

Review into the implications of any delayed or changed ATO advice on significant issues

**Terms of Reference &
Submission Guidelines**

21 April 2009

BACKGROUND

1.1 On 10 March 2009, the Assistant Treasurer, the Hon. Chris Bowen MP, directed the Inspector-General to review and report on concerns in relation to any perceived Tax Office delayed or changed approaches — so called ‘U-turns’ — on significant interpretative matters or on past administrative practices. Particular concerns were raised with the retrospective effect of changed Tax Office views or practice and with their consequential adverse impact.

1.2 If substantiated, these concerns raise the systemic tax administration issues of adequacy of prospective certainty and taxpayer protection against the retrospective effect of Tax Office views.

1.3 During consultation on the Inspector-General’s work program, representatives of businesses and the tax profession pointed to recent examples of purported delayed Tax Office views and Tax Office changes to pre-existing views or practices. These include the Tax Office’s approach to service trusts, managed investment schemes, transfer pricing and thin capitalisation rules, royalty withholdings on copyright payments, trust cloning and the taxation of trusts more generally.

1.4 Generally, the examples purport to evidence four different types of cases that give retrospective effect to a delayed Tax Office view or an actual or perceived Tax Office change to a pre-existing view or practice.

1.5 These four types of cases involve the Tax Office releasing new advice or guidance which allegedly differs from one of the following previous categories of views or practices:

- a Tax Office binding view — for example, a public ruling;
- a Tax Office non-binding view or practice — for example, a private ruling which is binding only in relation to the rulee;
- an industry practice developed in absence of Tax Office guidance and/or unchallenged by the Tax Office for a significant period of time despite the Tax Office being well aware of the practice; or
- a view adopted by taxpayers on new law and in relation to which there was no Tax Office view for a significant period of time.

1.6 The Inspector-General now seeks to establish whether there is substantiated evidence of these examples and consideration of the issues that the examples may raise. In investigating whether there was an actual delay or change, the Inspector-General will view the relevant Tax Office files and may interview Tax Office staff to identify the reasons for the Tax Office’s delays or changes, the steps it took to minimise adverse outcomes for taxpayers and identify potential improvements.

Terms of reference

1.7 In accordance with subsection 8(2) of the *Inspector-General of Taxation Act 2003*, the Inspector-General conducts the following review at the direction of the Minister.

The Inspector-General will review any examples of circumstances in which stakeholders claim the Tax Office has delayed or changed its approach on significant interpretative matters or on past practices, with a particular focus on:

- a. whether the perceptions that the Tax Office has changed its approach with retrospective effect are justified;***
- b. how the Tax Office provides 'prospective certainty' (to the extent it can) when announcing its views;***
- c. whether the time taken by the Tax Office to announce its approaches and the way it has applied them have caused adverse consequences for taxpayers; and***
- d. what options taxpayers could or should have in these circumstances and whether any alternative processes would deliver improvements.***

Submissions

1.8 The Inspector-General invites written submissions to assist with this review. Submissions should address the terms of reference set out above and the issues and questions outlined in the attached submission guidelines. It is not expected that each submission will necessarily address all of the issues and questions raised.

1.9 The closing date for submissions is 31 May 2009. Submissions can be sent by:

Post to: Inspector-General of Taxation
 GPO Box 551
 SYDNEY NSW 2001

Fax to: 02 8239 2100

Email to: changereview@igt.gov.au

1.10 The Inspector-General intends to publish submissions on his website, unless the submitter has clearly requested that the submission remain confidential.

SUBMISSION GUIDELINES

2.1 These guidelines envisage that, broadly, your submissions will be divided into two parts.

2.2 The first part would provide a detailed account of evidence of the delay or change in views or practices that you believe have occurred.

2.3 Assuming that there is an actual delay or change or your perceptions that there was a delay or change are justified, the second part seeks your recommendations as to how to deal with such situations.

2.4 The following is provided to assist you in developing these two parts of your submission.

EVIDENCE OF DELAYED OR CHANGED VIEW OR PRACTICE

2.5 A summary of around 20 recent examples of purported delayed Tax Office views or Tax Office changes to pre-existing views or practices has been brought to the Inspector-General's attention. These include the Tax Office's approach to service trusts, managed investment schemes, transfer pricing and thin capitalisation rules, royalty withholdings on copyright payments, trust cloning and taxation of trusts more generally.

2.6 To determine whether there has been a delay or change, the Inspector-General now requests more specific details on each of these examples, as well as any other relevant examples that taxpayers or tax practitioners have experienced.

