# *PS LA 2011/6 - Risk and risk management in the ATO*

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# Practice Statement Law Administration

# PS LA 2011/6

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*This practice statement is issued under the authority of the Commissioner of Taxation and must be read in conjunction with Law Administration Practice Statement PS LA 1998/1. It must be followed by tax officers unless doing so creates unintended consequences or where it is considered incorrect. Where this occurs tax officers must follow their business line's escalation process.*

**SUBJECT:** **Risk and risk management in the ATO**

**PURPOSE:** **To provide guidelines to staff on risk management in the context of dealing with outstanding taxation debts**

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## BACKGROUND

1. The taxation system relies on taxpayers voluntarily complying with their obligations under the law. The risks involved in administering this system may require decisions that, while not cost effective, are designed to support the integrity of the system by reinforcing the message that there are serious consequences for those who choose to avoid their obligations under the tax laws.

2. Unlike someone operating in the private sector, the Australian Taxation Office (ATO) cannot select its clients and cannot refuse to deal with taxpayers simply because they have not lodged or paid. On the other hand, the ATO is not, and never will be, resourced to chase every last dollar of revenue payable under the law. This means that the ATO is required to make intelligent choices about what compliance risks will be treated, how such risks will be treated and where to best apply available resources.

3. 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 or late payment imposed by legislation) is that, the returns and statements may not be lodged or debts may not be paid within time frames acceptable to the Commissioner, if at all.

4. 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.

5. The factor of risk is not only involved in the more common decisions about events such as extending time for lodgment, deferring further action, remitting additional charges for late lodgment, deferring time for payment, permitting payment by instalments or remitting general interest charge (GIC), but it is also a factor in decisions about matters such as:

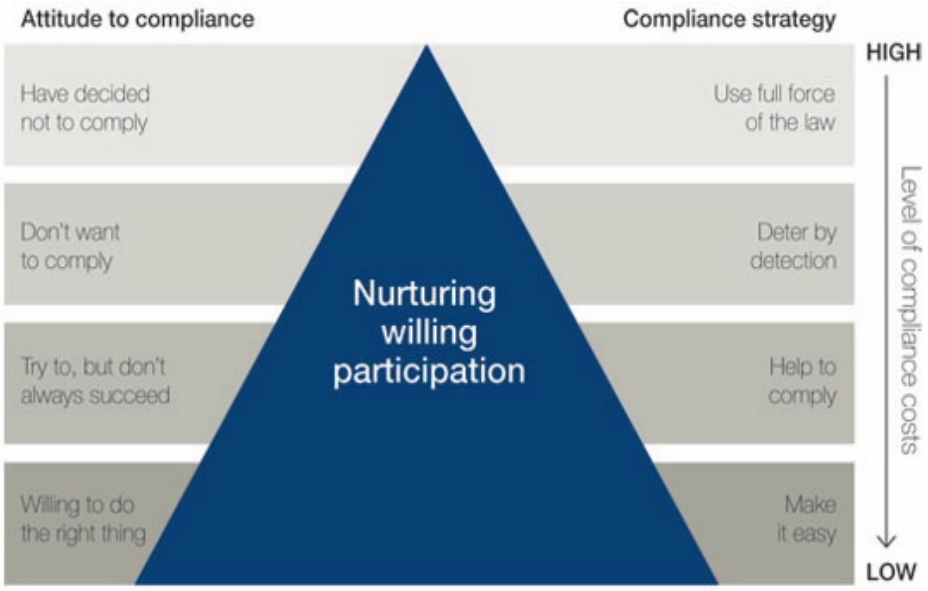
   - identifying risk groups
   - non pursuit of debts
   - how to vote at creditors' meetings
   - whether to initiate recovery action for collection of disputed debt
   - the type of action initiated
   - taking action to protect or secure the debt
   - granting an indemnity to a trustee or a liquidator, or
   - whether or not to settle defended debt recovery litigation and/or the necessity to test cases to clarify the law where the prospect of recovery is uncertain.

   In other words, risk management must be seen as preparation for events - in advance where possible, rather than responding as they happen.

