector-General on the *ATO receivables policy*.

5.3 Overall, the Taxation Ombudsman commented that, from his observation, the *ATO receivables policy*:

would appear adequate to address any issues around small business ... tax debt collection. For example, the ATO Receivables Policy sets out comprehensive guidelines for negotiating payment arrangements, remission of interest and penalties, and for legal recovery action, including the use of garnishees, bankruptcy and liquidation. In our experience, these guidelines are fair, clear and accessible, although it would seem many taxpayers and tax agents are unaware of their scope.³⁵

5.4 However, submissions from the private sector express the following views on the *ATO receivables policy*:

- the policy does not appropriately balance the competing interests of the debtor, other creditors and the Tax Office.
- the policy does not sufficiently consider the underlying viability of small businesses.
- the policy was developed without sufficient consultation with the business sector.
- there is poor awareness of the *ATO receivables policy*.
- there is a lack of certainty and transparency as to the Tax Office's processes and timeframes for collection of debt.

³⁵ Taxation Ombudsman, written submission, 25 May 2004.

BALANCING COMPETING INTERESTS

5.5 Submissions argue that there are a number of interests that need to be appropriately balanced and articulated in the *ATO receivables policy*. These competing interests include that of the creditor, the debtor and the public generally. They generally articulate those interests as follows.

5.6 Firstly, the interest of the creditor is that debts due be paid to enable the creditor to conduct their business.

5.7 Secondly, the interest of the debtor is that debts due be paid in a manner that enables them to conduct their business. This is from the perspective of allowing the debtor:

- to budget and properly assess cash flow requirements;
- to continue trading;
- to continue employing others in the business;
- to obtain credit; and
- to avoid bankruptcy or any similar proceedings.

5.8 Thirdly, the public interest requires that the interests of all parties be reasonably balanced. This requires that the public benefit in ensuring that tax debts are voluntarily paid on time be achieved without placing debtors under undue hardship in their business or personal operations. Underlying this point is that the Tax Office must protect the revenue but in such a way as not to penalise the many for the few who engage in questionable conduct.

5.9 Submissions to the Inspector-General suggest that the *ATO receivables policy* does not appropriately acknowledge or consider these other interests when setting out how the Tax Office will collect outstanding debt.

CONSIDERING UNDERLYING VIABILITY

5.10 The media reports that the Tax Office does not sufficiently consider the viability of small businesses before taking legal action against them to recover tax debts.³⁶ Tax practitioners and a taxpayers' representative body also observe this approach.³⁷

5.11 The CPA Australia September 2003 small business survey found that:

- 46 per cent of CPAs surveyed saw the Tax Office interested in the continued viability of small businesses either because the Tax Office offered a payment arrangement, came to an arrangement rather than take legal action or allowed the continued trade of small businesses;

³⁶ See for example, 'Will the taxman send you broke?', *Business Review Weekly*, 29 January 2004, pp. 47-51.

³⁷ CPA Australia, *Small Business Survey Program: Perceptions of Risk*, August 2002, p. 2.

- 35 per cent of CPAs surveyed saw the Tax Office as not interested in the continued viability of small businesses because they were of the view that the Tax Office either only wanted money or had no understanding of running a small business.

5.12 The Inspector-General observes that when determining whether a garnishee notice is appropriate action to take in the circumstances, the *ATO receivables policy* requires tax officials to consider the impact of a garnishee notice on the viability of a business. However, the Tax Office was unable to point to similar references in relation to bankruptcy, winding-up or payment arrangement actions.

5.13 Notwithstanding these references, senior tax officials state that a business's viability is not a matter they can accurately determine, nor should they. The Tax Office states that it is concerned with the risk of non-payment of tax debts, not businesses' viability.

CONSULTING SMALL BUSINESS

5.14 Representatives from the small business and tax practitioner sectors recommend that the Tax Office consult with the small business sector on debt management issues. One tax practitioner comments that the Tax Office generally over-engineers its design of systems by seeking to use otherwise simple processes also to gather intelligence for data-matching purposes.

5.15 The Tax Office responds that it has a number of forums in which small businesses could raise debt-related issues. The following forums discuss issues of concern to small businesses or debt:

- Small Business Advisory Group;
- Small Business Market Segment Forum;
- GST Tax Professionals and Insolvency Forum; and
- ATO Tax Practitioners Forum.

5.16 The Small Business Advisory Group is chaired by the Commissioner and is attended by small business operators on a quarterly basis. It provides a forum for the Tax Office to consult with small to medium business people about taxation issues affecting them. The focus of the forum is quite broad.

5.17 The Small Business Market Segment Forum is chaired by the Deputy Commissioner for Operations and attended by other senior tax officials. The matters discussed are issues that concern different areas of the Tax Office.

5.18 The GST Tax Professionals and Insolvency Forum comprises Tax Office and tax professional industry representatives and is responsible for identifying and resolving issues of concern to the tax professionals industry concerning GST and associated matters.

5.19 The ATO Tax Practitioners Forum is chaired by the Tax Office's Deputy Commissioner for Small Business and attended by representatives of the accounting profession and tax practitioners. It aims to identify, discuss and jointly resolve significant tax administration issues of a day-to-day nature and to identify, discuss and commission work

in relation to initiatives that would assist tax administration overall. It has several subcommittees including the Lodgment Working Party that focuses on lodgment issues.

5.20 However, tax practitioners and representatives of small businesses indicate that these forums are not focused on small business debt issues but other issues, such as lodgment, GST or broader concerns of small businesses' experience in the tax system generally.

AWARENESS OF *ATO RECEIVABLES POLICY*

5.21 Related to the administration of the *ATO receivables policy* has been the nature of the document itself. A number of accountants, tax agents, legal practitioners and tax practitioner associations comment that there is generally a poor awareness in the tax practitioner and small business sectors of the *ATO receivables policy*. Tax practitioners indicate that this may be because tax officials do not refer to the policy when providing reasons for decisions.

5.22 Also, tax practitioner bodies say that they find the *ATO receivables policy* not easy to access and use and that the Tax Office's website frequently denies access to the document because of internet traffic. They suggest that the Tax Office could improve accessibility to the policy by having publications specifically targeted to different sectors, such as small business, and to particular issues, such as what chapters of the policy are relevant when a debtor is unable to meet tax obligations.

5.23 In response, the Tax Office states that it is difficult to articulate a course of action that will be taken in every case as this is dictated by the circumstances of the debtor. As such, the *ATO receivables policy* can only articulate what factors the Tax Office will consider in making a decision to take a particular course of action.

CERTAINTY AND TRANSPARENCY

5.24 Some tax practitioners state they do not see a methodology in the Tax Office's approach to debts it targets for collection. They argue that the *ATO receivables policy* should provide greater clarity and guidance to taxpayers and their advisers of what action the Tax Office will take if certain timeframes or milestones in paying outstanding tax are not met. Submissions have suggested that these milestone events could vary from being required to contact the Tax Office regarding an outstanding debt to providing information to the Tax Office in respect of the business's viability and making payment by a certain date.³⁸ These submissions state that rather than providing small business with a blueprint to avoid payment it will improve the Tax Office's accountability by having a public target to meet. They point to the publication of the Commissioner's compliance program as an example.

5.25 Representatives for small business gave support for this option to be explored further.

5.26 The Tax Office states that if it were to publish timeframes and milestones for the debt collection processes it would encourage otherwise compliant taxpayers to delay paying tax in accordance with those timeframes and milestones.

³⁸ Chapter 7 of this document discusses stakeholders' views on the lack of certainty and transparency in the *ATO receivables policy* specifically in relation to the initiation of legal action by the Tax Office.

5.27 However, tax practitioners refute this argument. They state that the Tax Office response indicates that it does not understand small businesses' behaviour and how that affects tax debts. In the tax practitioners' view, the issue is a question of minimising borrowing costs and access to finance.

5.28 They argue that a small business that does not have readily available cash to pay the tax debt will seek to borrow money at the cheapest possible cost. For unsecured borrowings, commercial lenders generally charge a cheaper rate than the general interest charge (GIC). Therefore, small businesses will try to borrow from commercial lenders rather than incur the GIC.

5.29 However, where a small business either does not intend to pay its outstanding tax or commercial lenders will not lend money to the small business, the small business will effectively use the Tax Office as a source of borrowings. In these circumstances the rate of the GIC will not act as a deterrent and its adverse effect may be offset by the lack of needing to apply for borrowings, to pay for application fees for borrowings or to give notice to secured creditors of increasing debt exposure.

5.30 Therefore, they conclude, publication of timeframes and milestones would not affect the behaviour that is driving non-payment.

5.31 Insolvency practitioners point to the adverse effect that the Tax Office's inconsistent approach has on voluntary compliance. For example, they comment that many businesses know that the Tax Office may never take action against them despite the letters the Tax Office sends them and the phone calls it makes.

5.32 Tax practitioners also comment that the small business community should be consulted in developing clear debt management guidelines. They argue that it is self-evident that more transparency would not only promote certainty with the Tax Office's processes but it would also promote equity by reducing uncertain risks in the market—for example, removing other creditors' perceptions that a business is viable based on the assumption that the Tax Office acts like any other creditor, when in fact, the business has an aged tax debt.

CHAPTER 6: IMPLEMENTATION OF TAX OFFICE POLICY

INTRODUCTION

6.1 The second focus for the terms of reference asks the Inspector-General to consider the manner in which the Tax Office implements its small business debt collection practices. All submissions considered this issue.

6.2 The third focus for the terms of reference asks the Inspector-General to examine the impact of the Tax Office's small business debt collection policies and practices on aspects of that collection. One of those aspects specified in the terms of reference is the Tax Office's management of debt collection cases.

6.3 This chapter will outline the views expressed on the Tax Office's small business debt collection practices generally and the Tax Office's management of debt collection cases. These views overlap to some extent with those expressed in the later chapters. The later chapters focus on specific aspects of the Tax Office's debt collection practices.

6.4 Submissions raised a variety and range of themes and issues on the Tax Office's implementation of debt collection policies and the impact of the Tax Office's management of debt collection cases. The views expressed on these themes and issues sometimes conflicted. They are:

Overall

- There are a variety of systemic problems with the Tax Office's debt collection practices.
- There are no apparent significant or systemic problems with Tax Office's debt collection practices.

Flexibility

- The Tax Office's flexibility allows small businesses sufficient opportunity to trade out of debt where that business maintained contact with the Tax Office.
- The Tax Office's flexibility in collecting debt has an undue adverse effect on other creditors of a debtor business, which usually include other small businesses.

Commerciality

- The Tax Office does not understand the underlying causes of small business collectable tax debts.
- Tax Office staff do not appreciate the pressures faced in running a small business.
- The Tax Office could implement fair and more effective solutions.

- The Tax Office lacks the ability to distinguish between small businesses who seek to meet their tax obligations but have difficulty doing so and those who could pay but seek to avoid or defer obligations.

Coordination

- The Tax Office would benefit from coordinating the actioning of debt collection cases with the Australian Securities and Investments Commission.

Consistency

- The *ATO receivables policy* is applied haphazardly and inconsistently.
- There is an inconsistent approach between different Tax Office sites that handle debt collection cases.
- There is an inconsistent approach between different levels of tax officials.

Certainty and transparency

- Tax practitioners and small businesses find it difficult to determine how the Tax Office implements the *ATO receivables policy*.
- There is insufficient transparency in the debt collection process as a debt case moves from one area within the Tax Office to another for actioning.

Timeliness

- The Tax Office is not timely in its recovery of debt.

6.5 Specific aspects of the Tax Office's implementation of debt collection policies—payment arrangements, legal recovery action, compromise of tax debts and release—are discussed in the following chapters.

OVERALL

6.6 Overall, submissions voice a variety of concerns with the Tax Office's debt collection practices. With the exception of the Taxation Ombudsman, submissions indicated that these concerns were of a systemic nature.

6.7 The Ombudsman submits that notwithstanding the complaints received and investigations conducted by his office:

it is not apparent that there are any significant or systemic problems with ATO tax debt collection practices.³⁹

6.8 The Ombudsman reported in his 2003 annual report that almost a quarter of complaints to his office about the Tax Office were related to debt collection, particularly the

³⁹ Taxation Ombudsman, written submission, 25 May 2004, p. 1.

application of penalties, negotiations over payment arrangements and the attitude of debt collection staff.⁴⁰

6.9 The Ombudsman found the Tax Office open and cooperative if debtors initiated contact with the Tax Office and stated that he was not aware of any evidence of undue legal action. Most complaints received by him were based on a debtor's lack of awareness about the debt collection process—for example, they perceived reminder letters as threats.

6.10 Other views raised in submissions are discussed below.

FLEXIBILITY

6.11 The Tax Office states that it seeks to be flexible in the terms and conditions offered to those businesses that were facing difficulties in paying their tax obligations in full by the due date. This may take the form of agreeing to nominal repayments in times of a business's low cash flow.

6.12 The Tax Office also states that it aims to keep taxpayers 'engaged in the system'. This means that it seeks to encourage taxpayers to maintain compliant behaviours, such as contacting the Tax Office if there are difficulties in making payments.

6.13 Further, the Tax Office also states that it ensures that it checks that the business has been afforded every opportunity to negotiate repayment—including Tax Office-initiated contact—before initiating legal action to recover amounts.

Media perception not shared

6.14 Representatives for small businesses perceive that there is growing media coverage indicating that the Tax Office is uncompromising when recovering debt, may be unnecessarily harsh and is trying to catch out small businesses rather than assisting them.⁴¹

6.15 With the exception of those involved in mass-marketed schemes and isolated cases brought to the Inspector-General's attention, representatives for small business, the accounting, tax practitioner and legal professions all agree that the Tax Office is flexible in its approach to collecting debt from the small business sector.

6.16 However, parties disagree on whether this approach should be supported.

Some support for Tax Office approach ...

6.17 With the exception of those representing mass-marketed scheme investors, representatives for small businesses state that the Tax Office is generally sympathetic and accommodates the needs of individual small businesses and that the Tax Office's processes for collecting debt generally reflect the circumstances of business.

40 Commonwealth Ombudsman, *Annual Report 2002-03*, Canberra, July 2003, pp. 36-50.

41 See for example—'Number of failing businesses to rise', *Sydney Morning Herald*, 23 January 2004, Internet article; 'Will the taxman send you broke?', *Business Review Weekly*, 29 January 2004, pp. 47-51; and 'Crackdown under way', *Business Review Weekly*, 11 March 2004.

6.18 Most representatives comment that so long as a business is willing to discuss its circumstances with the Tax Office, it would generally be treated reasonably and a suitable arrangement could be brokered which enabled the business sufficient opportunity to trade out of its debt with the Tax Office. However, they did comment that the Tax Office's approach could be improved through an increased understanding of small business needs.

6.19 Tax practitioners also observe that, with the exception of isolated and rare cases, the Tax Office adopts a conciliatory approach towards small businesses. In support of this view, a tax practitioner body comments that it has not heard complaints from its members in relation to the Tax Office's debt collection activities in the last five to six years.

However, tax practitioners divided on support

6.20 Tax practitioners appear divided over whether to support the Tax Office's flexible approach to debt collection. A significant sector of tax practitioners, especially those who advise small business clients, support the Tax Office's 'soft' approach. They comment that this approach was appreciated given the recent significant changes to the tax system with the introduction of *The New Tax System*.

6.21 The tax practitioners generally advising the larger businesses of the small business sector express concerns about the Tax Office's 'soft' approach. They comment that the Tax Office appears reluctant to collect small debt and offers initial payment arrangements that are far too generous. They argue that the full effect of the Tax Office's 'soft' approach is masked by the recent good economic environment. Given the 25 per cent increase of collectable debt in the 2002-03 year they see no systemic changes in the Tax Office's approach to stem this trend and feel that the level of collectable debt would continue to rise significantly and would harshly affect small businesses' exposure to tax debts when the economic conditions change.

