



Australian Government
Inspector-General of Taxation

**Improvement to tax administration
arising from the Inspector-General's case study
reviews of the Tax Office's management of major,
complex issues**

A report to the Assistant Treasurer

Inspector-General of Taxation

6 August 2008

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Australian Government
Inspector-General of Taxation

6 August 2008

The Hon Chris Bowen MP
Assistant Treasurer
Parliament House
Canberra ACT 2600

Dear Minister

I am pleased to present to you my report on improvements to tax administration arising from my case study reviews* of the Tax Office's management of major, complex issues. The case study reviews covered three topics put forward by community stakeholders as examples of their concern that the Tax Office takes too long to come to grips with and satisfactorily resolve major, complex issues.

This report provides my summary of the systemic issues arising from the three case studies. It identifies areas for improvement and specific changes agreed for implementation through joint work with the Tax Office.

In addition to the recommendations made in the case study reviews themselves, and together with the recommendations of my review into Potential Revenue Bias in Private Binding Rulings Involving Large Complex Matters (which are also relevant to the issues arising from the case studies and are in an appendix to this report), this review completes and delivers a significant package of improvements to tax administration.

I particularly acknowledge the co-operation of senior Tax Office staff in working with me to identify areas for improvements arising from the case study reviews and to develop the specific changes they have agreed to implement. These changes will add to the significant improvements introduced by the Tax Office itself over recent years.

I offer my thanks to the support and contribution of professional bodies, business groups and individuals to this review. The willingness of many to provide their time in preparing submissions and discussing issues with myself and my staff is greatly appreciated.

Yours sincerely

A handwritten signature in black ink that reads 'David Vos'.

David Vos AM
Inspector-General of Taxation

* *Review of Tax Office Management of Complex Issues – Case Study on Research and Development Syndicates*, publicly released 16 August 2007; *Review of Tax Office Management of Complex Issues – Case Study on Living Away From Home Allowances*, publicly released 10 May 2007; *Review of Tax Office Management of Complex Issues – Case Study on Service Entity Arrangements*, publicly released 24 April 2007.

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CHAPTER 1 — CONDUCT OF REVIEW

1.1 This is the fourth and final report on the review conducted by the Inspector-General of Taxation (the 'Inspector-General') into the Tax Office's ability to identify and deal with major, complex issues¹ within reasonable timeframes. This report is pursuant to section 10 of the *Inspector-General of Taxation Act 2003* (the 'IGT Act').

1.2 The Inspector-General made public his intention to undertake this review on 11 August 2005. This announcement followed concerns expressed by tax professionals and certain sectors of the community that the Tax Office takes too long to come to grips with and satisfactorily resolve major, complex issues. They argued that the Tax Office appeared to allow significant periods of time to elapse before an issue is seen to have accumulated enough potential revenue leakage to initiate compliance action. This, they argued, causes significant uncertainty and unnecessary costs. They pointed to significant amounts of money and time the private sector spends in dealing with the Tax Office on these types of issues.

1.3 Stakeholders gave a number of examples to illustrate their concerns, including:

- research and development (R&D) syndication arrangements claiming deductions under section 73B of the *Income Tax Assessment Act 1936*;
- living away from home allowances (LAFHAs); and
- service entity arrangements.

1.4 Community stakeholders said they would welcome the identification of any systemic changes which might prevent prolonged timeframes occurring in the future as major issues arise.

1.5 On 31 October 2005 the Inspector-General formally announced terms of reference for this review (Appendix 1) and called for submissions on the three examples identified by stakeholders that were to be case studies for the overall review. The Inspector-General foreshadowed that a fourth report could be produced to bring together recommendation on systemic issues raised by the case studies.

1 'Major, complex issues' should not be too tightly defined, but the three case studies are good examples. These issues generally involve a significant number or class of taxpayers and significant amounts of revenue or substantial community attention. Issues identified by the Tax Office as Category 1 (the most significant) Priority Technical Issues (PTIs) would also generally qualify. Of itself, legal complexity in a matter may not be a 'Large, complex issue'.

1.6 The Inspector-General reported separately and progressively on the three case studies as follows:

- *Review of Tax Office Management of Complex Issues – Case Study on Research and Development Syndicates*, publicly released 16 August 2007;
- *Review of Tax Office Management of Complex Issues – Case Study on Living Away From Home Allowances*, publicly released 10 May 2007; and
- *Review of Tax Office Management of Complex Issues – Case Study on Service Entity Arrangements*, publicly released 24 April 2007.

1.7 Collectively, the case study reviews attracted 53 submissions from community stakeholders. The reports of these reviews can be found on the Inspector-General's website at www.igt.gov.au.

1.8 Following completion of the case studies, the Inspector-General summarised the generic issues arising from them and worked progressively with Tax Office senior management to distil key areas where there was scope for improvement, and to agree specific changes.

1.9 During the period that the Inspector-General was working with the Tax Office to finalise this report, he also finalised his review into the *Potential Revenue Bias in Private Binding Rulings Involving Large Complex Matters*. Some of the recommendations arising from that review also addressed issues identified by the case study reviews and they are included in this report at Appendix 3.