## STATEMENT

### The compliance model

6. This policy for the securing of lodgment of outstanding returns and statements and the collection of taxation debts is an integral part of the ATO's strategy to improve taxpayer compliance. While the policy is primarily concerned with taxpayers meeting their payment and lodgment obligations, its contribution to taxpayer compliance overall can be demonstrated by reference to the compliance model, as illustrated:




7. The compliance model promotes a deeper understanding of taxpayers' motivation, circumstances and characteristics so that assistance and enforcement actions can be tailored to improve compliance. The ultimate aim of the compliance model is to influence as many taxpayers as possible to move down the pyramid into the 'willing to do the right thing' zone. Analysing compliance behaviour in this way assists us to address the actual causes of non-compliance rather than the symptoms.

8. The principle of the compliance model applies to every facet of tax administration and is used widely at both strategic and operational levels.

9. A taxpayer's attitude to compliance, and their consequent behaviour, is unlikely to be limited only to having an effect on lodgment of returns or other documentation or payment of taxation debts. It may also include the making of false statements, non-cooperation or illegal activities. While the immediate effect of our strategies and actions may result in a payment or lodgment, they should also be designed to maximise the likelihood that the taxpayer will comply voluntarily with all of their obligations in the future, including the obligation to lodge correct documentation and pay the correct amount on time.

10. The determination of which strategies to adopt to achieve this is predicated on an evaluation of the overall compliance risk posed by the taxpayer, and this is based on their individual circumstances. In other words, the ATO needs to differentiate its treatment of taxpayers according to their ability to meet their tax responsibilities and the circumstances they face in doing it. This is consistent with the intent of the taxpayers' charter. The compliance model clearly links the degree of compliant attitude (and consequent behaviour) to the severity of the strategies. In applying this model, the ATO will consider all available behavioural information (not just lodgment history, or payment and debt performance), together with an understanding of why there was any previous non-compliance. As an example, previous non payment of a debt could be the result of either an unwillingness to pay, or of a willingness to pay combined with an inability through various circumstances (for example flood, fire). This policy recognises that the former attitude and behaviour warrants more severe sanctions (prosecutions, actioning debt despite outstanding disputes, denial of arrangements without security), while the latter does not.

## Fraud on the Commonwealth

11. As noted in the Commonwealth Fraud Control Guidelines 2002, fraud against the Commonwealth is a major concern to the Australian Government. The Government is committed to protecting Commonwealth revenue, expenditure and property from any attempt to gain illegal financial or other benefits. The Commonwealth Fraud Control Guidelines outline the Australian Government's requirement that Australian Government agencies put in place a comprehensive fraud control program that covers prevention, detection, investigation and reporting strategies. The Corporate Management Practice Statement PS CM 2007/02 describes the ATO's policy and attitude towards fraud, including both internal fraud and taxpayer fraud.

12. Fraud is defined for the purposes of the Commonwealth Fraud Control Guidelines as 'dishonestly obtaining a benefit by deception or other means' – and includes both tangible and intangible benefits.

13. Australian Government agencies such as the ATO are expected to consider prosecution in appropriate circumstances, in accordance with the Prosecution Policy of the Commonwealth. Criminal prosecutions are vital to deterring future instances of fraud and to educating the public generally about the seriousness of fraud. As expected of all Australian Government agencies, the ATO is committed to recovering losses caused by illegal activity through proceeds of crime and civil recovery processes and, in the absence of criminal prosecution, to applying appropriate civil, administrative or disciplinary penalties.

14. Where a loss to the Australian Government has occurred as a result of a fraud, the Commissioner will apply the principle of the compliance model in ensuring that every recovery sanction is pursued in seeking restitution of the loss to the Australian Government. Where such loss cannot be recouped through the proceeds of crime process, the Commissioner is committed to pursuing civil recovery against the perpetrators of such fraud to bankruptcy, if necessary.

## Aggressive tax planning schemes

15. Aggressive tax planning (ATP) undermines the policy intent of the law and erodes community confidence in the fairness and equity of the tax system. It spans a range of activities including some arrangements which are mass marketed to salary and wage taxpayers. The common intention of participants in these activities is to obtain some form of tax benefit. ATP arrangements are likely to attract the operation of the general anti-avoidance provisions in the tax laws.

16. To achieve long term compliance, the ATO is undertaking a range of strategies to counter ATP. These strategies, which are consistent with the compliance model, are intended to encourage participants in ATP schemes to voluntarily meet their future taxation obligations.