Insolvency practitioners

6.22 Insolvency practitioners argue that in certain circumstances the Tax Office's flexibility is not a good thing for the business community generally.

6.23 They point to circumstances where small businesses are unable to determine adequately their own viability and rectify loss-making activities. In these circumstances, they state that the Tax Office's flexibility exacerbates the business's downward slide towards insolvency and that although it wants to be treated like any other creditor it is not acting like any other creditor—for example, providing access to funds where other creditors would request a personal guarantee from the proprietor.

6.24 These practitioners also point to the broader effects on the business community: loss-making businesses are able to trade longer on Tax Office-supplied credit and therefore increase other creditors'—usually other small businesses'—exposure to loss. Additionally, this continuing trade has an inequitable effect on competitors of the business who are likely fully compliant with their tax obligations.

6.25 Insolvency practitioners did concede that their experience was not representative of all small businesses. They only saw those businesses likely to be in financial difficulty. However, they indicated that the Tax Office could be taking a more considered approach in relation to those small business collectable debt cases with larger debts such as those of over

\$100,000. On figures supplied by the Tax Office, approximately 7000 small businesses owe more than \$100,000 each.

COMMERCIALITY

6.26 A common comment in submissions is that the Tax Office is not 'commercial' in its debt collection activities. The reasons underlying this comment are varied.

Underlying causes of small business collectable tax debts

6.27 The lack of commerciality on the part of the Tax Office was expressed to include a lack of adequate understanding of the reasons why a small business gets into debt with the Tax Office and other creditors. Representatives for small businesses and tax practitioners state that the factors that influence the small business sector's compliance with tax payment obligations – outlined in Chapter 2 – contribute to the reasons why a small business accrues a collectable debt.

Failure to make provision for debts

6.28 All parties generally agree that a major cause for small business collectable debt was the failure to make provision for tax debts. This is either because the business does not realise how much it would be liable to pay or because cash flow is tight and the Tax Office is the only institution willing to provide the business with credit. However, a representative for small businesses points out that a business will generally not fall into debt with the Tax Office where the business uses accounting software that automatically calculates the Business Activity Statement item entries and the business does not use the monies it puts aside for future tax liabilities.

6.29 Parties were divided on what could be done to help businesses make provision for tax debts and whether the Tax Office's actions (such as audit activity retrospectively adjusting prior year claims) or inaction (such as delay in chasing up the small business for the debt) contributed to this behaviour.

Tax Office's initial educative approach

6.30 There is a general perception that the level of small business collectable debt can be attributed to the Tax Office's educative approach in implementing *The New Tax System* during the first couple of years from inception on 1 July 2000.⁴²

6.31 The reasoning is generally that during this period Tax Office resources were diverted from compliance activities to educating small businesses. Now recently refocused compliance activities have found a history of non-compliant behaviour which, when corrected, results in the raising of debts covering periods going back to 1 July 2000 – four years ago. To support this argument further, insolvency practitioners state that they are seeing an increasing amount of potentially insolvent businesses, mainly one-person enterprises, with unascertained tax debts because the business has not lodged activity statements over the last few years.

⁴² See Commissioner of Taxation, speech to the Chartered Accountants in Business (CABs) Congress '98, 'A New Tax System – Changing Cultures', Sydney, 19 November 1998.

6.32 The Tax Office disputes this argument and states that it has maintained its compliance activities throughout the implementation of *The New Tax System*. It indicates that the perception could be as a result of a mixture of confusion over the Commissioner's undertaking not to use information that officers came across in education activities for the purpose of compliance action and the fact that the small business sector is now remitting more tax than ever before.

6.33 However, in an interview with Inspector-General staff, senior tax officials stated that the 25 per cent increase in collectable debt for the 2002-03 year was due to a backlog of activity statements being lodged. The Tax Office refused to provide reasons for the increase in collectable debt over the 2003-04 year. The Tax Office was unable to determine whether lodgment of multiple and outstanding activity statements by businesses was as a result of its audit and enforcement activities.

Tax Office conduct

6.34 Small businesses and their representatives state that the Tax Office allows debts to accumulate and then takes recovery action at a later date without notice. Also they comment that Tax Office errors, such as crediting payments against wrong Tax Office accounts, may contribute to small businesses accruing debts. They point to the financial strain that the Tax Office's approach had on small business. Businesses with limited cash flow were liable not only for the outstanding tax but additional penalties and the general interest charge (GIC).

6.35 The Tax Office advises that it cannot determine the GIC component of those collectable debts incurred by businesses which continue to trade:

The Tax Office's accounting system operates on a running account balance account. Liabilities are posted and credits (payments) are applied to the balance of the account rather than matched to individual liabilities. Categories of primary tax, interest and penalty amounts cannot be readily identified.

6.36 Some tax practitioners argue that collectable debt can also be attributed to the time lag (between entrepreneurial activities giving rise to a future tax liability and the lodgment of forms leading to an assessment of tax liability) and the fact that 50 per cent of small businesses lodge their own Business Activity Statements and therefore get advice from their tax practitioner at the time of preparation of annual income tax returns. Therefore, they recommend, the Tax Office needs to be more proactive in relation to these types of small businesses.

6.37 In 1997, the Auditor-General recommended that the Tax Office conduct research into the causes of outstanding debt.⁴³ In 2000, the Tax Office reported that implementation of that recommendation was in progress:

The ATO has initiated a wide range of research projects and strategies including specialised research projects into classes of like debtors, and other research into debtor population. This was conducted using the risk profiling neural net algorithms, predictive analytic research undertaken with the ABS, the use of specialised risk-focused work analysis software such as the

⁴³ Australian National Audit Office, *Audit Report number 13 of 1996-1997: Tax Debt Collection*, 18 November 1996, recommendation 1.

On-Line Analytic Processing (OLAP) facility, and the ATO's in-house research facility the Kdnet.⁴⁴

6.38 The Tax Office has identified some systemic reasons for payment arrangement default. It identified payment instalments coinciding with quarterly Business Activity Statement payments and the second and third payment of an arrangement as areas of higher risk of non-payment. They also identified a culture within certain groups of debtors that enter serial payment arrangements but consistently fail to pay instalments.

6.39 The Tax Office has trialled staff monitoring high-risk payment arrangement cases on an ongoing basis. They found improved compliance. They attribute this to the improved rapport between staff and debtors and the signal being sent to serial defaulters that they will deal with the same case officer in the event of default. The Tax Office states that this system, however, is resource-intensive and unlikely to become a national practice.

6.40 The Tax Office did not point to other work done to understand the causes of tax debts.

6.41 In the *Compliance Strategy 2004-05*, the Tax Office points to activities it sees as improving small businesses' compliance with their payment obligations. With the exception of the small business debt initiative involving structured repayment arrangements, these measures are the current Tax Office approach.

Appreciating the pressures faced by small business

6.42 Accountants and representatives for small businesses suggest that in determining how a small business debt collection matter is to proceed, the Tax Office does not adequately understand the pressures being faced by small business taxpayers.

6.43 A taxpayer representative body submits that the Tax Office has no regard to the timeliness or negative effects upon a taxpayer of delays to enquiries and requests for information. They also submit that tax officials have poor commercial knowledge and ability and that their attitude does not support a business.

6.44 They argue that the Tax Office, through its debt collection policies and practices, has failed to recognise that a business that continues to trade may have a better chance of paying off its debts and more taxes into the future than one that is prematurely forced to stop trading.

6.45 It has also been stressed by a number of practitioners that it is important that the Tax Office do more to remain in touch with the realities of small businesses. This could be achieved through consultation and an expansion of the form of assistance provided by the Tax Office to small business taxpayers identified as having difficulties meeting their tax obligations.

6.46 Another concern raised by a number of stakeholders including accountants, tax agents, legal practitioners and small business taxpayers is that the Tax Office appears to have adopted a process-driven approach in managing its debt collection cases as opposed to one focused on achieving an appropriate outcome in the circumstances.

⁴⁴ Australian National Audit Office, *Audit Report number 23 of 1999-2000: The Management of Tax Debt Collection*, 20 December 1999, p. 121.

Alternative arrangements

6.47 Submissions raise many suggested solutions. However, representatives for small businesses counsel caution as these solutions may 'throw the baby out with the bath water'. They recommend further research into the potential for these solutions to improve tax administration.

Increased small business training

6.48 Some tax practitioners assert that notwithstanding the Tax Office's initial education focus when implementing *The New Tax System*, small businesses have faced an increased burden without a corresponding increase in training. Given that many new small businesses are entering the tax system—small businesses account for more than 90 per cent of the 600,000 annual new registrants for an Australian Business Number—they argue that the Government should provide the funds for training, that the training be provided by either government bodies or peak organisations, and that any costs would be offset by reduced levels of collectable debt and compliance resourcing. Accountants suggest that this training should assist the small business community to manage cash flow and funding of tax debt. They consider that such a measure would go some way toward addressing the systemic problem that exists.

6.49 Representatives for small business comment that this proposal may have merit, and opportunities to tailor existing training programs for small businesses could be examined.

6.50 Most submissions propose that the Tax Office have more well-trained staff to encourage debtors to come forward with problems they may be having in meeting their tax obligations. This could be similar to the assistance provided to taxpayers with the introduction of *The New Tax System* and involving seminars to educate small business on their responsibilities under the tax laws and how to manage cash flows better.

6.51 The Tax Office states that it already provides education to small businesses through the form of BizStart seminars and record keeping products. Further, the Tax Office states that it is not its role to educate small businesses in how to manage their business.

Periodic amnesties

6.52 Some tax practitioners and commercial debt recovery agents agree that one cause of small business collectable debt was that some businesses ignore paying the debt for some time until it amounts to an unmanageable amount. In these cases, tax practitioners observe that proprietors feel they are unable to approach the Tax Office to negotiate. They say that providing periodic amnesties would help to reduce collectable debt as small businesses would feel more inclined to approach the Tax Office. They were of the view that a 'one-off' amnesty would only help to reduce currently existing collectable debt and not address the underlying problem of small businesses' reluctance to approach the Tax Office where a debt is unmanageable.

6.53 They were also of the view that the Tax Office's current small business debt assistance initiative was such an amnesty. This initiative is discussed further in Chapter 7.

Increasing frequency of payments

6.54 Tax practitioners also suggest that because, in their view, the failure to make provision for tax debts is due to a short-term focus on managing cash flow, non-compliant businesses should be forced to make payments more frequently to the Tax Office before a liability is raised. They point out that this does not necessarily mean that the Business Activity Statement needs to be lodged more frequently, only that payments be made more often.

6.55 Amounts to pay could be estimated either on an industry average basis, on the same lines as the Commissioner's amount on quarterly Business Activity Statements, or as a percentage of either of the former.

6.56 Tax practitioners for the smaller of the small business sector suggest that improved payment methods would reduce small business collectable debt. They suggest that the Tax Office extend its taxi industry payment card arrangements to all micro-businesses. This card effectively allows businesses to make payments of any amounts at any Australia Post outlet. These practitioners rejected the idea of direct debit or Electronic Funds Transfer (EFT) payments for those small businesses that did not take up these payment methods as part of their business practices.

6.57 Representatives for small businesses indicate that this option is worth exploring further.

6.58 One tax practitioner was of the view that most small business proprietors were not really business owners but 'self-employed' and therefore should have tax deducted at source in much the same way as in the old Prescribed Payments System and reconciled on lodgment of the Business Activity Statement.

Exposing business proprietors to personal liability

6.59 Insolvency practitioners and tax practitioners observe that small businesses with significant collectable debts are more motivated to take steps to resolve the debt where the proprietors are exposed to potential personal liability for the debt. They observe increased motivation where the Tax Office serve Director Penalty Notices on directors. Also they observe increased motivation where commercial creditors pursue avenues involving a proprietor's personal liability for the business's debts. They recommend that the Tax Office seek personal guarantees.

6.60 However, one tax practitioner comments that the Tax Office effectively does this where the directors have been served Director Penalty Notices and the director loans funds to the company to repay their personal liability. In these circumstances, the Tax Office allocates those funds across all the debts.

Discount on primary tax amounts for pre-payments

6.61 It was brought to the attention of the Inspector-General that New Zealand was considering a proposal to give small businesses a 6.7 per cent discount on taxes where they made voluntary payments before any liability was due in the first year of that business's

trade.⁴⁵ The New Zealand Government found that New Zealand small businesses were finding it hard to budget for tax payments, had their cash flows significantly affected by tax payments and generally defaulted on tax payments in the third year of trade.

Increased Tax Office training

6.62 Most submissions assert that tax officials do not understand the circumstances in which small businesses find themselves or do not have sound financial knowledge. The reasons given for this view are either because the staff appear to have poor commercial knowledge and ability or because the staff do not display an understanding of running a small business. They recommend that either the Tax Office train its staff, employ people with business knowledge or outsource the debt collection function.

6.63 The need for the Tax Office to collect debt in a more commercial manner has also been raised in one of the Tax Office's peak forums for tax practitioners, the National Tax Liaison Group, at its December 2003 meeting.⁴⁶

6.64 Some taxpayer representative bodies and tax practitioners stated that in some circumstances the Tax Office treats small businesses as 'tax cheats'. They indicate that veiled threats have also been used in negotiating arrangements to recover debt—for example, if payment is not made the business will be targeted for future audit action.

6.65 A tax practitioner explained that the Tax Office views 'messy' commercial arrangements as an indicator of deliberate non-compliant behaviour. However, commercial arrangements with small businesses may not be 'clean cut' for many reasons. Although there are some arrangements that are deliberately structured to sit on the cutting edge of tax planning, tax practitioners state that this is rare because the existence of a 'messy' arrangement is generally an indication of either not obtaining or not following quality advice in the first place.

6.66 The Tax Office advises that it has delivered 'specialised debt collection techniques skilling' to 2,000 of its debt collection staff in the last 18 months. There is no specific skilling or training on awareness of small business circumstances. However, it states that this is taken into account in other training—for example, training on listening skills, determining needs and wants, learning through day-to-day work experiences, developing common sense approaches based on the circumstances presented by the taxpayer, collection skilling questions embedded in the dialogue and explaining and articulating reasons for decisions. Staff are also trained in financial skills and analysis.

6.67 The Tax Office notes that small businesses are one of the many types of taxpayers with a debt. It also poses the question of whether focusing on small business would be equitable to other types of taxpayers.

6.68 Further, the Tax Office is of the view that concerns expressed to it of its 'lack of commerciality' were from disgruntled taxpayers who did not get the decision they wanted. However, the Tax Office does acknowledge that in certain circumstances the taxpayer may

45 New Zealand Government, *Making it easier for small businesses: A government discussion document*, September 2003, <http://www.taxpolicy.ird.govt.nz/publications/files/html/makingtaxeasier/> viewed on 4 May 2004.

46 Australian Taxation Office, *NTLG Minutes of 3 December 2003*, 1 June 2004, <http://www.ato.gov.au/print.asp?doc=/content/44415.htm> viewed on 24 August 2004.

not fully understand the Tax Office's position and the reasons why it has adopted such a position.⁴⁷

Outsource debt collection functions

6.69 In 2003, the Tax Office contracted Ledlin Partners, business and commercial lawyers, to review a number of debt collection practices in the Tax Office. Ledlin Partners provided their final report to the Tax Office in March 2003. They commented that:

... it is worthwhile that outsourcing remain on the ATO agenda.

6.70 They recommended that:

... a 'watching brief' be developed for the [American proposal to outsource some of the American Internal Revenue Service's debt collection function] and its effectiveness be re-visited in 12 months.⁴⁸

6.71 The Tax Office accepted this recommendation and stated:

As this report acknowledges, the Tax Office has considered outsourcing possibilities in the past and will continue to do so on the basis of effectiveness. However, any proposal would need to be consistent with the Tax Office's responsibilities to the community. The ATO would remain accountable for tax debt and the manner in which it is managed, irrespective of who actually does this.⁴⁹

6.72 Commercial debt recovery agents point to other circumstances where Commonwealth bodies have outsourced part of their debt collection function to commercial debt recovery agents for several years. In these circumstances, the body's responsibility to the community was able to be protected by tailoring commercial recovery processes. In particular, these processes included in the agent's performance indicators a measure of its sensitivity to the circumstances of the particular classes of debtors from which amounts were recovered.

