



THE TAX INSTITUTE

18 January 2013

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

By email: datamatching@igt.gov.au

Dear Ali,

Review into the Australian Taxation Office's compliance approach to individual taxpayers – use of data matching

The Tax Institute is pleased to have the opportunity to make a submission to the Inspector-General of Taxation (**IGT**) in relation to the *“Review into the Australian Taxation Office's compliance approach to individual taxpayers – use of data matching” (Review)*.

Summary

In summary, data matching programs are a key tool in capturing unreported and underreported income and gains and they therefore have their place in the suite of activities the ATO undertakes to administer and maintain integrity in the tax system. However, as noted below, they can also unnecessarily capture gains that have been reported properly and in full. This comes at a cost to both the ATO in unnecessarily using up resources and taxpayers and their agents in time spent following up queries (and incurring associated fees). Therefore, as the ATO will continue to use data matching programs in the future, they are a tool that needs to operate effectively to ensure relevant transactions are captured and reported, thus assisting to protect the revenue.

Discussion

1. Experience in dealing with the ATO

The ATO often uses data matching programs to ensure relevant amounts are reported and associated tax is paid. As a prime example of these programs, in October 2011 the ATO embarked on a data matching program to match up capital gains from real property sales publicly recorded to gains from real property disposals declared to the ATO.

The ATO became aware of these disposals through its investigations using data from public sources, such as State and Territory land titles registers. During the operation of the program, taxpayers and their agents received written correspondence alerting them to the fact the ATO was aware of certain real property disposals of theirs or their clients respectively. In the main, members who had received letters noted that the letters included estimates of taxable gains based on the purchase and sale prices for the properties and, in the absence of receiving further information, their clients' returns would be amended to reflect the capital gain.

The following are just some of the more specific circumstances surrounding the receipt of these letters members advised us of (with identifying facts excluded):

- Receipt of a letter by a tax practitioner stating a client of theirs disposed of real property in 2009. Included in the letter was an estimate of the capital gain. However, the property was the client's principal place of residence and no taxable gain arose on disposal.
- Receipt of a letter by a tax practitioner stating a client of theirs disposed of real property in 2010. Included in a letter was an estimate of the capital gain based on publicly recorded buy and sell costs (and allowing for estimated purchase, sale and holding costs) and in the absence of further information, would amend the client's 2010 income tax return. However, the gain from the sale of the investment property had been included in the client's 2010 return, the actual gain was approximately \$3,000 higher than estimated by the ATO and the client was already on a payment plan to pay the tax on the capital gain owing.
- Receipt of a letter by a tax practitioner advising a client of theirs appears not to have reported a disposal of real property in their 2010 return. Included in the letter was detailed financial information pertaining to the property as well as an estimate of the taxable gain (based on the purchase and sale prices). The letter also stated the property had been sold in July 2009. After investigating their files, the tax practitioner found that the contract date (disposal date for CGT purposes) was in May 2009 and the disposal had already (correctly) been recorded in the client's 2009 income tax return.
- Receipt of a letter by a tax practitioner stating a client of theirs disposed of real property in 2010. Included in the letter was an estimate of the taxable gain. The practitioner confirmed in his records the capital gain had been included in the 2010 return and the gain amount included in the return was higher than the gain estimated by the ATO due to some adjustments required because it was an ex-rental property.

Some members reported being able to get in contact with an officer of the ATO, who, after receiving further information (such as the property concerned was a principal place of residence or the gain from the disposal of the property disposed had already been included in the appropriate year's tax return) would confirm no further action was

required on the matter and close the matter. However, members had already spent significant time investigating their records, speaking to their client about the matter and contacting the ATO to resolve a matter that did not result in any change.

One member quantified the irrecoverable costs incurred in resolving the matter to be \$300. However, actual costs incurred by a particular practitioner would depend on the amount of time spent and the fees charged by the practitioner¹.

Some members were pleased to note they were able to contact ATO officers that were willing to help them resolve the issue quickly. However, a majority of the members who notified us they had received these letters were very unhappy they had to spend time on investigating matters that the ATO could have resolved internally by checking their own records.

2. Opportunities for improvement

Lessons from the CGT real property data matching program

From the examples given above, it is clear the data matching program employed to capture undeclared gains from real property disposals has resulted in many instances of capturing capital gains that have either already been reported or are not assessable gains (according to the information provided to us from members).

Our members' concerns in respect of this particular data matching program arise from aspects such as an apparent absence of some form of internal checking system by the ATO where it may have been discovered that the capital gain has already been reported. Our members also hold concerns about the improper use of third party information, such as published buy and sell prices and a State/Territory's land titles records.

Data obtained from a State land titles register confirms that a property has been transferred. What it does not indicate is the nature of the property (eg principal place of residence, investment) or how the property is held (eg directly, on trust). It also does not indicate how the transfer occurred (eg sale, inheritance) or the correct date of disposal for income tax purposes. Obtaining this information requires further investigation.

The sales history of real property may also be obtained from public sources. However, all the expenses incurred in maintaining a property that may be factored in to calculating the capital gain are likely to only be known by the taxpayer (and their tax agent).

More broadly, data from third party sources is generally not enough on its own to form a true picture of the nature of the property sold.

¹ The amount of fees would vary from practitioner to practitioner.