17. Risk management in the context of an ATP case requires a balanced approach to moderate any loss and ensure the best return to the revenue having regard to commercial considerations. This can be a difficult task as the past behaviour of a participant which reflected a non-compliant attitude may not necessarily translate into a risk to revenue, particularly where the participant is willing and able to meet payment of the resulting debt. Accordingly, the risk assessment process must take into account the potential risk exhibited by the participant's non-compliant attitude in the past as well as the participant's present capacity and willingness or otherwise to pay.

18. Risk management decisions should take into account the participant's history of involvement in ATP arrangements as well as the attitude and behaviour exhibited by the participant before and after the assessment process. Such behaviour and attitude may be reflected in the steps taken to mitigate any perceived risk. These steps may include:

- enquiries made with the ATO prior to entering the ATP arrangement
- willingness to assist with ATO enquiries
- willingness to enter payment arrangements
- voluntary disclosure through self-amendment
- minimum payment of 50% of the tax in dispute
- provision of adequate security, or
- diligent actioning of objection and appeals.

19. In line with the theme of the compliance model and within the intent of the taxpayers' charter, the measures to be applied in ATP cases should, therefore, reflect the taxpayer's past and present circumstances without being unduly punitive by reason of their involvement in ATP. On the other hand, care should be exercised to ensure that no financial advantage is conferred upon scheme participants to the detriment of those taxpayers who comply with their taxation obligations.

**Disputed debts**

20. The ATO debt collection strategy is premised on prompt payment being received as it recognises that an ageing debt becomes more difficult to collect.

21. An ageing debt normally increases in size through the accrual of 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.

22. Generally, the longer a debt is in dispute, the greater the risk to the collection process. In order to assess the level of risk associated with a disputed debt, the following matters need to be considered:

- The subject matter of the dispute (genuine dispute, ATP, tax evasion or other), which may reflect a non-compliant attitude to taxation laws, though not necessarily a risk to collection of the disputed debt.
- Whether the subject matter of the dispute is dependent on a test case which may be an indicator that the disputed debt may not be collected for some time (that is, until a final decision is given on a test case).
- Whether the dispute is frivolous or meritorious, which may indicate a high level of risk in instances where the taxpayer has no prospect of succeeding and is deliberately prolonging the inevitable while possibly rearranging their financial affairs to frustrate the Commissioner's recovery action.
- Whether any tax not in dispute is outstanding. This is an inherent risk and could include an indication of unwillingness or inability to pay.
- Whether a minimum of 50% of the tax in dispute has been paid (which would indicate good faith) reducing the GIC and lowering the perceived level of risk.

- The level of cooperation by the taxpayer which is an indicator of the bona fides of the taxpayer to promptly resolve the dispute and remove any impediment to collection.
- Whether the taxpayer's assets are held in the name of other entities (for example, company, trust, superannuation fund, or family members). This may be an indication of high risk - particularly where the taxpayer is personally insolvent and protracted litigation for recovery of the debt may prove futile.
- Any significant change in the taxpayer's financial position since the raising of the debt (that is, any evidence of dissipation or alienation of assets). This is another potential indicator of high risk which may compel the Commissioner to institute immediate legal action or seek injunctive relief.
- Any subsequent action by the taxpayer since the raising of the debt (for example, signing of a section 188 authority under the *Bankruptcy Act 1966*, frivolous application for release, frivolous application under section 39B of the *Judiciary Act 1903*). Any of those actions may, on their facts, be construed as an attempt to avoid payment and as indicative of a high level of risk.

**Defended debt recovery litigation**

23. Risks identified in the debt collection process may often warrant the commencement of litigation for recovery of taxation debts. The delay caused by the lodgment of defences to debt litigation proceedings can pose a significant risk to the timely collection of revenue.

24. Law Administration Practice Statement PS LA 2009/9 Conduct of Tax Office litigation outlines the ATO's approach to risk management in ATO litigation. Once a matter is in litigation, the litigation team must undertake a separate risk assessment to determine the level of the litigation risk associated with the case. This will assist the team to determine and apply the most appropriate litigation strategy.

