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Australian
Taxation
Office

ATO Supplementary Submission

to the House of Representatives Standing Committee on

Economics, Finance and Public Administration's

Inquiry into

The Management of the Tax File Number System

10 April 2000

ATO Supplementary Submission to the Inquiry into The Management of the Tax File Number System

The ATO provided its initial views to the Inquiry in its Submission of 2 November 1999. This supplementary submission provides some discussion and update of issues which have been raised since that initial Submission and as a result of further submissions and additional evidence given at public hearings since the ATO last appeared on 6 December 1999.

1 Continuing Progress on ANAO Recommendations

The ATO is continuing to address each of the individual recommendations arising from the ANAO Report No 37 and notes the alignment of these to the major issues raised in submissions and evidence given to this Parliamentary Inquiry. The initial Submission summarised the status on each recommendation and further progress reports will be provided as required by normal processes.

2 Progress on ATO Proposed Hierarchy of Strategies to address Proof of Identity (PoI) and Identity Fraud Issues

The ATO notes the general support (whilst acknowledging concerns regarding privacy) which has been expressed for continuing work on the proposed hierarchy of POI strategies as outlined in its initial Submission (Section 4) to the Inquiry. The hierarchy (with an enhancement to one step) is repeated in Attachment 1 for convenience.

ATO convened workshops conducted with Commonwealth, State and Local Government Agencies (see below) have also provided support for progressing with the hierarchy of solutions.

The ATO, in conjunction with other Commonwealth and State Agencies, the Federal Privacy Commissioner and other community interests, will continue to develop formal proposals for common P01 processes and the extension and updating of datamatching of identity information (Steps 2-6 of the solutions hierarchy).

We also note several submissions provide in principle support to investigating a whole of government Client Service Number (Steps 7-8 of the solutions hierarchy), though with some greater reservations being expressed on privacy and cost-benefit implications. We believe our work on the earlier steps will also help in evaluating the pros and cons of this concept.

3 Major Issues arising from Hearings

The ATO believes that there are six major issues arising from the hearings and submissions lodged to date and where the Inquiry may appreciate an update and some further information. These are:

- a) Identity fraud
- b) Data matching
- c) Data quality - inactive TFNs
- d) Non resident issues
- e) Links to ABN & integrity of ABN system
- f) Extension of TFNs to AUSTRAC & other transactions

a) Identity Fraud & PoI issues

Evidence has been provided to the Committee regarding the relative ease with which identity fraud can occur. The deliberate creation of multiple identities and the 'theft' of another's identity are also well recognised by law enforcement agencies as a significant problem which can result in fraud. At the same time, it needs to be stressed that those intent on fraud do take a significant risk. Specific programs and actions are currently undertaken, both within and between Agencies, to detect and prosecute individuals for identity fraud. Thus individuals are made aware that their actions to deceive are not without risk.

i) Extent of Identity Fraud

- The ATO notes that the Committee has been advised in several submissions about how little quantitative data is available on the extent of losses and costs associated with identity fraud. In particular, we note Dr Russell Smith's evidence where he suggests the need for such research.
- Given that such quantification within the public and private sectors is likely to be difficult and potentially sensitive, the suggestion of a joint independent research project may be a way forward. Early indications from an Australian bank, who are willing to work jointly with the ATO, suggest that there would be merit in pursuing such a study.

ii) Means of Preventing Identity Fraud (including cross organisation co-operation)

- The ATO has convened and facilitated day-long workshops with Commonwealth, State and Local Government agencies in Sydney, Adelaide, Perth, Brisbane and Melbourne between December 1999 and March 2000. These workshops examined current problems with PoI processes and developed a range of first cut potential solutions to these problems as well as identifying impediments to these potential solutions. Feedback from the agencies has been most supportive of the ATO's initiative in this area. In addition, all agencies represented see the need for ongoing future co-operation to develop strategies that are more robust and reliable.
- It is certainly the intention of the ATO to further progress this initiative. We are seeking the views of other agencies as to their preparedness to escalate the key issues and to resource further work to develop common approaches. We would anticipate that a sub-group of relevant agency representatives be tasked with the job of working up options to take forward.