2.7 At the outset of your submission, it is important to fully state the previous view or practice (including the evidence for that view or practice) and whether it falls in one or more of the following categories:

- a Tax Office binding view;
- a Tax Office non-binding view or practice;
- an industry practice developed in absence of Tax Office guidance and/or unchallenged by the Tax Office for a significant period of time despite the Tax Office being well aware of the practice; or
- a view adopted by taxpayers on new law and in relation to which there was no Tax Office view for a significant period of time.

2.8 It is then important to explain the subsequent Tax Office view that you believe changed the previous view or practice. It is important to recognise the limits of the Inspector-General's scope for inquiry, as he cannot reach conclusions on the merits of one view over another where those views determine tax liabilities under the tax laws. Therefore, the difference between the previous view or practice and the change should be clearly outlined. You should also set out how you and the Tax Office characterise the difference. For example, is it a change, clarification or expansion of what already existed? To the extent that you disagree with the Tax Office characterisation, reasons should be provided.

2.9 In investigating whether there was an actual delay or change, it may be useful to provide a time line of events evidencing how the previous view or practice was developed through to when the alleged change occurred and beyond.

2.10 Any adverse impact of the purported delay or change should then be set out and quantified, particularly those resulting from the retrospective effect of the purported change. These might include unanticipated tax liabilities (including tax, penalties and interest) for prior years, increased ongoing compliance costs and potential restructuring of significant commercial arrangements.

2.11 It would also be useful to set out why you believe such adverse consequences were not justified. For example, in relation to new law on which there is no Tax Office guidance, you may wish to demonstrate that you took a position that you believed was reasonable in the circumstances. In which case you should also include the Tax Office's opinion on whether your position was reasonably arguable.

2.12 In preparing submissions, you may find it useful to refer to the following documents:

- ***ATO, Miscellaneous Taxation Ruling, MT 2008/2 Shortfall penalties: administrative penalty for taking a position that is not reasonably arguable;***
- ***Treasury, Report on Aspects of Income Tax Self Assessment, 2004, pages 13-17 in relation to 'general administrative practice' and pages 58-60 in relation to a 'reasonably arguable position';***
- ***Explanatory Memorandum to Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005, paragraphs 3.130 to 3.132 on 'general administrative practice';***
- ***ATO, Taxation Ruling, TR 2006/10 Income tax, fringe benefits tax and product grants and benefits: Public Rulings, paragraphs 70 to 74 in relation to 'general administrative practice';***
- ***ATO, Taxpayers' Charter and related documents, such as Getting advice from the Tax Office; and***
- ***IGT, Review of the Potential Revenue Bias in Private Binding Rulings Involving Large Complex Matters, paragraphs 3.31-3.36 and 5.20-5.25 on the Tax Office's approach to statutory interpretation.***
- ***ATO, PS LA 2008/3: provision of advice and guidance by the Tax Office.***

2.13 In summary, we suggest that in preparing this section of your submission, you address the following issues as well as any other that you consider relevant:

- a. the prior practice or view which taxpayers believed existed and why it was reasonable to rely on it;
- b. the specific Tax Office conduct (if any at all) that, in your view, evidences the Tax Office's acceptance of this prior practice or view;
- c. the subsequent Tax Office practice or view and why you believe it was inconsistent with the prior practice or view that was initially relied upon by taxpayers;
- d. the extent to which the subsequent Tax Office practice or view had 'retrospective' effect and how it adversely affected relevant taxpayers;
- e. any alternative action which, in your view, could have minimised the adverse effects; and
- f. a time line of relevant events.

DEALING WITH A DELAYED OR CHANGED VIEW OR PRACTICE

2.14 At the outset, it is important to note that Tax Office views do not create or extinguish legal rights as they are only statements of administrative intent. However, it is appreciated that taxpayers seek to reduce uncertainty by assessing their liabilities in line with the Tax Office's interpretation of the law. For example, many taxpayers, particularly small businesses and individuals, may prefer to follow Tax Office views to avoid costly litigation where they feel they cannot match the resources of the Tax Office. In addition, large companies may have become more reliant on Tax Office advice in recent years due to encouragement by the Tax Office to address tax risks as a part of their corporate governance.

2.15 Whilst there is no legal obligation on the Tax Office to provide guidance, views or advice, the Tax Office has committed itself (in the Taxpayer's Charter and related documents) to giving advice and information that taxpayers can rely on. This reflects the community's expectation of a tax administrator in a self-assessment environment.

2.16 It should also be noted that the Tax Office operates on a risk management model in dealing with identified issues or risks as it considers that it does not have sufficient resources to address all issues at any given time.