25. The risk assessment process continues throughout litigation. Accordingly, at any time during the litigation proceedings, additional facts may emerge or the debtor may advance submissions for settlement, which show upon reassessment of the risks involved, that the level of risk warrants bringing litigation to an end by settling the matter. Law Administration Practice Statement PS LA 2011/7 Settlement of debt recovery litigation provides guidelines for settlement of debt recovery litigation.

**The risk management context**

26. Risk management is not an exact science. However, it is integral to the process of deciding what the Commissioner should do to avoid the undesirable outcome in which returns and statements are not lodged on time, debts are not paid promptly, and some debts are not paid at all. This decision-making process entails the evaluation of objective and subjective factors before reaching a conclusion as to the overall risk.

27. Evaluation of risk for a particular case is made in the following context:

    (i) Risk management for lodgment or collection occurs in a statutory framework. Those responsible for securing lodgments or collecting debts must not make risk decisions that may contravene the statutory framework.

(ii) Decisions on risk are also subject to policy considerations and one should avoid decisions which may contravene the policy.

(iii) Risk assessment is based on objective and subjective facts and logical inference, and not on rumour or innuendo. A risk assessment must be reasonable, having regard to the circumstances at the time it was made. Historical facts and current data will carry more weight than future conjecture.

(iv) Responsibility for providing relevant information to enable assessment of the risk lies solely with the taxpayer (although the ATO will also make use of information to which it has access or which it has obtained). If taxpayers are uncooperative or decline to provide all necessary information to enable appropriate decisions to be made, adverse inferences can be drawn and these may influence the decision made.

28. It is incumbent on decision makers to ensure that risk decisions are:

- authorised under relevant legislation
- within their authorised/delegated powers
- based on and consistent with established policy
- based on the particular circumstances of a case
- properly reasoned
- properly documented and reviewed at appropriate intervals.

29. It must be recognised that there is no one correct answer for dealing with outstanding returns and statements or debts. Different circumstances require different remedies and different people will make different decisions about what steps to take to secure lodgment or recover an outstanding debt based on their particular evaluation of the facts and circumstances applying to a particular case.

**How the risk is evaluated**

30. There are three essential elements to risk evaluation in the lodgment and collection contexts:

(i) the risk - using the most cost-effective method of lodgment or recovery and determining if and when the return/statement will be lodged or the debt will be paid. Allied to this are the implications of not pursuing the return/statement or debt and the cost of undertaking alternative courses of action

(ii) the risk probability - using all available information and the compliance model to determine whether the outstanding lodgment obligations or debt are likely to escalate and whether lodgment or payment is likely to occur and when, and

(iii) the risk exposure - determining the extent of any loss to the revenue that could result and the risk of being seen to encourage non-compliant behaviour. The loss would include the non lodgment of current returns and statements, the information contained therein, the non-payment of current debts, the outstanding amount and the additional charges for late lodgment or late payment/GIC. Coupled with that is the potential for loss of public confidence in the integrity of the tax system.

31. Evaluating risk is a dynamic process. For example, decisions to accept payment of a debt by instalments will need to be reviewed on a regular basis; not only to ensure payments are being made, but also to take account of changes in a taxpayer's circumstances. It could be that the taxpayer may be able to pay the debt in full at the time of review or that further time to pay may be warranted.

32. Risk should be evaluated having regard to all of the taxpayer's relevant circumstances. The cumulative effect of several factors, each suggesting varying degrees of risk, may indicate a more severe risk overall. On the other hand, the high risk inherent in one factor may be totally offset by low or no risk in other matters which are considered.

33. The following list identifies a number of the matters that may need to be considered when evaluating risk:

    (i) The total outstanding lodgment obligations or taxation debt.

    (ii) The characteristics of the total outstanding lodgment obligation or debt including:

    - whether the outstanding lodgment obligation is escalating or likely to escalate (and whether that is expected to be rapid or more gradual)
    - years outstanding (as a general rule, the earlier the year, the greater the risk of not securing it)
    - the components of the debt
    - how the debt was established (for example, voluntary disclosure, general compliance work, audits into proceeds of crime or ATP)
    - whether the debt is escalating or likely to escalate (and whether that escalation is expected to be rapid or more gradual)
    - the age of the debt (as a general rule, the older the debt, the greater the risk of not collecting it)
    - whether the debt is in dispute (see above)
    - whether other creditors are pursuing actions.