6.73 The Tax Office indicates that any trials to outsource debt collection functions will not be considered before the implementation of its 'Change Program'. Implementation is not expected to be complete before December 2008.

Improve access to better quality decisions

6.74 Accountants, tax agents and representatives of legal practitioners all express the view that the Tax Office appears to have a 'one size fits all' approach to debt collection. It is only where the debtor's representatives are able to escalate the issue to more senior tax officers that they feel they are able to get a better quality decision. It has been their experience that when dealing with tax officers at higher levels the circumstances of the debtor are adequately considered and there can be some deviation from lower level officers' strict application of the *ATO receivables policy*.

⁴⁷ *ibid.*

⁴⁸ Australian Taxation Office, *Australian Taxation Office response to the Ledlin report*, September 2003, <http://www.ato.gov.au/print.asp?doc=/content/37886.htm> viewed on 24 August 2004.

⁴⁹ *ibid.*

6.75 For example, accountants and representatives of legal practitioners state that small business taxpayers, particularly micro-businesses, are in a unique situation in relation to payment of tax liabilities. They comment that small business taxpayers do not have that same access to information or access to higher level officers within the Tax Office to provide assistance to them when they are having difficulties paying their tax debts. They also compare small business taxpayers' circumstances to other types of taxpayers' circumstances. Salary and wage earners have tax deducted at source. Large businesses are better able to afford advisers, accountants or lawyers to handle their tax affairs. Therefore, they conclude, unlike salary and wage earners and large businesses, small business taxpayers require a great deal more assistance from the Tax Office in ensuring that they are able to pay their outstanding tax debts.

6.76 As such, a number of accountants and legal practitioners suggest that tax officials managing debt collection cases not only need training in understanding small business pressures but also in how to identify cases for escalation to get a better quality decision. Also, they state that staff need to acknowledge the complexity of the laws and the lack of taxpayer understanding.

6.77 Legal practitioners submit that the Tax Office should consider engaging either staff that have extensive experience in the private sector such as legal practitioners who have acted for mercantile agents and are familiar with 'both sides of the equation' or staff that have worked for private mercantile agents.

Action to focus proprietor on viability

6.78 Insolvency practitioners, accountants and tax practitioners express the view that, through the management of debt collection cases, the Tax Office needs to ensure that small business taxpayers are made to focus on outstanding tax debts. They argue that this needs to involve requiring the debtor to consider the financial position of the business at the first sign of trouble and seek independent advice if necessary.

6.79 Accountants, tax practitioners and a legal practitioner specialising in debt recovery express the view that the Tax Office needs to be more proactive in how it manages debt collection cases. As part of the management of debt collection cases they suggest that the Tax Office should ensure that it incorporates in its practices the discipline of having small business people understand their business. They submit that the Tax Office has to get away from the idea that collecting outstanding debts is simply a matter of issuing a demand and then rote application of legal process. Rather, it should be able and willing to communicate with taxpayers and encourage them to enter into reasonable and binding instalment arrangements if they are not able to pay the full amount at once. However, they stress that such a response on the part of the Tax Office needs to be timely and commercial. The aim should be to motivate and assist debtors to pay the debt by focusing the debtor's attention on payment.

6.80 They suggest that the Tax Office could do more to assist small business debtors who are having difficulties meeting their tax obligations.

6.81 For example, they propose that the Tax Office could approach a number of targeted businesses with large debts, based on industry and risk, and assist them in focusing on their debt problems. Such focus could involve members of the insolvency profession going out to targeted businesses and discussing their financial state. This would be followed by the debtor seeking professional advice regarding their financial position and an action plan

being developed to assist the small business to meet its outstanding tax obligations. Depending upon the level of cooperation demonstrated by the debtor in dealing with the outstanding tax debt, part of that action plan could involve extended payment arrangements, temporarily writing off part of tax debts or possibly even the compromise of outstanding tax debts. This approach is similar to the approach adopted by the Australian Securities and Investment Commission in its National Insolvency Project.

6.82 Tax practitioners who advise small businesses comment that this proposal is directed towards the cases in higher debt levels and that if it were applied to the lower debt levels it may 'force businesses underground'.

6.83 The Tax Office states that it is not its role to determine the viability of small businesses or assist small businesses in this activity. Further it points to statistics which show that in 60 per cent of collectable debt cases debtors pay immediately after receiving the first reminder letter.

6.84 However, tax practitioners state that the reminder notice only works where a debtor has forgotten to pay and that no response after that first letter should indicate to the Tax Office that the small business is seeking to avoid contact with the Tax Office. In any event, they are of the view that the Tax Office should act to focus small businesses on their debts by commencing legal action within 90 days of the debt becoming outstanding.

6.85 Representatives for small businesses comment that a time threshold, to the exclusion of other triggers, is not an appropriate criterion to commence legal action.

Improving communication

6.86 Small businesses, tax practitioners and representatives for small business, accountants and taxpayers state that the Tax Office needs to improve its communication with small business over their debts. They perceive a lack of early, effective and sufficient communication, especially in relation to small businesses who lodge their own Business Activity Statements.

6.87 However, tax practitioners state that they still field many queries from their clients who need assistance in understanding their Tax Office statements—for example, not understanding how entries on different statements in relation to the income tax account and the integrated account interact.

6.88 The Tax Office states that it sends statements of account to taxpayers on a periodic basis and reminder notices and interest notices where a debt is outstanding. Also, small businesses could now access their accounts online via the business portal. It states that in any event, a small business self-assesses its liability and therefore knows before the Tax Office what amount of tax liability will need to be paid.

6.89 Additionally, the Tax Office is trialling an early payment reminder letter that is issued to the taxpayer before their debt is due and payable. It targets those in higher risk areas, including those who did not pay on time the previous year. It advises that for the 2 March 2004 due date, 133,000 letters were sent during 12 to 20 February 2004. For the 31 March 2004 period, 4,000 letters were sent on 18 February 2004. The Tax Office has not referred the Inspector-General to the results of this trial.

6.90 However, accountants say that statements of accounts are sent out on an ad hoc basis and that despite the public release of the business portal there is no widespread awareness of its existence.

DISTINGUISHING WILFUL NON-COMPLIANCE FROM DIFFICULTY TO PAY

6.91 Most private sector submissions agree that, in appropriate circumstances, the Tax Office should be flexible in how it seeks to recover debts from small businesses. However, all express concerns that the Tax Office does not sufficiently distinguish those businesses that want to pay their debt but have difficulty in doing so from those businesses that could pay but do not. They are of the view that those who are wilfully non-compliant should not be able to take advantage of the Tax Office's flexibility.

6.92 This inability to determine sufficiently whether a business is wilfully non-compliant or just in financial difficulty appears to affect detrimentally private stakeholders' perceptions of the fairness and equity of the Tax Office's debt collection practices.

6.93 Commercial debt recovery agents comment that the Tax Office could do more to 'protect everyone from tax predators' by being more 'commercial' or timely in its debt recovery function, resulting in fewer creditors suffering.

6.94 Others, such as insolvency practitioners, have expressed a concern that notwithstanding a business representing a risk to revenue, the business is afforded much flexibility by the Tax Office and allowed to enter into a payment arrangement when in fact more coercive action is required.

6.95 The Tax Office states that it 'errs on the side of the taxpayer' when deciding what recovery action to take in relation to a small business debtor. It also states that to be able to distinguish between these two types of taxpayers would require an assessment of the business's financial position. They state that this would mean that the business would need to supply either the Tax Office or an insolvency practitioner with a wealth of financial information. This would significantly increase a small business's compliance costs and distract the business from pursuing entrepreneurial activities.

6.96 Additionally, the Tax Office stated that it had done some work on assessing a business's likelihood of ultimate non-payment by looking at the coincidence of historical information, and implemented this into its IT system Net Risk. However and although the Net Risk system is 'switched on', this capability is not being used by the Tax Office.

COORDINATION

Better coordination with ASIC

6.97 In discussions with the National Insolvency Coordination Unit (NICU) of the Australian Investments and Securities Commission (ASIC), a number of concerns regarding the actions of the Tax Office on the work of the NICU were raised with the Inspector-General.

6.98 Firstly, it was suggested that the Tax Office only seems to focus on the debtor entity without appreciating the other associated entities in the group and how the debtor is interacting with those other entities.

6.99 Secondly, it was suggested that there needs to be a better and less restricted flow of information between ASIC and the Tax Office. This could involve ASIC passing over information to the Tax Office regarding debtors that ASIC identifies as potentially insolvent because of significant tax debts. Alternatively, it could involve the Tax Office identifying debtors for review by ASIC where there is information indicating that the directors of a debtor company may be in breach of their duties. Also the sharing of information between agencies in respect of possible phoenix companies could allow a more strategic approach to be adopted.

6.100 Thirdly, ASIC indicated that in some instances where the company is being reviewed, the Tax Office has been too lenient in allowing such a company to enter into a payment arrangement without a proper assessment of the company's capacity to pay.

Better coordination of relief measures

6.101 Concerns have also been expressed by a taxpayer representative body that the Tax Office does not have a coordinated approach in its application of the relief measures where taxpayers are having difficulty meeting their taxation obligations. It has suggested that a taxpayer needs to make separate applications for the various forms of available relief, for example, relief due to serious hardship and remission of the GIC applications, to allow payment by instalments and compromise of the debt. It suggests that the Tax Office needs to take a more global or 'whole-of-client' approach when considering whether relief is appropriate.

6.102 Where appropriate, this could involve applying the various forms of relief simultaneously to an application by a debtor. For example, it has been suggested that measures such as partial write-off or partial compromise can be considered together with a partial remission of GIC. This would allow a viable small business debtor that is having difficulties meeting its taxation obligations due to unforeseen business circumstances to make partial payments of tax while continuing to trade.

CONSISTENCY

Common views

6.103 In a comment echoed by many tax practitioners, accountants and lawyers, a taxpayer representative body stated that:

The ATO implementation of any small business debt collection policy that may be favourable to a taxpayer is haphazard and inconsistent.

6.104 Tax practitioners comment that the Tax Office's actions appear 'arbitrary' and may be one of the reasons for small business sector collectable debts. Also, that the Tax Office does not respond consistently to defaulters or appear to consider businesses' compliance history, whether good or poor. Similar comments were made by the Senate Economics Committee in 2001 in relation to the Tax Office's recovering debt from participants in mass market tax effective investments:

... the Committee is of the view that, at the very least, there seems to be a significant gap between the ATO's stated policy and its implementation by regional offices.⁵⁰

6.105 One tax practitioner provides an example of, on the one hand, the Tax Office suing one client for recovery of \$1000. On the other hand, the Tax Office does not attempt to contact another client who has owed the Tax Office over \$250,000 for over a year.

6.106 Tax practitioners urge the Tax Office to enforce payment obligations uniformly and consistently.

Consistency between Tax Office sites

6.107 Legal practitioners and accountants indicate that in certain instances, the debt collection matter will be handled in a different state to that where the taxpayer is located. This echoes comments made by the Auditor-General in 1997 before the Tax Office publicly released the *ATO receivables policy*.⁵¹ They suggest that this can sometimes lead to a tax officer not having an awareness or understanding of the circumstances facing the business. One view expressed was that systems and work practices should be state-based with, for example, New South Wales debtors being handled by staff located in New South Wales.

6.108 Accountants state that there is evidence of different approaches being taken by different offices and they perceive that it is all a matter of whom you talk to in terms of the likely outcome. They comment that clearer debt collection guidelines are required, with well-defined time lines and outcomes so as to promote a consistent quality control of delivery.

6.109 Accountants recommend that these guidelines be developed in consultation with practitioners and the small business community. They point to the need for effective communication of those guidelines to the small business community and practitioners so as to create certainty in expectation of how the Tax Office will manage debt collection. This would be achieved through practitioners and taxpayers having clear knowledge of critical and milestone events, where if the debtor does not meet these or make alternative arrangements they will be subject to certain Tax Office actions.

6.110 Representatives for small businesses raised another concern that in certain instances a decision by a tax officer in a regional office is disregarded if the issue becomes the focus of Tax Office scrutiny. For example, for a class of taxpayers being handled out of a regional office, a decision by a tax officer to accept a payment arrangement was not honoured when the cases became a Tax Office project and managed out of another Tax Office site.

6.111 The Tax Office states that it has a comprehensive quality assurance process which provides assurance that the quality of decisions and judgments exercised are consistent. Additionally, it states that by August 2004 all staff involved in technical decision-making in the debt collection function will have received training. The Tax Office states that the technical quality review process has not identified any systemic problems in the written advice given in the course of collecting debt.

50 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection – interim report*, June 2001, p. 48.

51 Australian National Audit Office, *Audit Report number 13 of 1996-1997: Tax Debt Collection*, 18 November 1996, paragraph 23.

6.112 Tax practitioners state that notwithstanding the Tax Office's quality assurance processes, they encounter inconsistent Tax Office approaches on a frequent basis.

CERTAINTY AND TRANSPARENCY

Transparency in management of debt collection cases

6.113 Accountants and tax practitioners express concerns that, at times, it is unclear where a particular debt collection case is in the debt recovery process. They state that there are usually periods of inaction on the part of the Tax Office in the collection of debts followed by sudden actioning. They indicate that this is especially relevant where the Tax Office seeks to take more coercive legal recovery action, such as issuing a garnishee notice or initiating bankruptcy or liquidation action.

6.114 Accountants and tax practitioners comment that they do not have a clear understanding of how a debt collection case will be handled by the Tax Office if the debt remains outstanding. They point out that, given this uncertainty as to how a debt collection case will be managed, it is difficult to advise clients on the Tax Office's likely course of action. Rather, they are only able to provide clients with general information of the consequences of failing to pay the debt on time, such as the imposition of interest and the possibility that legal action may be initiated. They also perceive that where the Tax Office does follow up a case there is no consistent pattern of approach. This point is echoed by taxpayer representatives. They state that more transparency would import a more equitable approach which would enable the market to make decisions on a better quality of information.

6.115 Tax practitioner representative bodies also express concerns with the transparency of the Tax Office's management of debt collection cases. They submit that it is difficult to determine how the Tax Office will pursue collection of an outstanding debt in particular circumstances. They indicate that the small business experience with the Tax Office in its debt collection has varied between two extremes, ranging from being quite flexible and entering into a payment arrangement to immediate legal action. They comment that this gives mixed signals to the private sector.

6.116 The Tax Office states that it has limited resources to target debt collection. It finalises 1.6 million debt cases per year and it only has approximately 3100 staff to manage both debt collection activities and lodgment activities. Although a majority of taxpayers voluntarily meet their payment obligations there are not enough staff to contact each taxpayer who has not paid on time. Therefore they target those cases identified as a higher risk.

6.117 Also, concerns have been expressed by accountants and tax agents about the handling of a debt collection matter when it is to be escalated for further actioning. Accountants and tax agents suggest that more information should be provided to them on where the matter will be escalated for actioning if the debt is not paid.

6.118 This, they submit, is required if the Tax Office is not able to specify with greater clarity and detail how it will pursue collection of an outstanding debt. Such information could be provided by way of letter or email and will be an indication to the debtor that the Tax Office is about to escalate the case for further actioning. They argue that this may focus the debtor on the outstanding debt and be a catalyst for some to seek advice on the viability of the business. Insolvency practitioners indicate that, once legal action is commenced with

the issuing of formal notices, debtors are more likely to consult a solicitor, who is unlikely to be skilled to provide advice on viability, rather than their accountant or business adviser.