- The ATO continues to convene a cross Commonwealth Agencies Forum on PoI issues. DVA and DETYA have joined AEC, Centrelink, DFAT, HIC, DIMA and AUSTRAC at this forum which met on 21 February and 5 April 2000. The Convenor of the Australian Registrars of Birth, Deaths and Marriages' Fraud Committee has been invited to join this group.
- The ATO has also continued to participate in the AUSTRAC chaired Steering Group on PoI and identity fraud. This group met on 16 February 2000. The Commonwealth Agencies Forum will be undertaking a joint exercise examining the 'perceived integrity' of PoI documents adopted from the Steering Group in early May.
- We have provided input into papers on identity fraud and PoI issues delivered by AUSTRAC at international conferences. (OCED FATF, Paris February 2000, and Asian Pacific Money Laundering Methods and Typologies Workshop (Use of False Identities for Money Laundering Purposes), Bangkok, March 2000). Our intention is to work more closely with international agencies with the view to benchmarking world's best practice.
- We have established an informal agreement to work with an officer from the Victorian Police Force (one of the recipients of the latest Churchill Fellowship Awards) who is specifically addressing Identity Fraud as his Fellowship topic in the next few months. The ATO will provide input arising from our workshops and glean information from his overseas experience.
- Verification of PoI documentation is an area of growing importance. The ATO is endeavouring to obtain further information from the state Road Transport Authorities (RTAs) to assist in the verification of driver's licences provided as Proof of Identity (PoI). ATO is also continuing to work with BDM Australia and DIMA on verification approaches.

iii) Detecting Identity Fraud and Case Studies

- It was noted earlier that those involved in identity fraud do so at some risk.
- A range of checks and control processes, together with specific risk mitigation and compliance strategies currently operate and/or are being developed within the ATO and across agencies to address identity fraud risks including:
 - checks with the current POI documentation used in initial registration - where 'high risk' categories of applicants are more carefully screened;
 - checks of mail returned unclaimed for recognised 'high risk' categories which may alert the office to the presence of a potential duplication and subsequent potential fraudulent case;
 - overall analysis of possible duplications;
 - using the 'dob-in' data base as a source of information;
 - the Cash Economy joint agency field work;
 - other joint agency investigations;
 - discrepancies identified from the Income Matching Systems;
 - matching of employment declaration information with Centrelink, DVA and DIMA records;
 - and
 - identification of unusual transaction patterns.
- We are always looking to improve these processes, including learnings from patterns of detected fraud cases.

- For example, an internal ATO study is examining the 'dob-in' (CISCO) database to check for potential identity fraud involving a TFN. Initial findings suggest some evidence of deliberate multiple TFN usage. Further work is required before accurate details can be provided. It is certainly the intention of the ATO to refer any proven cases for prosecution.
- As another example, initial work has commenced on analysing a number of sources of income data with "unmatched" TFNs from Centrelink and AIIR reports.
- As noted in our initial submission, duplicate TFNs have been an issue for the ATO for some time even prior to the ANAO audit and we are continuing to develop resolution strategies to address these. While our initial analysis and resolution of a pilot project of duplicate TFNs focussed on resolving the most obvious cases (for example a match on surname and potentially other details) there is an opportunity to expand this work to pick up a wider range of casework.
- From the cases which have been successfully resolved to date from that project, only a few cases (some 10 in 24,000) have involved potential identity fraud and have been referred for investigation. However, work is now continuing using Computer Assisted Audit Techniques (CAATS) to examine less obvious duplication cases for further analysis (e.g. cases where more subtle changes of identity data may have been attempted).
- Another specific ATO project has commenced into Centrelink referred cases of potential identity fraud. The sources of P01 used and benefits claimed are being investigated.
- Development of detailed case studies where TFN fraud has been detected are also underway in order that such learnings can be used in improved controls and for staff training and awareness.