    (iii) Taxpayer attributes (attitude, behaviour and circumstances) including:

    - previous compliance history (for example, compliance with lodgment and earlier payment requirements, accuracy of returns)
    - previous bankruptcy or another form of insolvency administration (including multiple bankruptcies)
    - previous corporate delinquency or failure (for example, phoenix activities, disqualification as a director)
    - previous participation in, promotion or marketing of ATP arrangements
    - previous derivation and/or non-disclosure of income from criminal activities
    - capacity to pay
    - financial position

- willingness to pay the debt, including efforts made by the taxpayer to borrow funds in order to pay the tax debt
- attitude to lodging expected taxation returns and statements and paying expected taxation debts. (It may be appropriate to draw adverse inferences about taxpayers who have given priority to acquiring personal assets ahead of paying their taxation liabilities. Taxpayers who appear to ignore their financial responsibilities and live beyond their means tend to represent a higher risk)
- steps taken by the taxpayer to ensure future lodgment obligations are met and future liabilities are paid as and when they fall due
- income and expenditure (that is, whether income is steady, fluctuating or seasonal; whether the level of expenditure can be considered to be reasonable; and whether there is any excess of income over expenditure)
- whether the taxpayer has been denied credit or further credit
- whether other creditors are being paid in preference to the ATO
- the level of cooperation provided by the taxpayer and the timeliness of any proposal that is made
- the truthfulness of the taxpayer (for example, whether the taxpayer has been candid in dealings with the ATO and whether the taxpayer's assertions are supported by documentation)
- commercial considerations, such as where a taxpayer faces a tight liquidity situation because stock is turning over slowly or because a major debtor has delayed payment of an account
- the nature of any undertakings that may have been given to other creditors, whether secured or unsecured
- any commercial advantage to the taxpayer that deferral of payment or non-payment of taxation debts generates
- the contents of any lodgment or payment proposal (including whether the proposal is legal and would benefit the ATO to a greater extent than alternative available actions)
- the cost of the proposal relative to the cost of alternatives.

(iv) The stage which the lodgment or recovery process has reached at the time a proposal or request is made and the cost of varying, terminating or staying that process.

(v) Relevant policy issues.

(vi) Relevant information about the taxpayer or the taxpayer's activities that may be held by the ATO.

(vii) Any reports on the taxpayer's financial affairs that may have been obtained, including insolvency practitioners' reports.

(viii) The existence of any impediment to the ready recovery of a debt (for example, where the taxpayer's assets are overseas and no asset is held in the jurisdiction or where the taxpayer has equitable interest in assets legally owned by other associated entities).

34. The compliance model clearly links risk with the indicators of unwillingness to comply with taxation obligations. While individual circumstances must be considered in each case, due regard needs to be given to any steps taken by the taxpayer to mitigate the risk. The following activities are considered to indicate the highest levels of risk:

- promotion of ATP activities including schemes
- participation in activities designed to avoid payment of an assessed or probable debt for example, multiple bankruptcies and phoenix activities
- participation in criminal activities
- continued participation in ATP activities including schemes
- continued participation in other contrived or artificial activities designed to avoid or reduce assessment.

35. In this context 'continued participation' means:

- continuing to participate in the ATP activity after the ATO view is advised to the taxpayer or their agent
- participation in more than one ATP activity.

36. In considering whether a taxpayer's participation in more than one aggressive tax planning activity constitutes the highest level of risk, due regard must be given to the level of mischief associated with the arrangements.

**Making a risk decision**

37. The management of risk involves making decisions in a statutory and policy framework, which means:

- all taxpayers will be treated professionally, equitably and fairly
- the ATO will form its own opinions on risk based on an impartial review of the facts and then respond to the risk (taxpayers can expect each case to be considered on its merits)
- taxpayers can expect the ATO to apply the most severe measures and sanctions in response to the highest level of risk in accordance with the compliance model
- taxpayers cannot expect the ATO to agree to any particular course of action on the basis of past actions or decisions. The ATO will assess risk based on current circumstances
- taxpayers can expect the ATO to make use of any or all available lodgment compliance/debt collection options, including prosecution and the bankruptcy/liquidation option. The fact that negotiations are taking place over payment of a debt or that a debt is disputed does not automatically preclude the ATO from taking action to secure the debt by appropriate means (for example, judgment, security over property, injunctions, or issue of "garnishee" notices as defined elsewhere in this policy)
- responding to changes in taxpayers' circumstances which, upon an evaluation of the risk to revenue, may warrant a decision to take action that could involve costs exceeding revenue collected (for example, action designed to ensure outstanding lodgments or debts do not escalate or action to support the integrity of the tax system)