6.119 Commercial debt collection agents also comment that they have a better recovery rate where the debtor is aware that their debt is about to be escalated to another area for recovery action.

TIMELINESS

6.120 Insolvency and tax practitioners commented that, notwithstanding its flexibility, the Tax Office was not timely in its recovery of debt. They stated that they continue to see the Tax Office as a significant creditor in almost all the businesses they come across in the course of their work. They comment that the Tax Office has given these businesses too long to trade out of their difficulties and allowed debts to accumulate to large levels.

6.121 7.121 The Taxation Ombudsman comments also echo these concerns:

If tax complaints to this office suggest anything, it is that the ATO is sometimes too slow to take more formal recovery action against some small business tax debtors. The situation is particularly evident in the case of superannuation guarantee complaints (from concerned employees), where there has in the past been evidence of ongoing delays in the ATO's pursuit of employers for unpaid superannuation contributions, and complaints from some small businesses that have over time allowed their tax debts to become so large that there seems little option other than bankruptcy or liquidation. Our investigation of superannuation guarantee complaints has also indicated that, where a small business has a superannuation guarantee liability, it is not uncommon that the business will have other tax debts as well (unpaid income tax, PAYG withholding or group tax, and GST)..⁵²

6.122 Commercial debt recovery agents point to research which demonstrates that the longer a debt is left outstanding the less likely that the debt will be recovered.

6.123 The Tax Office states that it has limited resources to manage 1.6 million debt cases a year. Therefore, it concludes that it must direct its resources to those cases of higher risk of non-payment. It also comments that, due to the taxes it collects and the nature of the Tax Office as a creditor, it will always feature as one of the largest creditors. The Tax Office states that, unlike other unsecured creditors whose exposure to bad debts can be minimised by refusing to trade with debtors, the Tax Office cannot choose whom it deals with.

6.124 Further, the Tax Office indicates that the small business community has not raised its timeliness of recovery action with the Tax Office as a significant issue of concern.

6.125 However, tax practitioners point to a significant number of cases in the lower debt levels where no action, other than issuing automatically generated reminder letters, has been taken. They state that based on this inaction a general perception in the tax profession and small business sectors has arisen that the Tax Office is a very lenient creditor where debts stay under a certain threshold.

6.126 The Tax Office has since stated that for those who are offered payment arrangement terms under the small business debt initiative but do not accept them, they:

⁵² Taxation Ombudsman, written submission, 25 May 2004, p. 1.

will face firm action, which may include legal proceedings or recovery of the debt from their bank accounts or other income sources.⁵³

6.127 Further discussion of this initiative is outlined in Chapter 7.

6.128 Further discussion of the lack of timeliness in relation to commencing legal action is outlined in Chapter 8.

⁵³ Australian Taxation Office, 'Small Business Offered debt assistance', Media Release—Nat 4/048, 30 June 2004, available at www.ato.gov.au.

CHAPTER 7: PAYMENT ARRANGEMENTS

INTRODUCTION

7.1 The third focus for the terms of reference asks the Inspector-General to examine the impact of the Tax Office's small business debt collection policies and practices on aspects of that collection. One of those aspects specified in the terms of reference is the impact of the Tax Office's approach to payment arrangements. Submissions voiced a number of views on this aspect of the Tax Office's small business debt collection practices. This chapter outlines those views.

Background

7.2 Generally, where a small business is unable to meet its debts when due and payable, a creditor to that small business may recover amounts owed by exercising legal rights, including initiating bankruptcy or winding-up proceedings. However, a creditor may choose to enter into an arrangement with the debtor small business whereby the debt is repaid over a period of time by instalments (a payment arrangement).

7.3 Where the Commissioner accepts a payment arrangement and the taxpayer meets that arrangement, the Commissioner will generally not exercise his power under subsection 255-5(2) of Schedule 1 to the *Taxation Administration Act 1953* to sue and recover the outstanding debt.

7.4 As at 30 June 2004, of the approximately 960,000 small businesses debt cases with the Tax Office,⁵⁴ only approximately 89,000 were in payment arrangements and about 105,000 were defaulted arrangements (cases that had failed to honour arrangements fully). Of the total small business sector collectable tax debt of approximately \$6.69 billion, only \$1.25 billion of this amount was covered by a payment arrangement and \$1.1 billion related to defaulted arrangements. Table 7.1 below further breaks up these numbers.⁵⁵

54 This figure includes 114,636 cases with credit or zero balances. No reason was provided for why the Tax Office's debt report figures include cases with credit or zero balances.

55 Note there may be minor inaccuracies in these figures as totals are as at 30 June 2004 and debt level figures are as at 13 September 2004.

Table 7.1: Small business collectable debt by arrangement type

		rrangement		Defaulted arrangement	
		\$m	Cases	\$m	Cases
Collectable debt cases	Total for all segments	1,451	134,159	1,305	157,719
Micro-business segment (<\$2 million annual turnover)	Total micro	935	84,460	1,050	102,994
	Micro debt level 4	223	6,356	242	6,887
	Micro debt level 5	213	3,118	154	2,358
	Micro debt level 6	219	1,208	75	481
SME segment (\$2 million-\$10 million annual turnover)	Total SME*	279	4,793	84	1,846
	SME debt level 4	27	713	12	313
	SME debt level 5	53	746	22	313
	SME debt level 6	163	691	56	263

Source: Tax Office

* Total SME figures are calculated as 85 per cent of \$2 million to \$100 million entities.

Views

7.5 With the exception of insolvency practitioners and some tax practitioners, all private sector parties consulted state that the Tax Office was generally flexible in its payment arrangement terms. Notwithstanding that comment the following views were expressed:

- the Tax Office does not appropriately consider how the terms of a payment arrangement will affect the underlying viability of a debtor business;
- the Tax Office does not appropriately consider how a payment arrangement will affect the underlying viability of the debtor's creditors and competitors;
- the Tax Office does not appear to consider a business's compliance history and therefore treats taxpayers inequitably;
- the Tax Office is inflexible in the period of time within which a tax debt is to be repaid; and
- the Tax Office is inflexible with its methods of repayment.

CONSIDERING THE UNDERLYING VIABILITY OF A BUSINESS

7.6 Representatives for small businesses state that the Tax Office's flexible terms and conditions generally allow small businesses to trade out of debt.

7.7 However, insolvency practitioners comment that many small businesses trade out of debt despite, not because of, the Tax Office's flexible terms and conditions for payment arrangements. They argue that entering a payment arrangement without determining a business's viability can, and does, result in loss-making businesses continuing to trade at a loss. They argue that, with the exception of those businesses who merely forgot to make a payment, a debt with the Tax Office should sound warning bells for all creditors. This is because it is most likely that the Tax Office will be the last creditor to be paid, therefore signalling potential insolvency because of an insufficient cash flow to meet liabilities when they fall due.

7.8 Insolvency practitioners observe that without a business taking quick action to make itself more profitable, the business will likely default in repayments and incur increasing debt to the point of an unsustainable amount, leading to insolvency.

7.9 Insolvency practitioners also comment that the Tax Office's flexible approach to payment arrangements is based on accepting a business proprietor's assertions of viability without seeking corroborating information. They are of the view that, where the proprietor's perception of viability is unfounded, the Tax Office reinforces that perception by accepting the proprietor's assertions. They state that, without some event to force a proprietor of a loss-making business to seek insolvency advice, the proprietor will miss opportunities to make the changes needed to their business to turn it into a profit-making enterprise. In their experience, these proprietors seek advice far too late as debts have accumulated to unmanageable levels.

7.10 Insolvency practitioners and accountants acting for larger businesses within the small business sector suggested that, where a business has a large debt and has defaulted in a payment arrangement with the Tax Office, it should be required by the Tax Office to seek independent third party advice on their viability. They state that the business proprietor should also provide the Tax Office with a summary of their financial situation within 30 days or else legal action for recovery will be commenced.

7.11 The Tax Office argues that it is neither in the business of assessing a small business's viability nor does it have the resources to encourage all non-compliant businesses to seek advice. It also argues that forcing businesses to seek advice on viability would significantly increase compliance costs for businesses—upwards from \$5,000 per assessment—that otherwise would not need to obtain that advice. In any event, such advice would be highly qualified—depending on the records available at the time and confidence in future earnings—and because of these qualifications, unsafe to rely upon. Some tax practitioners, in particular those acting for smaller businesses, also question the worth of obtaining this advice and have indicated that it may not provide the Tax Office with the assurances it would require regarding a business's viability.

7.12 Further, the Tax Office states that, out of the 1.6 million debt cases⁵⁶ it finalised in the 2002-03 income year and the 84,000 cases that were in payment arrangements, the Tax Office only initiated bankruptcy or wind-up proceedings in 771 cases, with 273 bankruptcies and 478 wind-ups.

7.13 Insolvency practitioners argue that this view highlights the Tax Office's 'one-size-fits-all' approach to collecting debts from a diverse group as the Australian taxpaying community. They argue that for the larger level debts of \$25,000 and above, steps could be taken to encourage those proprietors to assess their business's viability dispassionately. Less than 5 per cent of the collectable debt cases fall in this category and the approach would be consistent with the priority given by the Tax Office to higher debt level cases.

7.14 Further, they question whether there are more small businesses in default of their payment arrangement than those who keep their arrangements.

⁵⁶ The Tax Office indicates that a debt case refers to an instance of outstanding debt. One taxpayer may have many debt cases during the year depending upon whether they resolved a debt before any additional debt is raised.

UNDERLYING VIABILITY OF CREDITORS AND COMPETITORS

7.15 Insolvency practitioners comment that other creditors of a debtor business may perceive that a business continues to be viable because the Tax Office agrees to payment arrangements. This results in continued trade resulting in creditors extending further credit and further exposing themselves to greater loss.

7.16 They state that this perception is based on the assumption that the Tax Office will generally act like any other creditor and not allow a business to continue to trade if significant debt obligations are not met. This assumption may also be reinforced by the media perception that the Tax Office 'comes down hard' on defaulting businesses.

7.17 Tax and insolvency practitioners comment that at creditors' meetings other creditors are amazed at the age and amount of the debt that a debtor has with the Tax Office. They comment that the Tax Office is the largest creditor in Australia and arguably the most experienced.

7.18 Some argue that the Tax Office offers generous payment arrangements that have the effect of enabling unviable businesses to avoid insolvency proceedings initiated by other creditors. They suggest that this also has the effect of reinforcing the small business proprietor's perception of the ongoing viability of the business. Also, they indicate that in some instances the Tax Office's generous payment arrangements may also frustrate the efforts of the Australian Securities and Investments Commission (ASIC) in bringing an action against directors of companies that may be trading while insolvent. No suggestion is made that the Tax Office is implicated in avoiding insolvency proceedings, only that the business is not telling the Tax Office of the state of its debts with other creditors when negotiating a payment arrangement.

7.19 The effects of insolvency are discussed in Chapter 8.

COMPLIANCE HISTORY

7.20 Tax and insolvency practitioners, lawyers and representatives for small businesses comment that regardless of a debtor's previous compliance history, the Tax Office would offer the same flexible terms and conditions for payment arrangements. They saw this approach as having an unintended effect of treating non-compliant small businesses more favourably than compliant small businesses and therefore directly affecting a compliant business's viability.

7.21 In support of their claims they pointed to the automated interactive voice response (IVR) phone line that accepts lower debt level payment arrangement proposals without checking a business's compliance history. They also stated that, with the exception of very high level debt cases, in their experience and notwithstanding the stage of legal proceedings, they had rarely been questioned over a business's previous compliance history when negotiating payment arrangements with tax officials.

7.22 The Tax Office refutes this claim and states that, in determining payment arrangements, the *ATO receivables policy* requires staff to consider a number of factors, including the debtor's compliance history such as:

the manner in which the debtor has previously met tax obligations, including payment and lodgment obligations.⁵⁷

7.23 However, senior tax officials interviewed by Inspector-General staff consider it important to 'keep the taxpayer engaged' by keeping defaulting small businesses in payment arrangements. They state that they would 'err on the side of the taxpayer' in accepting reasons for delays and defaults.

7.24 Also, it is not clear what methods the Tax Office uses to distinguish those businesses with a capacity to repay without affecting their underlying viability from those who could not repay without affecting their underlying viability.

7.25 The Tax Office states that there is no method which can do so without viable businesses incurring further significant compliance costs and increasing Tax Office resources.

7.26 One insolvency practitioner recommends that the Tax Office should consider a proprietor's previous history with ASIC and the proprietor's involvement in any previous judgments.

TIME LIMIT FOR REPAYMENT

7.27 Representatives for small businesses and tax practitioners state that the Tax Office generally had no difficulty in agreeing to payment arrangements lasting under a 12-month period.

7.28 At the commencement of this review, submissions from the tax practitioner professional associations, insolvency practitioners and legal practitioners argued that the Tax Office was generally inflexible with the time within which a debt must be repaid where that period is more than 12 months. They were of the view that such inflexibility may unduly affect the viability of businesses that may otherwise meet all other taxation obligations and repay the debt over a longer period of time.

7.29 In any event, they comment that payment arrangements should be based upon the merits of the proposal, not an arbitrary timeframe. They recommend that businesses should be given extended time periods for repayments, such as five years.

7.30 However, since 30 June 2004, small businesses with debts under \$25,000 are able to enter into payment arrangements of up to 18 months if eligible for the small business debt initiative. This initiative is discussed below.

7.31 In relation to those small businesses ineligible for the initiative, the Tax Office disputes that payment arrangements will not be accepted unless full repayment can be made in one year. It states that this public perception may be due to one of the exceptions to the rules governing the IVR phone line.⁵⁸ This rule is that the payment arrangement must extinguish the tax liability within a year.

⁵⁷ Commissioner of Taxation, *ATO receivables policy*, April 2003, available from www.ato.gov.au viewed on 4 April 2004, paragraphs 4.3.4 and 4.3.5.

⁵⁸ See Chapter 5.

7.32 The Tax Office states that where the IVR phone line rejects a debtor's payment arrangement proposal because of a failure to satisfy either validation rules or business rules, the proposal will be transferred to an area in the Tax Office for 'human intervention' and consideration by tax officials.

7.33 Different officers have authority to enter payment arrangements on behalf of the Commissioner for different debt levels and different time periods up to unlimited amounts.

7.34 Where a proposal is referred for human intervention, it is considered by a tax official who may contact the debtor to renegotiate the proposal with a view to agreeing to an alternative arrangement that may be accepted within the officer's authorisation.

7.35 However, tax practitioners state that they continue to observe instances where longer term payment arrangements are unreasonably denied.

ATO practice of requiring repayment in 12 months

7.36 The *ATO receivables policy* does not expressly state that taxpayers are required to repay outstanding debts within 12 months. It requires tax officials to manage the risk of non-payment. One identified factor of this risk is 'ageing debt':

The Tax Office Debt Collection strategy is premised upon prompt payment being received as it recognises that an aging debt becomes more difficult to collect.

An aging debt normally increases in size through the accrual of additional tax for late payment/GIC and the taxpayer's financial position may deteriorate in the interim making collection of that debt more difficult than a new debt. Accordingly, any factor which is likely to cause or contribute to delay in the collection of a debt must be regarded as an inherent element of risk.⁵⁹

7.37 The period at which debt becomes 'ageing debt' is not defined in the policy. However, it seems to indicate that a debt outstanding for a period of more than one year is considered a greater risk – for example:

The Commissioner expects taxpayers paying by instalments to finalise their debts in the shortest possible timeframe. However, he acknowledges there will be instances where that timeframe may extend beyond one, two or more financial years depending on factors such as the ability to pay, the size of the debt and the likely costs of alternative collection activity.⁶⁰

Flexibility with instalments

7.38 Some submissions also commented that the Tax Office was inflexible with varying the instalment amounts and dates for payment. Small business saw varying amounts and dates as beneficial to coincide more tightly with a business's cash flow cycle and to minimise the risk of not making provision for the tax debt.