2.17 With this backdrop, we need to explore the circumstances in which the Tax Office would be justified to change pre-existing views or practice, irrespective of whether such change is to apply retrospectively or prospectively.

2.18 On the one hand, if the Tax Office were to regularly change its views or practices on significant issues, there would be adverse effects not just to the taxpayers but to the economy as a whole. The uncertainty that would result may be, for example, a significant disincentive to foreign investors (as well as Australian businesses and investors) to invest in our

economy. On the other hand, it may be desirable for the Tax Office to change views or practices in certain circumstances, such as to address the application of the law to new arrangements or to address compliance concerns.

Whether there is a 'change'

2.19 One specific area of interest is the distinction between a Tax Office view or practice that is a 'change' and one which is merely a 'clarification'. Where a view is said to be a clarification, it may mean that the previous view has not been changed and the subsequent advice merely articulates some of that pre-existing advice more clearly. You may wish to consider this distinction in your submission.

2.20 You should also consider what should happen where there is disagreement between taxpayers and the Tax Office as to whether there is an actual change, as opposed to a clarification.

Prospective or retrospective application of delayed or changed view

2.21 Having addressed the above, the issue arises from what date should Tax Office views apply, i.e. should the advice have retrospective effect? Also, it may be useful to identify situations where you feel such retrospective effect is not justified, bearing in mind that the law applies from the date of enactment.

2.22 If the advice constitutes a change to one of the following:

- a Tax Office binding view; or
- a Tax Office non-binding view or practice; or
- an industry practice developed in absence of Tax Office guidance and/or unchallenged by the Tax Office for a significant period of time despite the Tax Office being well aware of the practice; or
- a reasonable view adopted by taxpayers on new law and in relation to which there was no Tax Office view for a significant period of time,

you should explain to what extent retrospective application would be appropriate or not in each case.

2.23 It may be that the solution in every instance is not black and white, i.e. only having retrospective or prospective effect. You should consider whether some flexibility should be provided. Perhaps a framework could be developed where the default position is either retrospective or prospective but the Commissioner can make exceptions based on a number of well-defined factors. You may wish to suggest some of these factors.

2.24 Where you believe the change should be prospective, should the new advice have effect from the date of the advice or should the taxpayer be given a reasonable time to alter its affairs in accordance with the new advice? If the latter, what is a reasonable amount of time?

2.25 There may be cases where structures have been put in place in accordance with the previous position and restructuring is not possible due to costs or other factors. What should the Tax Office do in these circumstances?

2.26 There may also be cases where some taxpayers have knowingly taken overly aggressive positions in the absence of Tax Office advice, while others have taken positions which appear reasonable based on the law and available extrinsic materials. How can the Tax Office address deliberate non-compliance with the law in these circumstances while protecting those who sought to do the right thing?

2.27 Where you believe the change should be retrospective, should there be a limit on how far back the advice can be applied? Should this be the same as the time limits provided for amendment of assessments?

2.28 It may also be useful to consider what has prompted the Tax Office to issue a view. For example, where the Tax Office view reflects a judicial decision, they may have no choice other than to apply it retrospectively? Although the Tax Office's views are only statements of administrative intent, judicial decisions, by contrast, can have retrospective effect as they 'find' the law, i.e. state how the law has always applied.

Taxpayer protections

2.29 Related to the application of Tax Office views is the level of protection against the potential adverse consequences that may arise.

2.30 In relation to a view or practice adopted in absence of Tax Office guidance, the law does provide some protection against penalties (but not primary tax or interest thereon) so long as you can establish you have a reasonably arguable position. You may like to review the documents referred to in paragraph 2.12 above when considering whether this protection is enough and operating as intended.

2.31 In relation to any Tax Office administrative practices relied upon before the Tax Office issues the new advice, broadly, the law gives taxpayers protection against tax, penalties and interest so long as you can establish that the practice was a 'general administrative practice' and the Tax Office's new advice is published in a public ruling. The Tax Office has stated that its usual practice is to communicate any change of a general administrative practice by way of a public ruling. You may also like to review the documents referred to in paragraph 2.12 above when considering whether this protection is enough and operating as intended.

2.32 The law also provides protection against tax, penalties and interest in relation to binding Tax Office advice. You should also consider whether this protection is enough in these circumstances and whether it is operating as intended.

2.33 Notwithstanding the above, taxpayers wanting more certainty around the Tax Office's views of their particular arrangement can seek protection from tax, interest and penalties by obtaining a private ruling. This may be particularly useful where an existing view has been questioned and a new position has not been communicated. You may wish to share your views and/or experiences in this regard.