As one member pointed out to us, the address of the property being investigated by the ATO was the residential address of the taxpayer noted on their most recent tax return. This would have been the best indication that the property was most likely the principal place of residence of the taxpayer and that information was readily available in the ATO's own records.

Suggestions for improvement

Third party data can be used to verify information provided by taxpayers in their returns (eg matching up of the published sale price to the amount used in the taxpayer's calculations to estimate the capital gain; verifying the number of shares said to have been disposed by a taxpayer with the number contained on the public share register or in ASIC's records) rather than to originate the calculation of the gain.

a) Internal checklist

As part of investigating whether certain transactions have been reported to the ATO, we suggest the ATO look to implement an internal checking system (if one does not exist already). An important step in this process would be to look through a taxpayer's tax return history and see if a capital gain from a disposal has in fact been declared already. Even if the ATO officer investigating is unsure whether the reported gain is from the asset they are investigating, they will have a reference point with which to approach the taxpayer or their tax agent when querying the disposal.

An internal checklist could be created for ATO officers to follow prior to sending out communications to taxpayers querying transactions picked up through a data matching program. This could include for example:

- checking relevant possible tax returns in which the gain could have been included;
- checking other ATO records (eg a BAS statement if relevant) which may contain other information that help to characterise the particular transaction in question; and
- confirming third party information being relied on is the most up-to-date information available.

We are not aware whether such a checklist exists and therefore could be improved or whether the existing checklist already contains these steps that may or may not be properly being followed by ATO staff.

b) Corresponding with taxpayers and tax agents

If the preferred approach by the ATO is to notify taxpayers and their agents in writing, it would be preferable if pre-conceived outcomes (such as the size and assessable nature of the gain) were not drawn (and not included in the letter) prior to consulting with the taxpayer concerned. Letters could be more open in nature, querying a particular disposal and asking the taxpayer/tax agent to contact the ATO to discuss the

matter with them over the telephone to clarify the ATO's understanding of the particular transaction.

Also, in its initial communication with taxpayers and tax agents about a data matching program, the ATO could acknowledge the likely time and additional fee cost (where a tax agent is involved) that will be incurred by taxpayers and their agents assisting the ATO to review transactions picked up through a data matching process. Tax agents recognise the need for the ATO to carry out programs such as data matching programs to protect the integrity of the system and are willing to assist the ATO as needed. However, providing this assistance to the ATO comes at a cost (in time and usually irrecoverable fees) to the agent's practice and takes their time away from servicing other clients of their practice. There is little acknowledgement from the ATO about the impact on tax agents and their practice in assisting the ATO and some form of acknowledgement of the important role tax agents play in assisting the ATO is warranted.

c) Audit or review of recently completed programs

An audit or review of procedures used in a data matching program, for example the CGT real property program, could be undertaken to see what factors are contributing to disposals that have already been reported to the ATO being unnecessarily picked up. We cannot be certain, but this may also indicate that other disposals that should be picked up by the program might potentially be being missed. This may indicate there is a flaw in the procedure that should be fixed if the same procedures will be used in future data matching programs. The error rate from the results of the program (or a sample if the number of disposals reviewed under the program is too large) should therefore be determined to see if there is a flaw or the results fall within the expected margin of error.

The suggested improvements noted above may go some way to preventing the ATO from spending unnecessary resources following up amounts of income and gains that have in fact already been reported or are not required to be reported. This will also save both taxpayers and their agent time and money not chasing up queries from the ATO that the ATO could have resolved internally by taking an extra step in the review process prior to contacting the taxpayer.

These suggested improvements are particularly relevant for the structuring of future data matching programs (for example the program looking into cars purchased by businesses and the reporting of the provision of car fringe benefits). They will also contribute to the proper structuring and efficient and effective operation of data matching programs so the programs do in fact capture unreported and underreported income and gains. This will contribute to the overall improvement of data matching programs as an effective tool the ATO can use to protect the revenue (among the suite of other revenue protection tools available).

d) Other


A possible alternative for using information gained during a data matching program would be to flag the income or gain amount in a timely fashion in the relevant taxpayer's pre-fill information. For example, a possible CGT disposal could be flagged prompting the tax agent to query their client about the disposal. The disposal is then considered as part of the tax return preparation and not afterwards.

Rather than looking backwards over past transactions and affecting prior year returns, as is the current use of data matching programs, they could be used to gather information about transactions affecting the most current tax return of taxpayers.

This would give a better result for all parties involved in the process. The benefits of this are that the ATO is given the opportunity to flag the transaction with the taxpayer and their agent (which is what a data matching program otherwise allows them to do) and the taxpayer and agent can look into the transaction as part of the tax return preparation once and not again following a separate request from the ATO. This should assist to alleviate the burden placed on tax agents in assisting the ATO with these integrity programs. This would also allow the ATO to investigate transactions closer to the time they occur. It would increase accuracy of information included in tax returns when first submitted and alleviate the requirement for the ATO to amend many past years' tax returns for initial inaccuracies picked up through data matching programs.

If you would like to discuss any of the above, please contact either me or Tax Counsel, Stephanie Caredes on 02 8223 0011.

Yours sincerely

A handwritten signature in black ink, appearing to read 'S. Westaway', with a long horizontal line extending from the top of the signature.

Steve Westaway
President