7.39 The Tax Office states that there is no impediment to agreeing to these variations.

⁵⁹ Commissioner of Taxation, *ATO receivables policy*, April 2003, available from www.ato.gov.au viewed on 4 April 2004, paragraphs 3.3.11 and 3.3.12.

⁶⁰ *ibid*, paragraph 10.4.6.

METHODS OF REPAYMENT

7.40 Submissions also suggested alternative payment methods could be made to improve small business compliance. These included:

- using a card through which small businesses could pay instalments at third party outlets, such as Australia Post;
- making payment by way of credit card; and
- as a condition of agreeing to a payment arrangement, having instalment amounts deducted from the business's bank account.

SMALL BUSINESS INITIATIVE

7.41 At the outset of the Inspector-General's review, tax and insolvency practitioners argued for more flexible Tax Office repayment arrangements. Specifically, they argued that the Tax Office was reluctant to accept payment arrangement proposals involving a 'quarantining' of an existing tax debt. These proposals involved arrangements in circumstances where the underlying viability of small businesses was threatened if the tax debts were required to be repaid immediately. Under the terms of the proposal the Tax Office would defer recovery of the outstanding amount and remit the general interest charge (GIC) until a later time when the business had improved its trading position. This proposal was made on the condition that all other taxation liabilities were met.

7.42 On 30 June 2004, the Tax Office announced its 'small business debt assistance initiative'. In return for entering a payment arrangement, the Tax Office would reduce the GIC and allow the debtor to repay the amount over either a 6, 12 or 18 month period. Only those businesses with an annual turnover of less than \$10 million and a total taxation debt of less than \$25,000 are eligible. The terms of maintaining the arrangement are that, with the exception of the debt, the debtor must meet all past, current and future liabilities. Additionally, the debtor must pay the instalments by direct debit.

7.43 According to the Tax Office, this initiative will target about 500,000 small businesses and individuals that owe about \$2.5 billion in collectable debt. The reduced interest rate will only apply to the period in which the small business has a payment arrangement. The Tax Office advises that it will progressively send letters of offer to identified eligible small businesses over the next 12 to 18 months. The Tax Office advises that small businesses do not need to wait to receive a letter of offer to take advantage of the offer. Small businesses may initiate contact with the Tax Office immediately.

7.44 The Tax Office states that where a small business has been sent a letter of offer and has not responded to it, the Tax Office will take action to recover the debt without further notice.

7.45 The Tax Office's initiative has received public support from small business representatives, accounting and tax practitioner bodies. However, some tax practitioners are of the view that the initiative does not offer enough incentive for small businesses to resolve their outstanding debt, that the time period is rigid, it is limited to a certain threshold, and reduction of the GIC is 'not enough of a sweetener'.

7.46 The Tax Office publicly reported that of the first 3,500 offers made, around 60 per cent or 2,100 taxpayers have entered payment arrangements. However, further information provided by the Tax Office reveals a lower response rate for later offers. As at 17 September 2004, of the 51,077 offers made in which taxpayers have had a reasonable period to accept, about 9 per cent or 4,800 taxpayers had paid in full and 12 per cent or 6,362 taxpayers had entered arrangements. If taxpayer-initiated arrangements, post-1 July 2004 debts and converted existing arrangements are also added, then 24.4 per cent or 12,496 taxpayers have entered arrangements.

CHAPTER 8: LEGAL RECOVERY ACTION

INTRODUCTION

8.1 The terms of reference for this review do not explicitly mention the Tax Office's legal recovery action. However, one focus of the review is on whether the Commissioner's policies and practices unnecessarily force small businesses into either bankruptcy or liquidation. In effect, this focus invites the Inspector-General to consider the effect of the Tax Office's legal recovery action leading up to and related to either the bankruptcy or liquidation of a small business. Submissions expressed a range of views on this issue. This chapter outlines those views.

Background

8.2 Where tax debts are not paid by the due date and remain outstanding, the tax laws provide that they become a debt due to the Commonwealth.⁶¹ They also provide that the Commissioner has the authority to recover those debts in any court of competent jurisdiction.

8.3 Legal action is said to involve the use of the Commissioner's coercive powers under the *Taxation Administration Act 1953* (TAA 1953), such as:

- issuing a garnishee notice;
- issuing a director's penalty notice for unremitted Pay As You Go amounts; and
- initiating bankruptcy or winding-up (leading to liquidation) proceedings.

8.4 The type of legal action undertaken is determined by a range of matters including the type of debtor legal entity.

8.5 The final legislative sanction for debtors that do not pay or enter into an arrangement to pay by instalments is the sequestration of an individual's estate in bankruptcy or the liquidation of a corporate debtor.

8.6 The Tax Office indicates that bankruptcy or liquidation will normally be pursued only after other recovery actions have been taken and proven unsuccessful. This would include instances where the debtor has not taken steps to advise the Tax Office of an inability to pay and does not put forward an acceptable proposal to pay the debt by instalments.

8.7 The *ATO receivables policy* also states that the Commissioner or a Deputy Commissioner may institute legal recovery proceedings, but may adjourn those proceedings where the debtor has agreed to pay the debt, additional charges for late payment and legal costs, in full either by a specified date or by instalments over a period.

61 For example, Section 255-5 in Schedule 1 of the *Taxation Administration Act 1953*.

8.8 On the other hand, the *ATO receivables policy* provides that the Commissioner or Deputy Commissioner may see it as appropriate to continue with legal recovery proceedings notwithstanding an approach by the debtor.

8.9 Of the 22,637 bankruptcies in the 2002-03 income year there were 4103 business-related bankruptcies.⁶² Provisional statistics for the 2003-04 income year show that of 20,496 bankruptcies only 4055 were business-related.⁶³

8.10 The Tax Office advises that of the approximately 1.6 million collectable tax debt cases finalised in the 2002-03 income year, they initiated legal actions in 1183 instances prompting 316 payments in full. The balance of cases resulted in 273 bankruptcy orders, 498 winding up orders and 96 voluntary administrations. The Tax Office was not able to provide figures for the 2003-04 income year. Nor was the Tax Office able to provide a break-up by market segment of the 273 bankruptcy orders or the 498 winding-up orders recorded for the 2002-03 income year.

Views

8.11 There have been a range of views expressed to the Inspector-General regarding the impact of the Tax Office's small business debt collection policies and practices and whether they unnecessarily force small businesses into either bankruptcy or liquidation.

8.12 Broadly, these views relate to how the Tax Office exercises judgment in determining when legal action should be initiated. They may be summarised as follows:

- The Tax Office treats small businesses unnecessarily harshly.
- There is no evidence to suggest that the Tax Office takes precipitate legal action.
- The Tax Office acts too slowly to stop debt accumulating.
- The Tax Office is too slow to use its additional powers.
- The Tax Office is not consistent in its approach to legal action to recover outstanding tax debts.
- The Tax Office's policies and practices do not promote a transparent and accountable process.
- The Tax Office's approach to legal recovery does not strike an appropriate balance between the interests of the debtor, the creditor and the public interest.
- The Tax Office does not take a commercial approach when voting at creditors' meetings.

8.13 These issues overlap to a large extent with issues relating to payment arrangements. This is because entering a payment arrangement effectively stops legal recovery of tax debts.

⁶² Insolvency and Trustee Service Australia, *Annual Report by the Inspector-General in Bankruptcy on the Operation of the Bankruptcy Act 2002-2003*, Canberra, 2003, p. 14.

⁶³ Insolvency and Trustee Service Australia, *Administrations under the Bankruptcy Act 1966, Statistics (Provisional), Financial Year Ended 30 June 2004 - Release 88*, 9 July 2004, available at [http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/Statistics->Annual%20Statistics->Annual%20Stats%20Documents/\\$FILE/Jun%2003-04%20stats.xls?OpenElement](http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/Statistics->Annual%20Statistics->Annual%20Stats%20Documents/$FILE/Jun%2003-04%20stats.xls?OpenElement)

8.14 Background information on the relevant legislation and policy regarding a bankruptcy and liquidation action has been included in Chapter 4 of this document.

OVERALL

General perception that Tax Office treats small businesses unnecessarily harshly

8.15 During the initial scoping review which sought to identify issues for possible review, submissions and comments were received by the Inspector-General, along with media articles, that indicated that there was a general perception in the community that the Tax Office was unnecessarily harsh in its treatment of small business taxpayers. In particular, there was a perception that the Tax Office will come down hard on defaulting businesses with the initiation of bankruptcy and liquidation action.

No evidence of precipitate legal action

8.16 However, the Commonwealth body which is empowered to deal with complaints of this type of Tax Office conduct, the Taxation Ombudsman, comments that:

Certainly we have little or no evidence to suggest that the ATO is taking precipitate legal recovery action (namely bankruptcy or liquidation) against small business tax debtors. If tax complaints to this office suggest anything, it is that the ATO is sometimes too slow to take more formal recovery action against some small business tax debtors. This situation is particularly evident in the case of ... complaints from some small businesses that have over time allowed their tax debts to become so large that there seems little option other than bankruptcy or liquidation.⁶⁴

8.17 As to the trend of Tax Office activity in this area, information from the Insolvency and Trustee Service Australia shows that there has been an overall decrease in the number of business-related personal bankruptcies initiated by the Tax Office.

Table 8.1: Tax Office initiated business-related personal bankruptcies

Financial year	Total bankruptcies
1997	387
1998	287
1999	210
2000	118
2001	98
2002	148
2003	143
2004	135

Source: Insolvency and Trustee Service Australia, 8 July 2004.

8.18 Appendix 1 provides information on the business-related personal bankruptcies in which the Tax Office was a creditor but which were not initiated by the Tax Office.

⁶⁴ Taxation Ombudsman, written submission, 25 May 2004, p. 1.

8.19 Information from the Insolvency and Trustee Service Australia also shows that, for the 2003 calendar year, the Tax Office was a creditor in 18 per cent of all bankruptcies, as opposed to banks (70 per cent), finance companies (67 per cent) and utilities (38 per cent).⁶⁵

8.20 In dollar terms, tax accounted for 10 per cent of total debt while banks accounted for 29 per cent, finance companies 15 per cent and 'other' represented 44 per cent.⁶⁶ Creditors identified as 'other' would include trade creditors, professional fees, medical bills, school fees and family loans.⁶⁷

8.21 Regarding the characteristics of creditors entering into Debt Agreements, for the 2003 calendar year, the Tax Office was a creditor in 10 per cent of all Debt Agreements, as opposed to banks (95 per cent), finance companies (95 per cent), utilities (39 per cent), and credit unions (16 per cent).⁶⁸

8.22 In dollar terms, banks and finance companies were the largest creditor groups for debts subject to a Debt Agreement, respectively owed 48 per cent and 31 per cent of the total unsecured debt with tax accounting for 3 per cent.⁶⁹

8.23 Regarding the characteristics of creditors entering into Part X Agreements, for the 2003 calendar year, the Tax Office was a creditor in 53 per cent of all Part X agreements, as opposed to 'other' (89 per cent), banks (81 per cent), finance companies (70 per cent) and utilities (24 per cent).⁷⁰

8.24 In dollar terms, banks and 'other' were the largest creditor groups, respectively owed 27 per cent and 54 per cent of the total unsecured debt with tax accounting for 12 per cent of the total.

8.25 Commercially available figures detail the number of Tax Office-initiated liquidation actions, which indicate an increase in the number of Tax Office-initiated liquidations over the last two years.

Table 8.2: Tax Office-initiated liquidations

	Total number of court liquidations	Tax Office-initiated liquidations	Percentage of Tax Office liquidations
11 July 2002 to 10 July 2003	1897	320	16.8%
11 July 2003 to 10 July 2004	2036	580	28.5%

Source: Insolvency Notices Pty Ltd.

8.26 Recent media articles suggest an increase in Tax Office legal action activity. One newspaper article suggests that business-related bankruptcies are on the rise as 'the Australian Taxation Office chases down small businesses that have failed to pay their taxes on time'.⁷¹ The article reports that while the September quarter figures from Insolvency and Trustee Service Australia showed a 1 per cent fall in the overall number of bankruptcies from the same quarter last year, business-related bankruptcies increased by 18 per cent from 931 to 1100. The article goes on to suggest that accountants expect that business-related

⁶⁵ Insolvency and Trustee Service Australia, *Profiles of Debtors 2003, 2004*, p. 13.

⁶⁶ *ibid.*

⁶⁷ *ibid.*, p. 31.

⁶⁸ *ibid.*, p. 22.

⁶⁹ *ibid.*

⁷⁰ *ibid.*, p. 31.

⁷¹ 'More firms in strife over tax', *Australian Financial Review*, 19 October 2004, p. 47.

bankruptcies will edge up as poorly managed businesses are caught up in the Tax Office's 'hard-line' on non-payment of taxes.

8.27 Another newspaper article reports that the number of companies entering voluntary administration rose by 14 per cent in the July-September quarter, against the same period last year.⁷² It is also reports that companies wound up as a result of a court order rose by 42 per cent after 'aggressive' action by the Tax Office to recover unpaid taxes.

8.28 One practitioner argues that the Tax Office undertakes aggressive legal action despite a business's prior payment arrangement compliance.

8.29 The Tax Office states that the number of bankruptcy and liquidations it initiates should be considered in the context of the total number of director penalty notices, section 459E notices and statements of liquidated claims that it issues. For example, the Tax Office states that it has taken bankruptcy action in approximately 880 cases since July 2003, in relation to \$165 million in outstanding tax. This, it argues, represents 1.36 per cent of all bankruptcy orders for the period 1 July 2003 to 31 March 2004.

8.30 Table 8.3 below seeks to provide some greater detail on the flow of cases from the time a notice initiating legal action is issued to a taxpayer to when either bankruptcy or liquidation is initiated.

Table 8.3: Tax Office initiated legal actions and outstanding collectable debt by debt actioning

Legal action	Number of notices issued/actions initiated since July 2003 (Approximate)	Collectable debt by legal actioning (\$m)
Director Penalty Notices	20,000	1,500
Garnishee Notices	4,200	400
Section 459E Notices	10,500	1,100
Statement of Liquidated Claim	7,900	500
Writ of Execution	150	10
Bankruptcy	880	165
Winding up	1,700	240

Source: Tax Office

8.31 The Tax Office has reported that there is \$2.135 billion, representing 25.59 per cent of the total collectable debt, subject to advanced debt recovery action, with a total of 63,665 cases or 4.35 per cent of the total collectable debt cases. Advanced debt recovery action is defined by the Tax Office as the commencement of significant collection action including the initiation of legal action, issuing Director Penalty Notices or where relief applications have been received. Of that \$2.135 billion, \$773.18 million related to activity statement debt and \$970.04 million related to income tax debt.

8.32 Table 8.4 below provides some greater detail regarding the amount of collectable debt subject to advanced debt recovery action by the Tax Office.

⁷² 'Insolvency increase', *Australian Financial Review*, 6 October 2004, p. 4.

Table 8.4: Small business collectable debt by advanced debt recovery action

		Value (\$m)	% of total collectable debt by value	Cases
Total collectable debt(a)	Total for all segments	2,135	25.59	63,665 ^(b)
Micro-business segment(c) (<2 million annual turnover)	Total micro	1,295	15.52	46,686
	Micro debt level 4	243	2.91	7,026
	Micro debt level 5	208	2.49	3,048
	Micro debt level 6	466	5.59	1,727
SME segment(c) (\$2 million-\$10 million annual turnover)	Total SME	394	4.72	2,756
	SME debt levels 4	11	0.14	321
	SME debt levels 5	24	0.29	342
	SME debt levels 6	150	1.80	440

Source: Tax Office

(e) Information current as at 30 June 2004.

(f) Case numbers exclude credit/zero balance cases.

(g) Information current as at 13 September 2004.