- the decision taken in response to the risk evaluation must be commensurate with the perceived risk; rather than to 'reward' or 'punish' taxpayers for their action or inaction concerning the lodgment of their tax returns and statements and payment of their tax debts, and
- evaluating risk is not an isolated task. All relevant facts need to be considered and, where appropriate, other ATO areas should be consulted.

It may not be possible to consider every aspect of a taxpayer's circumstances before making a risk decision. ATO staff dealing with lodgment or debts should focus on the major risks (rather than the insignificant risks) that determine capacity to meet taxation obligations.

**Minimising risks to the ATO/risk avoidance**

38. Risk management is not focused solely on addressing perceived or real risks. It also requires an exercise of caution to ensure that the ATO's position is not put at risk by certain actions, for example in making comments or taking actions on matters unrelated to the lodgment of returns, or statements which cause the taxpayer to have certain expectations; or otherwise creating a situation which could cause the taxpayer confusion, loss or damage. These actions may create new risks.

39. In reviewing a taxpayer's records, or in making enquiries to establish facts to determine the risks inherent in the case and the most cost effective lodgment compliance action or recovery method, tax officers involved in the receivables management process will frequently see or hear comments that suggest that the taxpayer's situation (and, perhaps, the tax debt itself) arose through the actions, inaction or negligence of another person. In these circumstances, tax officers should not lose sight of the need to apply professional standards. These standards include refusing to express comments on issues outside their expertise. For example:

    - Tax officers involved in the receivables process are not financial counsellors and therefore, should not provide financial advice. If it is apparent that a taxpayer may benefit from financial counselling, that may be suggested to the taxpayer as an option for consideration.
    - Tax officers involved in the receivables process should not express views to taxpayers which suggest that the taxpayer's circumstances arose through the negligence of others. Any assertions by the taxpayer along these lines should not be discussed, apart from suggesting that the taxpayer discuss the matter with their solicitor.
    - If the taxpayer claims that their taxation return is incorrect, tax officers involved in the receivables process should refer the taxpayer to *TaxPack* or to their tax agent. If a taxpayer raises the issue of negligence by their agent or enquires about their rights against the agent, they should be advised to contact the Tax Practitioners Board. Tax officers should not discuss whether the taxpayer's tax agent erred or displayed negligence in completing the return.

### Documenting the decision

40. It is important that decisions and the reasons for making the decisions be properly documented in the case management system and the paper file (where appropriate) to:

- enable the decision to be quickly reviewed at a later date if the need arises or if circumstances change
- provide background information to any other officer who subsequently deals with the taxpayer so as to assist their decision-making
- provide an audit trail
- enable a ready response to any approaches/complaints by the taxpayer or the taxpayer's representative, and
- enable any legal challenge, including a request for review under the *Administrative Decisions (Judicial Review) Act 1977*, to be dealt with effectively and efficiently.

### Reviewing the decision at appropriate intervals

41. Risk management is an on-going process while a taxpayer's payment and/or lodgment obligations remain outstanding. Changes to the economic climate or to the particular circumstances of the taxpayer may give rise to a different level of risk which necessitates a different approach. Accordingly, regular reviews of any risk decision is paramount to ensure that the appropriate sanctions prescribed by the compliance model are being implemented based on the taxpayer's willingness and or ability to comply at any given point in time.

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|---|---|
| Legislative references | Administrative Decisions (Judicial Review) Act 1977<br>Bankruptcy Act 1966  188<br>Judiciary Act 1903  39B |
| Related practice statements | PS CM 2007/02 Fraud control and the prosecution process (internal link only)<br>PS LA 1998/1 Law Administration Practice Statements<br>PS LA 2009/9 Conduct of Tax Office litigation<br>PS LA 2011/7 Settlement of debt recovery litigation |
| Other references | Compliance model<br>Prosecution Policy of the Commonwealth<br>Commonwealth Fraud Control Guidelines |
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