Communication of intended changes

2.34 Encompassing all of the above is the issue of how and when the Tax Office should communicate to others that it is considering publishing either a new advice or changing a pre-existing view or practice. These types of views are rarely issued without some significant event triggering the Tax Office's re-appraisal of the pre-existing view or practice or deciding to publish a new advice. For example, re-appraisal may be triggered because

industry and tax professionals called for more certainty on a particular matter or because during audits the Tax Office identified compliance concerns about a pre-existing industry practice. These sorts of re-appraisals commonly involve substantial periods of time leading up to the announcement of the change.

2.35 Awareness of potential changes could be important for planning of business transactions and structures, but could also cause adverse effects in themselves. On the one hand, an announcement that the Tax Office is considering a change in a particular area may create a level of uncertainty. On the other hand, flagging issues of potential change can also alert the community to areas of which they should take particular care.

2.36 Whilst the Tax Office is consulting with stakeholders, including the Treasury, in forming its views, what position should taxpayers take in the interim? For example, where the existing view or practice has been questioned and no new position has been finalised, the uncertainty around potential tax liabilities may deter businesses from entering into economically beneficial transactions. Businesses may perceive a risk that the ultimate Tax Office view could result in potentially unprofitable transactions.

2.37 What assistance can the Tax Office provide in the above circumstances and how should the Tax Office conduct its consultation process? Ultimately the question is how can the Tax Office best provide prospective certainty in these communications and which events should trigger such a communication.

2.38 You may also wish to consider how Tax Office auditors should approach issues that are subject to these consultation processes. Before these consultation processes are finalised, should auditors rely on views expressed during these processes when checking taxpayers' compliance?

Other issues

2.39 Having addressed the above, your submission may raise other issues that you wish the Inspector-General to consider.

2.40 For example, the complexity of the law may have some impact on whether you think the Tax Office should provide further advice or guidance. Generally, the Tax Office is involved in consultations on the design of new tax laws and how these are intended to operate. You may wish to comment on whether this is enough or whether more certainty is needed within certain periods and how that could be best delivered, recognising that tax law administration often involves compromise between competing objectives, such as compliance costs, certainty and Tax Office resources. It should also be noted that the Tax Office has stated that it can only provide its view on the law once it is enacted.

2.41 Related to this matter is how the Tax Office selects issues on which to provide advice. You may wish to consider whether this process operates effectively, recognising that the Tax Office has limited resources and relies to a large extent on industry and tax professionals (for example, through its various consultative forums) to identify areas for greater certainty, in addition to the Tax Office's own identification of compliance concerns. Should this approach to selecting issues affect how subsequent Tax Office views are applied?

2.42 The Inspector-General is also open to considering other issues and invites you to raise any other areas that would lead to improvements in relation to delayed Tax Office advice or changes to pre-existing views or practice on significant issues.

2.43 In summary, we suggest that in preparing this section of your submission, you address the following questions as well as any other that you consider relevant:

- 1 In what circumstances would the Tax Office be justified to change a pre-existing view or practice?
- 2 In what circumstances should a Tax Office view be called a 'change' or 'clarification'? What consequences should flow from this?
- 3 What should happen where there is disagreement between taxpayers and the Tax Office as to whether there is an actual change of view or practice?
- 4 To what extent is retrospective application of a new view desirable, where that new view changes the following:
 - a Tax Office binding view;
 - a Tax Office non-binding view or practice;
 - an industry practice developed in absence of Tax Office guidance and/or unchallenged by the Tax Office for a significant period of time despite the Tax Office being well aware of the practice; or
 - a reasonable view adopted by taxpayers on new law and in relation to which there was no Tax Office view for a significant period of time.
- 5 Where you believe the change should be prospective, should the new advice have effect from the date of the advice or should the taxpayer be given a reasonable time to alter its affairs in accordance with the new advice? What is a reasonable amount of time?
- 6 In issuing new advice, how can the Tax Office address deliberate non-compliance with the law while protecting those who sought to do the right thing?
- 7 Where you believe the change should be retrospective, should there be a limit on how far back the advice can be applied?
- 8 Is the protection provided for a 'reasonably arguable position' enough and operating as intended?
- 9 Is the protection provided for a 'general administrative practice' enough and operating as intended?
- 10 Is the protection provided for binding Tax Office advice enough and operating as intended?
- 11 How could the Tax Office best provide prospective certainty in communications on potential new advices or changes in views or practice and what event should trigger such communications?

- 12 How should the Tax Office seek compliance whilst consulting on potential changes to pre-existing views and practices?**
- 13 What other issues would you like the Inspector-General to consider?**