8.33 For the micro-segment approximately 35.98 per cent of the collectable debt subject to advanced debt recovery action is classified by the Tax Office as debt level 6. For the small to medium enterprise (SME) segment, 38.13 per cent of the collectable debt subject to advanced debt recovery action fell into this category. Over the last 12 months, total segment trends indicate that collectable debt subject to advanced debt recovery action has remained relatively constant.

8.34 The Tax Office has indicated that segment-specific analysis of trends by debt actioning for debt levels 4, 5 and 6 over the last 12 months is not available.

ACTION TO STOP DEBTS ACCUMULATING

8.35 Stakeholders and practitioners are concerned with the timeliness of the Tax Office's response in initiating legal action.

8.36 For some, the concern is that the Tax Office adopts a 'soft approach' and at times is reluctant to initiate legal action and collect small business debts. A number of submissions were critical of the time taken by the Tax Office to follow up on outstanding debts. A focus group involving a number of tax practitioners was of the view that the Tax Office needs to act quickly to stop debt accumulating.

8.37 Accountants and taxpayer practitioners have indicated that the Tax Office did not have a timeframe after which it would initiate legal action. They stated that in extreme circumstances it may initiate legal action as soon as an assessment is raised, in other extremes it may never take legal action and wait for the business to lodge an activity statement or assessment and offset any credit owing.

8.38 In relation to bankruptcy, the Tax Office considers that it is a valid option for dealing with debtors and it will not hesitate to use this process in appropriate circumstances. However, the Tax Office states that the decision to initiate bankruptcy proceedings against a debtor will not be taken lightly, nor will it be taken to 'punish' a debtor. It states that the initiation of legal action is the final legislative sanction used to recover outstanding tax debts. This implies that the process of making a decision to take legal action takes time.

8.39 For some insolvency practitioners, taking a more commercial approach means that the Tax Office should act sooner to recover outstanding debt. They argue that the Tax Office

should initiate legal action after 90 days unless the taxpayer has approached the Tax Office to enter into a payment arrangement. They suggest that if small businesses do not respond to the first reminder letter, the Tax Office should immediately threaten legal action. For example, depending on the circumstances, this could be issuing a garnishee notice, issuing a letter of intention to sue or actual commencement of recovery through the courts.

8.40 Insolvency practitioners also argue that any period of time beyond 120 days before the commencement of recovery action is far too long a period to wait. They argue that this timeframe is consistent with commercial practice.

8.41 A number of insolvency practitioners were of the view that small businesses in debt with the Tax Office are effectively using public monies to prop up an under-performing business and allowing it to continue trading. With the continuing trade of the debtor business, other creditors become more confident and increase the credit limit of the debtor.

8.42 They argue that if the Tax Office does not act soon enough to recover the debt, and provide some indication to other creditors that the business is having cash flow problems, the small business debtor may run up larger debts with those other creditors than would otherwise have been the case. A number of practitioners stated that when attending creditors' meetings they, and other creditors, were often astounded with the amounts indebted to the Tax Office and the time the debt had been outstanding.

8.43 Some insolvency and tax practitioners were of the view that the Tax Office should only initiate legal action sooner where the outstanding tax relates to amounts withheld from employees, such as Pay As You Go withholdings, or to amounts that should be remitted to the Tax Office, such as GST. They argue that, unlike income tax owed by the business, these amounts are held on trust by the taxpayer and they should make provision for the timely payment to the Tax Office. They argue that a business should not be using such amounts for the purposes of paying other creditors or as a means to expand the business.

TIMELINESS OF USING ADDITIONAL POWERS

8.44 A debt recovery agent was of the view that the Tax Office was slow to use the additional powers that it had been afforded by Parliament, such as the ability to issue a garnishee notice under the TAA 1953. They were also of the view that when the Tax Office did use such powers, its approach was inconsistent and lacked transparency, with the issuing of a garnishee notice being like a 'lucky-dip'.

8.45 The Tax Office states that it has issued approximately 4200 garnishee notices since July 2003, in relation to \$400 million in outstanding tax. Of the 4,200 garnishee notices, the Tax Office indicates that the majority are issued because of businesses not responding to earlier opportunities to comply where the debt is escalating.

8.46 The Tax Office also states that the decision to issue a garnishee notice is a significant one and it recognises the impact it may have on a taxpayer. As such a taxpayer is notified of the issue of a garnishee notice when sent to a third party. Also, the Tax Office indicates that Chapter 12 of the *ATO receivables policy* covers the Commissioner's powers to recover tax debts from third parties owing money to, or holding money for, a debtor of the Tax Office and sets out the circumstances when those powers will be used.

8.47 Also a range of submissions suggest that the Tax Office should not rely on the issuing of reminder letters where it has insufficient resources to give individual attention to cases. Rather, it should consider whether there are alternative responses that could be taken, such as providing an amnesty to pay outstanding debts or the more efficient use of the power to issue a garnishee notice.

CONSISTENCY IN APPROACH

8.48 Submissions also indicate that when the Tax Office does initiate legal action then there is a lack of consistency in its approach to the recovery of debt between taxpayers with similar debt levels and also between taxpayers with different debt levels.

8.49 For example, one submission from an accountant indicates that in certain instances the Tax Office commences recovery action for a small amount of outstanding tax debt but that no action is being taken on larger taxation debt amounts. Also, one submission from a tax practitioner provides an example (previously provided in this document) of the Tax Office commencing legal recovery for a small amount owing while not taking any action to recover a significantly larger amount owing.

8.50 In response the Tax Office states that the initiation of legal action will not always be based upon the outstanding debt level. Rather, in considering whether to initiate legal action there are a number of factors that are taken into account, including the nature of the debt, the asset position of the debtor and the risk to revenue.

8.51 Further, the Tax Office states that in order to ensure that bankruptcy action is only initiated in appropriate circumstances, the Commissioner has advised that Tax Office staff are authorised to make decisions within the boundaries of specified delegations. While staff at lower levels are able to issue a summons as a first stage in the legal process, decisions to proceed to bankrupt an individual can only be made by higher level staff.⁷³

TRANSPARENCY AND ACCOUNTABILITY

8.52 The issues of transparency and accountability in relation to legal recovery action appear to be inextricably linked to the timeliness of the Tax Office's response. The issues and suggestions outlined below therefore overlap with those discussed previously.

Reasons for approach

8.53 A number of accountants and tax practitioners express some concern that there was little or no indication by the Tax Office as to why it had adopted a particular approach in recovering an outstanding debt from particular clients.

8.54 They observe that this tends to give the appearance of a 'lucky-dip' approach as to when recovery action will be taken. They submit that the Tax Office needed to provide clearer guidelines and explanations as to what approach it would take in particular circumstances so as to minimise an inconsistent approach in the recovery of debt amongst taxpayers.

⁷³ APS 5 and above.

8.55 According to submissions from a tax practitioner association, a tax practitioner and a small business, the Tax Office's debt collection practices vary between two extremes. On one hand the Tax Office may implement a repayment strategy, including periodical payments and payment options, without resorting to legal action. In other instances legal action is initiated by the Tax Office with little opportunity to enter into a payment arrangement.

8.56 A focus group involving accountants from a number of professional associations expressed the view that members could not identify what it is in the Tax Office that triggers off particular debt collection activities. It was said that the current Tax Office approach appeared to be random and lack consistency.

Clarity

8.57 Some practitioners suggest that this could be overcome by the Tax Office incorporating clear time lines and outcomes as part of the *ATO receivables policy*. These guidelines should provide clear time lines (for example, when legal action will be commenced) and outcomes with critical milestone events (for example, entering a payment arrangement). If debtors were to fail to comply with these critical and milestone events and not make contact with the Tax Office, the matter would be escalated and more coercive action would be taken within a set timeframe. They suggest that this would provide clear knowledge to taxpayers and their advisers as to what the critical and milestone events in the debt collection process are, and ensure consistent actioning by the Tax Office.

8.58 However, practitioners state that there should be widespread consultation in developing guidelines incorporating such changes, and the guidelines should be communicated to the small business community. They state that any recovery process involving the prompt initiation of formal legal recovery needs to be well-defined and transparent.

8.59 In response, the Tax Office states that it would be difficult to develop a standard debt collection process involving set time lines and critical events as the progress of each case is determined on its individual circumstances.

8.60 Furthermore, the Tax Office is of the view that to provide a time line of events and actions would promote non-compliance to the limits of the time lines set. In effect, it would provide a 'blue-print' of the Tax Office processes and responses. The Tax Office sees more compliant behaviour in an environment of uncertainty.

8.61 The Tax Office states that in any event the process for legal recovery is spelt out in its *ATO receivables policy*.

8.62 Broadly, Chapter 8 of the *ATO receivables policy* deals with the various avenues open to the Commissioner to collect outstanding taxation debts and the role of bankruptcy action within that process.

8.63 Chapters 16 and 17 specifically examine arrangements set up in accordance with Part X of the *Bankruptcy Act 1966* (Part X arrangements) and agreements entered in accordance with Part IX of the *Bankruptcy Act 1966* (Part IX debt agreements) respectively.

8.64 Chapter 18 examines the factors that should be considered by the Commissioner before making a decision to bankrupt an individual debtor. It also discusses situations where bankruptcy action may not be appropriate.

8.65 Finally, Chapter 19 sets out the matters the Commissioner will take into account when deciding how to vote at a meeting called by the bankrupt's trustee.

BALANCE BETWEEN INTERESTS OF CREDITORS, DEBTORS AND THE PUBLIC INTEREST

8.66 Concerns have been raised with the Inspector-General as to whether the Tax Office achieves an appropriate balance when implementing its policy to initiate legal action.

8.67 Submissions from legal practitioners specialising in debt recovery and accountants express concern that the Tax Office does not properly consider the interests of other creditors and small businesses in determining whether to initiate legal action. In particular, they argue that a soft approach can have a counter-productive effect, especially for other parties such as other creditors and competing businesses.

8.68 Some legal practitioners suggest that the Tax Office could better strike the appropriate balance between the competing interests by better using the additional legal powers afforded to it, like the power to issue a garnishee notice or a director penalty notice. They argue that, given the special circumstances in protecting the revenue, it is in the public interest that the Tax Office not only have these additional powers but also use them to ensure them in an appropriate and fair manner to ensure the balance is maintained.

Distinguishing between compliant businesses and non-compliant businesses

8.69 Small business representatives also indicate that the Tax Office's current approach is flexible and broadly sympathetic to taxpayer needs and in many cases accommodates the individual circumstances of a debtor. However, the small business representatives stress that repeat offenders are a burden on the tax system and should be dealt with accordingly, including imposing much stricter payment conditions. They also submit that in implementing stricter conditions on repeat offenders, the Tax Office should ensure that the flexibility currently offered to other small business taxpayers who are having difficulties paying should be maintained.

8.70 Of significant concern to many stakeholders including accountants, legal practitioners and tax agents was that in initiating legal action, the Tax Office does not appear to make a distinction between taxpayers who have the capacity to pay the debt but refuse to and those who want to pay but are unable to do so due to unforeseen circumstances or a downturn in business.

Considering viability

8.71 Some tax agents and taxpayer representative groups express the view that taking a more commercial approach involves properly considering the circumstances and viability of the business before initiating legal action. As such, they feel that the Tax Office is too ready to bankrupt a taxpayer or liquidate a company rather than negotiate acceptable payment arrangements.

8.72 In response, the Tax Office states that bankruptcy or liquidation action will only be initiated after reasonable attempts are made to make contact with the taxpayer to determine whether an acceptable payment arrangement could be negotiated.

8.73 However, a number of accountants assert that quite often the Tax Office is not willing to consider or does not appreciate or understand the nature and circumstances of the business and will not adopt a flexible approach to help the business continue trading. They indicate that there is no assistance or initiative provided by the Tax Office to help businesses in this situation, but rather, the Tax Office appears determined to proceed to bankruptcy or liquidation.

8.74 In particular, a number of tax practitioners are of the view that the Tax Office does not seem to appreciate other external factors that may affect a small business meeting its tax obligations. An example of one such external factor is where a debtor of the small business goes into liquidation owing them money for goods or services supplied. Some practitioners are of the view the Tax Office lacks commerciality when dealing with such matters and takes a very hard-line approach without appreciating the underlying viability of the business and the cause of the outstanding debt. They state that in many instances, the Tax Office would indicate to them that maybe they should get another loan from the bank or sell a business asset to pay the debt. They argue that in some instances such external factors may have only have a short-term impact on cash flow without affecting the underlying viability of the business. They suggest that by the Tax Office not properly understanding the cause of the debt or the circumstances of the business and by not examining the viability of the business, it may unnecessarily force a business into administration or liquidation.

8.75 The Tax Office states that at various stages along the recovery action process, a tax officer may need to consider issues related to the viability of a taxpayer. For example, where the Tax Office has issued a section 459E notice and a tax officer considers a proposal to pay tax by instalments or defer payment for a short term, an important consideration is to determine, on the facts available, whether a reasonable person would believe the taxpayer was insolvent.

8.76 The Tax Office also states that in the majority of cases the tax officer is guided to decide in favour of the taxpayer so as to provide a clear opportunity to bring their obligations up to date.

Motivating proprietor to focus on payment

8.77 Commercial debt recovery agents state that it is important that the Tax Office aim to motivate debtors to pay the outstanding debt by focusing the debtor's attention on paying at an earlier point in time. They state, and tax practitioners confirm, that initially debtors may try to ignore the debt and hope that circumstances will improve. In such circumstances, if there is a delay in initiating the collection of the debt, then there is the risk that it may accumulate to the point where the debtor will not be able to repay.

8.78 They argue that the absence of a timely response on the part of the Tax Office, either in initiating legal action or even actively following up on an outstanding debt, means that small business debtors, in particular, those with cash flow problems, do not focus on paying their outstanding tax debt. Tax practitioners observe that in some cases there are debts that are one to two years outstanding where the Tax Office has not taken active follow-up action. They observe that in these situations the taxpayer normally receives an automatically generated reminder letter or final notice from time to time, but there is no follow-up action.

This, they argue, has the effect of creating an atmosphere where the Tax Office is seen as not simply as another creditor but one who does not chase up on its debts.

8.79 They assert that the Tax Office's current responses do not focus the debtor's attention to either paying the debt or entering into a payment arrangement. Rather, the lack of follow-up causes the debt to the Tax Office to be 'put near the bottom of the pile' notwithstanding the compounding interest charges.

8.80 Furthermore, they argue that the process of issuing of reminder notices after 60 days lacks commercial reality, as debtors will not put this account on their credit ledgers.

8.81 The Tax Office indicates that the Director Penalty Notice provisions are designed to provide directors of the company with the opportunity to assess whether they have the funds to pay the tax now or in the future. The Tax Office suggests that these provisions encourage directors to make an assessment of solvency.

8.82 The Tax Office states that it has issued approximately 20,000 notices to directors since July 2003, in relation to \$1.2 billion in outstanding tax.

8.83 The Tax Office also indicates that the common outcomes of issuing a section 459E notice are either payment or entry into a payment arrangement.

8.84 The Tax Office states that it has issued approximately 10,500 section 459E notices since July 2003, in relation to \$1.1 billion in outstanding tax. Of the 10,500 notices, the Tax Office indicates that the majority are issued in relation to businesses not responding to earlier opportunities to comply and the debt is escalating.

TAX OFFICE APPROACH AT CREDITORS' MEETINGS

8.85 Another concern raised by insolvency practitioners is that, at times, the Tax Office is not commercial when voting at creditors' meetings. They indicate that the Tax Office appears to be unduly influenced, at the detriment of other creditors, by promoting compliance. They argue that the position adopted by the Tax Office at creditors' meetings should be solely based on commercial outcomes. They reject the Tax Office's contention that voting at these meetings should be used effectively to punish non-compliant proprietors. They suggest that there are other avenues available for the Tax Office to effect compliance without unduly affecting other creditors' interests. This could include taking a far stricter approach with non-compliant proprietors in the future.