iv) Identity Fraud Offence Provisions

- There is currently a wide variation in offence provisions and associated penalties with respect to identity fraud in the Commonwealth sphere. We understand that the USA has recently enacted a statute focussing specifically on identity fraud in recognition of the growth in such offences at different levels of government. We believe that a review of the effectiveness of existing offence provisions and of agency prosecution policies would be of merit, especially given the potential for identity fraud to increase with electronic commerce.

b) Data Matching on Identity Data

- The data set from the Births, Deaths and Marriages (BDM) National 'Fact of Death' file has been received and plans are being developed to 'run' the information against the ATO database. The ATO is also liaising with BDM to improve the standard and the data field synergy of its data.
- The South Australian RTA provides a significant part of its database on licences and motor vehicle registration in South Australia to the ATO to assist with the tracing of taxpayers. Ideally such information on a national basis would be advantageous. We will continue to work to obtain such information from other states and territories where possible.

- The ATO is also continuing to work with DIMA to gain access to its 'Movements Database.' This information is critical to enabling the proper cleansing of ATO records in relation to persons who have left the country. Ongoing access to this information would also enable the ATO to maintain the standard of future data quality in relation to this group of taxpayers. DIMA have responded positively to the proposal and are currently reviewing their legislative timetable. The relevant Section (s488) of their Act is included in this review for potential amendment.
- Following earlier informal discussions, a formal approach has been recently made to HIC seeking their views about the potential for a data match of identity information.
- A proposal to research current community attitudes to privacy and sharing of information between Commonwealth Agencies is being developed jointly with the Office of the Federal Privacy Commissioner. ATO is keen to input into the research methodology and to support the research. We intend to continue discussions with the Privacy Commissioner about the Audit Office recommendations, the ATO response to these and other initiatives described in our submissions to the Inquiry.

c) Data quality - inactive TFNs

i) *Inactive ('Excess') TFNs*

Our initial submission identified 5.3 million potentially inactive registrations on the ATO individuals data base. As we indicated, we do not believe that there is a significant risk arising from this as the vast majority of the TFNs are readily explainable and are not being utilised. The main components of this apparent 'excess' number of TFNs are:

- short term visitor departures not notified to the ATO;
- permanent departures not notified to the ATO;
- clients who are deceased, but the ATO has not been advised of this fact; and
- clients who have registered, but have not lodged for the first time yet.

Broad analysis of the statistics suggests that these factors alone would account for the vast majority of the 5.3m 'excess' records.

We expect to be able to more precisely identify inactive TFNs, if and when we are able to match against BDM and DIMA data as indicated above.

ii) *Duplications*

As noted above, identified duplicated Ms are being actively identified and removed.

iii) Value of Data Quality

The ATO is currently conducting a two phased exercise to develop a methodology and enable the measurement of the cost of holding poor quality/excess data on ATO databases and is piloting this methodology.

The outcomes of this exercise will be used to ratify or modify current risk mitigation strategies and will also help determine the priority of data cleanse activity.

d) Non resident issues

- The ATO has participated in various joint compliance activities with DIMA and Centrelink where tax offences may have occurred. For instance, the ATO had received information from the community indicating TFN abuses and related fraudulent activity in the Riverland area of South Australia. In recent months the ATO, Centrelink, DIMA and the AFP have therefore conducted joint activities within the area and found evidence of various taxation offences, illegal workers and pension/benefit abuses. The evidence gathered is now being examined and decisions will be made as to the appropriate response from the agencies involved.
- As mentioned earlier the ATO continues to liaise with DIMA regarding access to movement information and visa grant information. It is anticipated that access to this information will greatly assist the ATO in cleansing the TFN database of non residents no longer in Australia. We recognise that early detection of illegally quoted TFNs will prevent this becoming a growing issue in the Australian community and the ATO will continue to seek solutions in line with other government agencies. Recent Harvest Trail initiatives through DWRSB have highlighted the continuing need for a cross-agency strategy.
- The ATO supports the DIMA request to amend Taxation Administration Act section 16 to broaden the level of co-operation between the Agencies. The amendment seeks to broaden the definition from "illegally in Australia" to include "illegally working in Australia."
- The ATO is working to develop protocols with DIMA to provide Employment Declaration information to DIMA on a more regular basis. This information will be used to detect overstayers and illegal workers by DIMA.