8.86 Insolvency practitioners indicate a tendency on the part of the Tax Office to vote against proposed deeds of arrangement. This is despite a better commercial outcome for all creditors if the arrangement was accepted as opposed to proceeding to winding-up the business. Insolvency practitioners argue that the Tax Office should not be punishing businesses for non-compliance through the non-acceptance of proposed deeds of arrangement, especially where other creditors are also involved.

8.87 The *ATO receivables policy* provides some guidance on how the Tax Office approaches settlement offers made to liquidators by debtors to a company in liquidation.

8.88 The *ATO receivables policy* states that in the course of the winding-up, a liquidator is required to pursue amounts due to or claimed by the company. When seeking to recover these amounts, it is common for the liquidator to receive settlement offers for a sum less than

the full claim. If the amount claimed is more than \$20,000 the liquidator cannot compromise the debt without the approval of the court, the committee of inspection or a resolution of creditors.⁷⁴

8.89 The Tax Office states that, as a creditor, it will generally vote in favour of such a compromise offer when it appears that the settlement will result in a greater return to the liquidation administration than if litigation to recover debts is allowed to take its full course.

8.90 In coming to such a decision, some of the relevant considerations listed in the *ATO receivables policy* include:

- the chances of success if litigation is to be initiated or continued;
- if the litigation is ultimately successful, the ability of the defendant to meet the judgment debt;
- the costs of pursuing the debt, particularly if creditors, including the Commissioner, will have to indemnify the liquidator to progress the litigation further;
- the time it may take to achieve recovery through litigation, including the additional costs of the liquidator that will be incurred in this period and which will rank ahead of the unsecured creditors' claims; and
- the attitude of other 'arms length' creditors.

8.91 The Tax Office also states that in some instances the Commissioner may, for public interest reasons, consider that an offer should be rejected and litigation continued. An example of where the Tax Office may take such a stance is where a director has deliberately structured the company's and their own affairs in an attempt to minimise creditors' chances of recovery.

8.92 The Tax Office is of the view that to accept an offer in these circumstances, especially for a token amount, may only encourage non-compliant behaviour in the future.

8.93 However, before voting against an offer solely on public interest grounds, the Commissioner states that he will also consider the attitude of the other 'arms length' creditors and the effect that his vote will have on them. In particular, this will include the extent to which they may be financially disadvantaged by the rejection of the settlement offer.

8.94 Insolvency practitioners have also expressed some concern that the Tax Office does not provide any explanation or basis at such meetings as to why it is rejecting a settlement offer, leaving other creditors frustrated and generally unhappy with the Tax Office stance. In response, the Tax Office has indicated that quite often its stance would be based upon additional information it has in its possession. However, under the taxation law secrecy provisions a tax officer is precluded from disclosing information relating to the taxpayer to another person.

8.95 Additionally, insolvency practitioners observe that in many instances the Tax Office will not turn up at creditors' meetings.

74 Pursuant to subsection 477(2A) of the *Corporations Act 2001*.

CHAPTER 9: COMPROMISE OF TAX DEBTS

INTRODUCTION

9.1 The third focus for the terms of reference asks the Inspector-General to examine the impact of the Tax Office's small business debt collection policies and practices on aspects of that collection. One of those aspects specified in the terms of reference is the Tax Office's approach to the compromise of tax debts. Few submissions voiced views on this aspect of the Tax Office's small business debt collection practices. This chapter outlines those views.

Background

9.2 Essentially, a compromise represents an agreement between a creditor and a debtor that involves the creditor accepting a lesser sum in full satisfaction of a debt.

9.3 The Tax Office defines a compromise as an arrangement in which it accepts an amount less than the primary tax outstanding in full settlement of an undisputed debt in circumstances where a taxpayer does not have the capacity to pay a debt in full. By contrast, an arrangement in which the Tax Office accepts less than the primary tax in full settlement of a disputed debt is called a 'settlement' by the Tax Office.

9.4 Applications for compromise are considered on a case-by-case basis. A tax officer is to follow the guidelines set out in Chapter 27 of the *ATO receivables policy* in considering an application for compromise.

9.5 The Commissioner has delegated to all tax officers carrying out the debt collection function the power to reject applications from taxpayers to compromise tax debts due to the Commonwealth.

9.6 Any applications for compromise that are to be rejected are handled at the case officer level. If a tax officer is of the view that the circumstances set out in an application may warrant compromise of the tax debt, then the case is escalated to a tax officer who has the authority to approve a compromise application.

9.7 According to the *Instrument of Delegation*, the Commissioner's power to approve applications from taxpayers to compromise tax debts due to the Commonwealth has been delegated to only 13 senior tax officials. However, in later correspondence the Tax Office has stated that only six senior tax officials presently hold the delegation to approve compromise applications.

9.8 For the year of income 2001-02, the Tax Office states that it received a total of four applications for the compromise of tax debts totalling approximately \$1.3 million. Three applications were from small business taxpayers, totalling \$610,885. For the year of income 2002-03, the Tax Office states that it received a total of five applications for the compromise of tax debt totalling approximately \$2.5 million. Two applications were from small business taxpayers, totalling \$1,682,866.

9.9 However, private sector submissions have indicated that there may be more applications for compromise than those reported by the Tax Office.

Views

9.10 The main theme of the views expressed to the Inspector-General regarding the Tax Office's compromise policy relates to whether the compromise policy strikes an appropriate balance between the competing interests of the debtor, the Tax Office as a creditor, the additional obligations imposed upon the Commissioner by the *Financial Management and Accountability Act 1997* (FMAA 1997) and the public interest.

9.11 Specifically, submissions express the following views:

- The Tax Office's compromise policy is far too strict in its approach.
- The Tax Office's compromise policy is not commercial, with little or no regard for the ongoing viability or circumstances of a business.
- The Tax Office's compromise policy is unclear whether losses are taken into consideration in determining whether to accept a compromise.
- The Tax Office's compromise policy and practices do not promote a transparent and accountable process.
- There is general confusion concerning the Tax Office's compromise policy.

TAX OFFICE APPROACH

9.12 Submissions indicated that the Tax Office was too strict in its approach to compromise because:

- the Tax Office's approach to compromise is more onerous than bankruptcy or liquidation; and
- the Tax Office does not compromise a part of tax debts.

9.13 However, an insolvency practitioner counsels caution in the use of the power because of the high risk of treating compliant businesses inequitably and the Tax Office's difficulty in assuring itself that a business has disclosed all assets.

Bankruptcy or liquidation approaches

9.14 A submission to the Inspector-General from a taxpayers' representative body argued that the practical result of a compromise with the Tax Office is more onerous than bankruptcy or liquidation. This is because compromise with the Tax Office entails taking all the assets of the taxpayer without any of the legal protection or objectivity afforded by bankruptcy or liquidation.

9.15 The Tax Office responds that the power to compromise undisputed debt is not an unfettered power to accept a lesser sum in full satisfaction of a debtor's indebtedness for any reason which it thinks appropriate:

The Commissioner's power to compromise must be exercised in accordance with the purpose of the taxation legislation (that is, to secure the highest net return taking into account considerations of good management and/or administrative common sense).⁷⁵

Debtor's total net assets in full satisfaction of the taxation debt

9.16 The Tax Office states that any compromise offer will be expected to consist of no less than the full value of the whole of the debtor's present property, with such conditions also applying to corporate debtors. Excluded from such property would be items of basic necessity such as clothing, furniture, tools of trade and the like.

9.17 The Tax Office states that given this approach, a compromise will generally deliver a better result for the Commissioner than would be obtained by any other available recovery process. It also states that the amounts ultimately recovered using other recovery approaches may be significantly less than the amounts calculated under this approach.

9.18 In fact, the Tax Office suggests that it may be for this reason that many, if not most, debtors may be unwilling to reach a compromise settlement. The Tax Office takes the view that corporate debtors would therefore probably seek an arrangement with creditors under Part 5.3A of the *Corporations Act 2001* or go into liquidation.

9.19 The Tax Office requires that there must be some benefit flowing to it in entering into a compromise agreement. That benefit may take different forms:

[it] might take the form of a saving in the costs of collection, collection at an earlier date than would otherwise be the case, collection of a greater sum than could be otherwise recovered or abandonment by the debtor of some claim or right arising under a taxation law that has a monetary value (for example, the right to carry forward losses).

Consideration will not be focused solely on the short term benefits and costs. Longer term considerations such as general compliance with taxation legislation are also relevant. Any immediate benefit of cost savings may be offset many times over if the debtor's compliance history is poor.⁷⁶

Benefit over and above bankruptcy or winding-up

9.20 The *ATO receivables policy* specifically provides that the Tax Office will not accept compromise proposals unless there is a benefit in doing so, over and above the return that would flow from taking actions under either the *Bankruptcy Act 1966* or the *Corporations Act 2001*. The Tax Office indicates that it will take this position notwithstanding that it may suffer the expense and delay of legal proceedings necessary to realise assets.

9.21 The reason for the Tax Office's stance is the view that to do otherwise would be to reward behaviour which amounts to non-compliance with a debtor's obligations. It argues that this would be inconsistent with the objective of achieving a high level of voluntary compliance by the community generally.

⁷⁵ Commissioner of Taxation, *ATO receivables policy*, April 2003, available from www.ato.gov.au viewed on 4 April 2004, paragraph 27.6.3.

⁷⁶ *ibid*, paragraph 27.6.4.

9.22 The Tax Office states that in considering whether or not to enter into a compromise, it is necessary to ensure that the proposed compromise does not disadvantage any other creditor. The Tax Office will not consider a proposal if another creditor intends to take, or has initiated, formal recovery proceedings. Also, a compromise proposal will be refused unless it can be shown that all affected creditors consent to the arrangement.

9.23 This also means that any compromise arrangements that have been, or are proposed to be, made in relation to other creditors do not place them in a position of advantage relative to the Commonwealth.

9.24 Further, the Tax Office states that not only do debtors have a responsibility to meet their payment obligations as they fall due for payment but that any alternative arrangements must be perceived as equitable by other taxpayers who do meet their payment obligations.

No compromise of part of the debt

9.25 Accountants and business advisers comment that the Tax Office's compromise policy appears to be an 'all-or-nothing' approach. They argue that the Tax Office's compromise policy does not address instances where a taxpayer seeks compromise of only part of the tax debt with an arrangement entered into for the remaining debt.

TAX OFFICE COMPROMISE POLICY'S REGARD FOR ONGOING VIABILITY OF BUSINESS

9.26 Taxpayers' representative bodies and tax practitioners also raise the concern that the Tax Office's compromise policy is not commercial and has little or no regard for the ongoing viability or circumstances of a business. This is especially so where the most significant assets of the business are intellectual property rights or rights to occupy premises or conduct a particular business. They argue that if the debtor was to be made bankrupt or enter into voluntary administration in such circumstances there would be a forfeiture of all such rights. This would mean the business has lost its most significant asset and along with it any prospect of continuing to trade.

9.27 The Tax Office states that it is not in a position to determine the viability of a business. However, it points out that in considering a compromise proposal, tax officials are required to make an assessment of what the position will be without a compromise. They are required to consider the value of the debtor's present property along with the debtor's future prospects, past transactions and the position of any related entities.

9.28 The Tax Office has stated that it has additional obligations imposed under the FMAA 1997 that do not allow a purely commercial approach to be taken in deciding when to compromise a tax debt. It also argues that a broader exercise of the compromise power would have a detrimental effect on promoting and encouraging voluntary compliance. As such, the Tax Office argues that the compromise power should only be exercised in very limited circumstances, especially given the other legal avenues available to deal with outstanding debt such as bankruptcy and liquidation.

9.29 The Tax Office indicates two broad areas where it thinks it is appropriate to enter into a compromise agreement.

9.30 Firstly, it may be appropriate where considerations of good management or administrative commonsense mean that it is the most efficient way in which to achieve the purpose of collecting taxation liabilities.

9.31 Secondly, it may be appropriate where the Commissioner concludes that more tax can be recovered by entering into a compromise than by pursuing alternative remedies, such as agreeing to accept payment over an extended period of time or instituting legal proceedings leading to bankruptcy or liquidation.

9.32 However, the Tax Office has qualified the comments regarding the circumstances where compromise is appropriate by stating that:

considerations which are not directly related to the Commissioner's function of collecting taxes cannot justify the use of the power to compromise.

9.33 By way of example, the Commissioner has listed the following circumstances where it would not be permissible to compromise to:

- (i) assist those debtors who may have overcommitted themselves;
- (ii) save a business from closure because a large number of people in a particular region depended on the business for employment;
- (iii) avoid the failure of a business because the activities of the business might be seen to be serving a national interest (for example, a large exporter, a producer of a key raw material or product);
- (iv) alleviate what may be perceived to be a harsh or unfair operation of a tax law in particular circumstances;
- (v) avoid hardship (such as the need to sell a home or a business); or
- (vi) create for the Commissioner a benevolent public image or in the furtherance of some charitable objective.

9.34 Further, the losses arising from the costs or delay involved in enforcing any remedies outside compromise are seen by the Tax Office as costs associated with the achievement of the broader objective of voluntary compliance by the taxpaying community at large. For the Tax Office, exercising good management and administrative commonsense in the general administration of the tax law entails giving precedence to this objective over the recovery of some additional funds in individual cases.

9.35 This means that non-compliant behaviour in the form of reckless or careless failure to make provision to pay an expected tax liability, even by instalments over time, is not rewarded or condoned by the Tax Office.

POSITION REGARDING AVAILABILITY OF TAX LOSSES

9.36 A submission by a taxpayers' representative body raised the concern that the Tax Office's compromise policy is unclear regarding whether losses are taken into consideration in determining whether to accept a compromise proposal. It suggests that, if this were not the case, it would be a serious short coming as it would mean that a debtor is not able to use

its available prior losses as a trade-off to allow the business to continue trading, especially where particular circumstances have placed the business in trouble.

9.37 In any event, the body suggests that the *ATO receivables policy* needs to be clearer on this issue and provide far greater guidance to taxpayers on what the Tax Office will consider so as to allow taxpayers to prepare compromise proposals that will provide a business with every opportunity to continue to trade.

9.38 The Tax Office points out that the *ATO receivables policy* makes specific mention of losses in the context of a compromise settlement: paragraphs 27.6.34 to 27.6.37. These paragraphs require tax officials to bind the debtor not to claim losses against income of future years and to exclude capital losses from the calculation of future net capital gains or losses. No reason for this approach is provided by the Tax Office other than:

it would be quite unacceptable that a debtor be allowed the benefit of a compromise, whether in respect of an income tax debt or some other tax debt, but at the same time retain the right to offset losses against future income or capital gains.⁷⁷

TAXPAYER UNCERTAINTY WITH TAX OFFICE'S COMPROMISE POLICY

9.39 In discussions with various stakeholders including accountants, tax agents, legal practitioners and a taxpayers' representative body, an issue of concern raised was whether the Tax Office's policy and practices promoted a transparent and accountable process.

9.40 Stakeholders suggest that there is a lack of awareness that the Tax Office even has a compromise policy or that the compromise policy is not widely revealed by the Tax Office.

9.41 A submission from a taxpayers' representative body stated that, apart from the *ATO receivables policy*, there is very little information available on the Tax Office's administration of the compromise power. This includes the number of compromise applications received by the Tax Office, number of compromise applications accepted by the Tax Office and forms for making an application for compromise of a tax debt.

9.42 The Tax Office provided the following information for the 2001-02 year.

Table 9.1: Total compromise applications for 2001-02

Total Cases	Amount subject to compromise request	Decision pending	Referral to SES/EL2	Accepted by SES/EL2
1	\$45,062.57*	No	Yes	Yes
1	\$673,098.18	Yes	No	No
1	\$200,583.71*	No	Yes	Yes
1	\$365,238.91*	No	Yes	Yes
4	\$1,283,983.37			

Source: Tax Office

* relates to small business taxpayers

9.43 The Tax Office provided the following information for the 2002-03 year.

⁷⁷ *ibid*, paragraph 27.6.34.

Table 9.2: Total compromise applications for 2002-03

Total Cases	Amount subject to compromise request	Decision pending	Referral to SES/EL2	Accepted by SES/EL2
1	[no amount provided]	No	Yes	Yes
1	\$762,089.51	No	Yes	Yes
2	\$1,682,866.00*	No	Yes	Yes
1	\$18,402.00	Yes	No	No
5	\$2,463,357.51			

Source: Tax Office

* relates to small business taxpayers

9.44 The taxpayers' representative body was of the view that there is little additional guidance on determining whether or not the Commissioner would compromise a taxation debt. It commented that the Tax Office could provide clearer guidance on key terms that are relevant in that determination.

9.45 The Tax Office states that the *ATO receivables policy* outlines the relevant considerations in determining whether or not to compromise a taxation debt. The Commissioner indicates that in determining whether a taxation debt should be compromised, there are a number of matters that need to be considered. These include:

- determining the potential return to the Commissioner if there is no compromise;
- what allowance should be made, if any, for tax losses that may be available; and
- determining the return to the Commonwealth if the compromise were accepted.

9.46 Further, the Tax Office states that the *ATO receivables policy* specifies the circumstances in which it will not enter a compromise and those circumstances in which it will.

GENERAL CONFUSION CONCERNING 'COMPROMISE'

9.47 Other concerns were raised with the Tax Office's compromise policy including whether such a policy actually existed, the complexity of the policy, what compromise entailed and the circumstances in which compromise was available.

9.48 There was also some uncertainty as to what the term 'compromise' actually entailed. For some, the term was associated with the liability to pay the debt as opposed to the obligation to pay. Also some people confused the compromise of primary tax debts with the notion of remitting interest and penalties.

CHAPTER 10: RELEASE

INTRODUCTION

10.1 The third focus for the terms of reference asks the Inspector-General to examine the impact of the Tax Office's small business debt collection policies and practices on aspects of that collection. One of those aspects specified in the terms of reference is the Commissioner's exercise of his power to release small businesses from their tax debts on the grounds of serious financial hardship. Few submissions voiced views on this aspect of the Tax Office's small business debt collection practices. This final chapter outlines those views.

Background

10.2 Division 340 of Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953) confers a discretion on the Commissioner to release taxpayers from tax-related liabilities on the grounds that the taxpayer is suffering serious hardship if they are required to satisfy the liability. A 'release' is a term used in taxation law to mean the extinguishment of a taxpayer's tax liability.

10.3 Prior to legislative changes on 1 September 2003, the Tax Relief Board had the power to grant release.

10.4 For the 2002-03 year, the Tax Relief Board considered 1798 release applications. Of those applications, 636 were granted a full release, 270 a partial release, 835 were refused and 57 either were deferred or withdrawn. These figures are substantially similar to those for the 2001-02 year. The Tax Office was unable to provide details on how many of these applicants were small businesses as they state that no data is available from the former Board. However, from 1 September 2003 to 30 April 2004, the Tax Office reports that approximately 30 per cent of release applicants have been small businesses.

Views

10.5 Submissions express the following views:

- the Tax Office's published release policy is out-of-date;
- the Tax Office's interpretation of 'serious hardship' is inconsistent with the underlying legislative policy when considering a debtor's family home and the income of the debtor's spouse;
- the Tax Office did not properly advise Parliament, and consequently the public, of the removal of non-individuals' eligibility to apply for release; and
- the Tax Office insufficiently informs potential applicants of the existence of their right to apply for release.

CURRENCY OF POLICY

10.6 Before 1 September 2003, sections 265 of the *Income Tax Assessment Act 1936* (ITAA 1936) and 133 of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA 1986) conferred a discretion on the Commissioner to release taxpayers from tax-related liabilities on the grounds of serious hardship. On 1 September 2003, both sections 265 and 133 were repealed and effectively replaced by Division 340 of Schedule 1 of the TAA 1953.

10.7 Chapter 24 of the *ATO receivables policy* sets out the Commissioner's policy in exercising his discretion to release taxpayers from taxation debts on the grounds of serious hardship. However, chapter 24 does not refer to Division 340 but rather refers to sections 265 and 133. Both of these provisions were repealed on 1 September 2003. There are significant differences between the repealed provisions and Division 340.

10.8 The Tax Office advises that the policy is in the process of being updated to reflect the September 2003 amendments. The Tax Office provided the Inspector-General with a copy of a draft updated release policy. However, as at 13 October 2004 chapter 24 of the *ATO receivables policy* has still not been updated.

September 2003 amendments

Before 1 September 2003

10.9 Before 1 September 2003, the Tax Relief Boards were empowered with the discretion to release taxpayers, both individual and non-individual, on the grounds of serious hardship from liabilities under the ITAA 1936 and the FBTAA 1986.⁷⁸ The Boards comprised the Commissioner of Taxation, the Secretary of the Department of Finance and Administration and the Chief Executive Officer of the Australian Customs Service.

10.10 For debts under \$500, the Commissioner could take the place of the Boards. The Boards could refer any application for release to the Administrative Appeals Tribunal (AAT). For debts over \$10,000, the Boards were required to refer the application to the AAT. The merits of a Board's decision could not be reviewed.

1 September 2003

10.11 On 1 September 2003, the Tax Relief Boards were abolished along with the AAT's role in receiving and investigating applications for release.⁷⁹ The Commissioner of Taxation was empowered to exercise the discretion in his own right. However, the Commissioner's decisions could now be reviewed under Part IVC of the TAA 1953. This meant that the merits of the decision could be reviewed by the AAT.

10.12 Additionally, the range of liabilities was expanded to income tax, Medicare levy, Medicare levy surcharge, administrative penalties, general interest charge, other penalties, FBT instalments and Pay As You Go instalments.

⁷⁸ Section 265 of the ITAA 1936 and section 133 of the *Fringe Benefits Tax Assessment Act 1986*.

⁷⁹ Schedule 9 to the *Taxation Laws Amendment Act (No. 6) 2003*.

10.13 Serious hardship remained the sole criterion for deciding whether release should be granted. However, only individual taxpayers and trustees of deceased estates could apply to the Commissioner of Taxation for release.

INTERPRETATION OF 'SERIOUS HARDSHIP'

10.14 Some submissions indicate that the Tax Office is not exercising the release power consistently with the underlying legislative intent. They point to the Tax Office's policy which requires tax officials to consider the income of the debtor's spouse and the value of the debtor's family home.

10.15 A taxpayer representatives' group comments that the Tax Office policy of considering whether proceeds from the sale of a jointly owned family home or the debtor spouse's income could be used to help repay a debtor's tax debt is generally unfair. Additionally, the Commonwealth Ombudsman recommended in relation to its investigation of the Tax Office's handling of investors in the mass-marketed tax-effective investment 'Main Camp' that:

the Commissioner not seek to make a person bankrupt, or to require them to sell their principal place of residence to repay a debt, unless an unacceptable risk factor has been identified.⁸⁰

10.16 The Tax Office points out that its interpretation of serious hardship is supported by case law. For example, Justice Gummow in the Federal Court considered whether the Board had taken irrelevant considerations into account when not exercising a discretion for relief under section 265 (the predecessor to Division 340):

the determination of whether the exaction of the full amount of the tax would entail serious hardship properly involves a consideration of the financial affairs of the taxpayer, including his financial relations with the other members of his household, and with any family company.⁸¹

Tax Office policy

10.17 In considering whether to release a taxpayer from a tax-related liability, the Commissioner decides whether the taxpayer is suffering from serious hardship. Chapter 24 of the *ATO receivables policy* does not define 'serious hardship'. Although chapter 24 does not reflect the September 2003 changes to the release provisions, the Tax Office states that the amendments did not affect the definition of 'serious hardship' and therefore the updated policy guidance for what constitutes serious hardship will not change.

10.18 In determining the existence of serious hardship the *ATO receivables policy* provides three tests that:

follow a conceptual position that the term serious hardship has connotations of unduly burdensome consequences, the magnitude of which would be likely to lead to persons being deprived of necessities according to normal community standards. Thus, serious hardship would be seen to exist where payment of a tax liability would result in the debtor being left

⁸⁰ Commonwealth Ombudsman, *The ATO and Maincamp*, Canberra, January 2001, recommendation 17, pp. 5 and 24.

⁸¹ *Van Grieken v Veilands* 1991 ATR 1639/91 ATC 4423, per Gummow J, at paragraph 21.

without the means to achieve reasonable acquisitions of food, clothing, medical supplies, accommodation, education for children and other basic requirements.⁸²

10.19 In considering an application for release, the effect of hardship may be on other family members:

As a first step in considering an application for release, the [Commissioner] must determine the person or persons to be included in its assessment of hardship factors. Although hardship will be largely personal to the debtor, or the dependant of a deceased debtor, it is not limited to the immediate state of that person. Rather, the prospect of inability to provide food, clothing, etc., for family members or others for whom the person has responsibility will also constitute a hardship faced by the person.⁸³

10.20 However, the *ATO receivables policy* states that the financial resources of family members may also be taken into account when assessing the capacity to meet family expenditures:

Conversely, although a debtor's immediate situation may suggest inability to meet the combined total of the tax debt and family expenditures, that factor will not indicate hardship if the income or asset positions of other members of the family are such as to suggest that the debtor cannot reasonably be regarded as responsible for all relevant outgoings. For example, the separate earnings, allowances or benefits received by other family members will be relevant to an assessment of the debtors overall financial circumstances.⁸⁴

10.21 Additionally, the Tax Office states that if an applicant has other creditors, then a more appropriate avenue for an applicant in financial hardship may be to apply for voluntary bankruptcy under the bankruptcy laws. It is of the view that these laws are aimed at achieving a balance between protecting creditors and enabling a debtor to bring finality to a financially unsurmountable position and allow them to start again.

10.22 The Tax Office also points to the September 2003 amendments that provide a release applicant with the right to apply to the AAT to have the merits of the release decision independently reviewed.

REMOVAL OF NON-INDIVIDUALS' ELIGIBILITY

10.23 The repealed sections 265 of the ITAA 1936 and 133 of the FBTA 1986, entitled a 'person' to apply for release. A person is defined in section 6 of the ITAA 1936 as including a company.

10.24 However, the new subsection 340-5(3) of Schedule 1 to the TAA 1953, only permits either an individual or a trustee of a deceased estate to apply for release. An individual is defined as a natural person.⁸⁵

10.25 There is no express statement in the material surrounding the legislative change that it would remove rights from non-individuals.

⁸² Commissioner of Taxation, *ATO receivables policy*, April 2003, available from www.ato.gov.au viewed on 4 April 2004, paragraph 24.4.1.

⁸³ *ibid*, paragraph 24.4.3.

⁸⁴ *ibid*, paragraph 24.4.4.

⁸⁵ Section 995-1 of the *Income Tax Assessment Act 1997*.

10.26 The Explanatory Memorandum states that:

Schedule 9 to this bill amends the ITAA 1936, FBTA 1986, TAA 1953, ITAA 1997 and the *Administrative Appeals Tribunal Act 1975* to streamline the procedures under which an individual taxpayer can be released from a tax liability where payment would entail serious hardship.⁸⁶

10.27 The table under that paragraph indicates that the repealed law only applied to individual taxpayers also.

10.28 The Tax Office confirms that one of the main effects of Division 340's introduction was that non-individual taxpayers were not entitled to release.

10.29 However, there is no reference in the Explanatory Memorandum or the Second Reading Speech that indicates that under the repealed law a non-individual was eligible to apply for release on the grounds of serious hardship.

10.30 The Tax Office states that it is unable to advise how many non-individual taxpayers applied for release on the grounds of serious hardship before September 2003, as those records were kept with the Board.

DEBTORS' AWARENESS OF HARDSHIP PROVISIONS

10.31 Submissions indicated that the Tax Office may not bring to debtors awareness that they may apply for release on the grounds of serious hardship. In 2001, the Commonwealth Ombudsman commented that this was the case in relation to certain investors in mass-marketed tax-effective investments. He recommended that:

The Commissioner ... consider providing taxpayers with information about ATO debt recovery policy, the existence and role of the Tax Relief Board, and relevant contact points, including access to the Ombudsman, when they are advised that a debt is to be raised.⁸⁷

10.32 The Tax Office states that it now publishes a booklet, *Difficulty in paying your tax debt (business clients)*.⁸⁸ This booklet contains the following entry on applications for release:

What if the payment will cause you serious hardship?

Serious hardship is when you are unable to provide food, accommodation, clothing, medical treatment, education, or other necessities for yourself or your family, or other people for whom you are responsible.

You can apply to the Tax Office for a release from payment of your tax debt.

For more information and an application, phone the Client Account Management helpline on 13 11 42.

10.33 Other Tax Office publications contain substantially similar wording. Additionally, the *ATO receivables policy* states that debtors should be made aware of the right to apply for a release.

⁸⁶ Explanatory memorandum to the Taxation Laws Amendment (No. 6) Bill 2003, paragraph 4.1.

⁸⁷ Commonwealth Ombudsman, *The ATO and Maincamp*, Canberra, January 2001, recommendation 18, p. 7.

⁸⁸ First published on 2 September 2003.

Appendix 1: Business-related personal bankruptcies where the Tax Office has been disclosed as a creditor

State	Financial Year Ending	Debt Levels									Total
		Less than \$25,000	\$25,001 to \$50,000	\$50,001 to \$75,000	\$75,001 to \$100,000	\$100,001 to \$125,000	\$125,001 to \$150,000	\$150,001 to \$175,000	\$175,001 to \$200,000	Greater than \$200,000	
NSW/ACT	2002	469	62	31	10	12	2	16	4	20	
	2003	443	82	30	22	11	2	6	0	23	
	2004 (YTD)	391	107	44	17	15	6	5	7	32	
	Total	1303	251	105	49	38	10	27	11	81	
QLD	2002	549	62	20	5	6	2	2	4	6	
	2003	642	83	31	13	2	1	2	1	6	
	2004 (YTD)	494	98	32	12	1	6	3	4	12	
	Total	1685	243	83	30	9	9	7	9	24	
SA/NT	2002	92	17	9	5	2	1	0	1	0	
	2003	143	28	16	4	2	6	1	1	2	
	2004 (YTD)	149	27	10	3	5	1	2	0	7	
	Total	384	72	35	12	9	8	3	2	9	

Business-related personal bankruptcies where the Tax Office has been disclosed as a creditor (continued)

State		Financial Year Ending	Debt Levels									Total
			Less than \$25,000	\$25,001 to \$50,000	\$50,001 to \$75,000	\$75,001 to \$100,000	\$100,001 to \$125,000	\$125,001 to \$150,000	\$150,001 to \$175,000	\$175,001 to \$200,000	Greater than \$200,000	Total
TAS	2002		77	8	2	1	0	1	0	0	2	
	2003		93	6	1	4	1	0	0	0	1	
	2004 (YTD)		55	5	2	1	1	0	0	0	3	
	Total		225	19	5	6	2	1	0	0	6	
VIC	2002		317	34	16	9	8	2	7	2	7	
	2003		320	40	17	9	5	5	2	1	7	
	2004 (YTD)		311	46	23	12	14	9	4	3	13	
	Total		948	120	56	30	27	16	13	6	27	
WA	2002		380	34	23	9	4	7	2	0	2	
	2003		293	39	22	8	0	0	0	4	1	
	2004 (YTD)		210	42	22	5	4	1	3	1	2	
	Total		883	115	67	22	8	8	5	5	5	
	2002		1884	217	101	39	32	15	27	11	37	2363
	2003		1934	278	117	60	21	14	11	7	46	2488
	2004		1610	325	133	50	40	23	17	15	69	2282

Source: Insolvency and Trustee Service Australia