We note the thoughtful Submission from Mr Ian Johnston particularly in respect to risks associated with residency status. However, a number of residency risk assessment commentaries and reviews have been completed by the ATO and Mr Johnston's estimation of risk, is not fully supported by more recent reviews that have been conducted. The most recent formal residency evaluation undertaken by Compliance Management Strategy staff assesses the revenue risk of taxpayers incorrectly stating their residency status as being comparatively low.

c) Links to ABN & integrity of ABN system

There have been some representations and comments made to the Committee about perceived risks associated with the ABN reform processes; for example the risk of 'dummy' businesses being set up for various purposes.

One of the minimum current requirements for a business wishing to apply for a TFN is that the TFN of one of the directors or other natural people responsible for the business needs to be provided as part of that application as a form of POI. This practice ensures that there is a link between a 'natural person' and the entity wishing to be registered.

This quotation of an individual TFN is also required for those wishing to register an ABN. No doubt there have been and will be attempts to register some form of a 'dummy' enterprise (potentially by using a questionable TFN as part of that POI process) in the hope of committing some form of fraud (tax avoidance, criminal activity, money laundering etc).

However, the ATO has in place specific risk-minimisation strategies to deal with such behaviours.

Firstly, we note that the introduction of the ABN does not in itself change the potential for such fraudulent activity which is already possible in the current system of business related TFNs.

Secondly, we note that there are a number of characteristics of the ABN that will allow a greater degree of confidence in the integrity of the ABN. These include

- the fact that the ABN along with certain details of registration is to be publicly available and able to be used in multiple agencies, will provide a greater degree of intrinsic scrutiny and integrity;
- more extensive use of the number for transactions will provide a more apparent and obvious picture of 'abnormal' behaviour compared with other enterprises - significant variations in patterns of activity will alert the ATO to this fact; and
- further, when compared with the profiles of 'genuine' business activities irregular transactions or other unusual behaviours will be quite visible and open to investigation.

Thirdly, the ATO has taken special steps to validate the authenticity of each business from the outset including through a complete cleanse of the database of business records such that only 'active' business were included in the ABN initial database for registration purposes. In this way the existence of a genuine enterprise has been confirmed and will continue to be monitored via the ongoing transactions with the ATO.

Fourthly, whilst it is clearly impossible to entirely eradicate underlying TFN identity fraud, we have mentioned elsewhere in this submission, the steps taken to reduce and detect this potential.

Finally, we note that even in the event that a 'dummy' business entity and any underlying fraudulent individual identities should not be detected directly by the above measures, the ATO has a range of targeted compliance and increasingly sophisticated profiling approaches to detect consequent suspect and fraudulent transactions.

f) **Extension of TFNs to AUSTRAC & other transactions**

i) **AUSTRAC reports**

- The ANAO report raised the proposal to include TFN details (if held by cash dealers) on financial transaction reports provided by cash dealers to AUSTRAC. To date, there has not been a study as to the percentage or quantum of AUSTRAC reports that, potentially, would carry a TFN if the proposal is successful.
- Only certain types of AUSTRAC financial transaction reports are capable of attaching a TFN. Those are:

Significant Cash Transaction Reports - (including Significant Betting Transaction Reports) are required to be reported by cash dealers and solicitors for transactions involving \$10,000 cash or more. Generally, these reports are provided to AUSTRAC electronically. A TFN, if known, could be included for the account owner(s).

International Funds Transfer Reports - are required to be reported by cash dealers where funds are telegraphically transferred or wired into or out of Australia. These reports may be for any amount, cash or otherwise. Generally, these reports are provided to AUSTRAC electronically. A TFN, if known, could be included for the ordering customer (sender) of an outgoing transfer. A TFN, if known, could be included for the beneficiary customer (receiver) of an incoming transfer.

Suspect Transaction Reports - are required to be reported by cash dealers where they suspect tax evasion or a breach of Commonwealth, State or Territory law. These reports are reported without the knowledge of the customer and are, generally, sent to AUSTRAC via paper. A TFN, if known, could be included.

- The other type of AUSTRAC reporting (**International Currency Transfer Reports** that are required from individuals in relation to cash of \$ 10,000 (Australian or foreign equivalent) or more being physically transported into or out of Australia) is not capable of attracting a TFN. These reports are generally collected by the Australian Customs Service at international departure and arrival points.
- If the proposal were to proceed, it would be on the basis that AUSTRAC would have the ability to ensure that any TFN received from a cash dealer is quarantined to ensure that the TFN can only be accessed by the ATO.
- ATO and AUSTRAC meet regularly to provide feedback on the operation of the Financial Transactions Reports Act reports and suggestions for improvement. The TFN proposal has been raised in this forum. As the Director, AUSTRAC has outlined in her submission, she has an obligation to consult with cash dealers in the operation of the Act. In doing this, we acknowledge that there are broader issues that need to be considered including the compliance cost to cash dealers and privacy concerns of those making transactions.

ii) **Real Estate transactions**

Since the 6 December hearing, the ATO has worked productively with the ANAO to clarify the revenue estimate associated with extending the TFN system to real estate and rental transactions. Some additional research conducted in 1995, July 1999 and since has also been examined.

The initial ATO and ANAO focus was to clarify the non-resident property revenue risk. It was clarified that the \$250 million quoted in the ANAO report was actually income, not revenue risk. Our collaboration also extended to a review of the total revenue at risk from all real estate transactions (resident and non-resident). An order of magnitude estimate of the revenue at risk for all property transactions currently outside of the TFN quotation arrangements is agreed to be \$280 million to \$350 million.

While this revenue at risk does not automatically translate to added revenue, the ATO is continuing to evaluate the ANAO recommendation that real estate transactions be included within the TFN withholding arrangements. As noted in our initial Submission, we already have programs to address significant components of this compliance risk. We are mindful too of the submissions of third parties who have pointed out the likely added cost of compliance for businesses and financial institutions.

The evaluation will also need to take account of the Business Tax Reform, (Ralph Review) recommendation for a broader non-resident withholding tax. This recommendation seeks to address low non-resident compliance and applies to Australian source payments to non-residents without a permanent presence in Australia. It includes non-residents deriving rental income from Australian properties.

In terms of this Ralph Review recommendation, the Government has indicated in principle support but final decisions have not been taken.

iii) Unmatched A11R transactions

At the 6 December hearing, the Standing Committee also queried the revenue risk associated with the ATO's ability to accurately match MIR transactions to an ATO registered client. ANAO reported in Table 5 that there were 3.7 million "unmatched" AIM transactions (1997). This is in the context of 30 million transactions received each year from investment bodies.

Our Client Identification Data Capture team has since provided a break down of the "unmatched" data. They advise that the 3.7M unmatched AUR transactions is highly likely to have included transactions that belonged to registered ATO clients who in fact lodged returns. However, the absence of a TFN or other identity data provided was insufficient to enable a "high confidence" match to occur.

In addition, there were a number of categories of investor who are specifically exempted from having to quote a TFN. For example, investors under the age of 16, investors who are pensioners, investors who are in the business of providing consumer or business advice and non residents. We estimate pensioners made up 7% and non-residents 32% of the total number unmatched.

In looking at potential revenue risk, the value and type of income reported in the "unmatched" A11R transactions was also examined. CIDC analysis identified that 52% of "unmatched" transactions were less than \$ 100 in value. 56% of "unmatched" transactions also comprised franked dividends.

The above analyses would need to be taken into account in evaluating potential risk to revenue.