1.10 During the review the Tax Office identified significant improvements it has made over recent years to the way it manages major issues. The report includes an Appendix 2 prepared by the Tax Office that summarises its current approaches.

1.11 In accordance with section 25 of the IGT Act, the Commissioner of Taxation was provided with an opportunity to give submissions on any implied or actual criticisms contained in this report.

CHAPTER 2 — OVERVIEW

2.1 Following concerns raised by taxpayers and their representatives, the Inspector-General undertook case studies into the Tax Office's management of three major, complex issues – Service Entities, Living Away From Home Allowances and Research and Development Syndicates. These issues shared similar features of scale and complexity, and all have taken an exceedingly long time to progress.

2.2 The Inspector-General's reports on these case studies show that the Tax Office can have difficulty grappling with the interplay between complex interpretational issues, and complex internal and legal administrative frameworks, in equally complex and dynamic commercial settings. The case studies have also highlighted the challenges for top management in ensuring that espoused values are maintained throughout a large, complex and culturally evolving organisation.

2.3 The case studies go back over a considerable number of years. The Inspector-General notes that the Tax Office has introduced significant improvements to its approaches over those years, and continues to do so. Over the last decade, major investments in services and infrastructure have enabled the Tax Office generally to deliver highly effective administration and support to taxpayers in a complex system, especially in high volume areas. The Inspector-General has, in formal reports and elsewhere, noted that the Tax Office is a world-class tax administration.

2.4 In responses to the case study reports, the Tax Office referred to measures aimed at improving timely consideration and resolution of complex issues, for example, case management leadership, aged case management, the Priority Technical Issues (PTI)² process and alternative processes to the statutory dispute resolution Part IVC process. Appendix 2 to this report has been prepared by the Tax Office to present a current picture of its approaches.

2.5 Nevertheless, the case studies showed that despite the introduced measures prolonged delays were still experienced, indicating further changes are needed. In a complex system it is not surprising that tax administration is tested most in the management of major, complex issues. If these matters are not handled effectively, concerns arise that larger numbers of individual cases of lower profile may also be experiencing difficulty. All the case studies still have residual matters on hand and the Tax Office has noted that improvements can still be made.

2 Practice Statement 2003/10 – 'The Management of Priority Technical Issues'.

2.6 Following consideration of the case study reports, the Inspector-General and the Tax Office have agreed that there is scope for improvement in the following inter-related areas which are expanded upon in this report:

- timeliness – reducing the risk and consequences of delayed resolution;
- compliance and risk management strategies – balancing efficiency and differentiation;
- Tax Office values and obligations in a self-assessment system; and
- communication and transparency.

2.7 This report outlines the changes that the Tax Office has agreed to implement to further improve on its approaches to managing and resolving complex issues in the context of improvements already made over recent years. The report also cross-references to changes agreed recently as part of other Inspector-General reviews, (notably the review of the potential revenue bias in private binding rulings (PBRs) involving large complex matters – see Appendix 3) that are relevant to the case studies.

2.8 As well as improved management, the agreed improvements should increase community confidence in Tax Office approaches to major issues. The Inspector-General believes that improvements in these areas collectively have the potential for moving Australia further towards a values-driven tax administration that is appropriate to a complex and sophisticated, self-assessment based tax system.

CHAPTER 3 — INSPECTOR-GENERAL’S SUMMARY OF SYSTEMIC ISSUES ARISING FROM THE CASE STUDIES

3.1 This chapter summarises the generic issues arising from the case studies and specifies the changes agreed by the Tax Office to achieve further improvements to tax administration in each of the areas identified at para. 2.6.

Timeliness — reducing the risk and consequences of delayed resolution

3.2 In responses to the case study reports, the Tax Office referred to measures aimed at improving timely consideration and resolution of complex issues, for example, case management leadership, aged case management, the priority technical issues (PTI) process and alternative processes to the statutory dispute resolution Part IVC process. The Tax Office’s PTI process is an established approach to the resolution of complex technical issues and provides a foundation for further improvements. However, the case studies showed that, despite the introduced measures, prolonged delays were still experienced, indicating further changes are needed.

3.3 The changes in this area need to recognise the impact on taxpayers who are faced with making decisions during protracted periods of uncertainty about the Tax Office’s technical and compliance position. The case studies have shown that delays also compound the negative impact of compliance strategies, entrench taxpayer resistance and exacerbate management complexity for the Tax Office. Changes are needed to increase the general sense of urgency for providing guidance in matters where taxpayers need to make decisions or may be making decisions that do not comply with the Tax Office view. Where there is uncertainty in the law the Tax Office must deliver clarification in a timely manner. However, in all the case studies the Tax Office took too long to finalise its view of how the law applied, which is a crucial prerequisite to resolution.

3.4 The case studies have shown that resolution can proceed more quickly when very senior managers become directly involved. This suggests that strong disciplines are required to guarantee early intervention at top management levels where resolution is not being achieved within expected timeframes. A reliance on bottom-up escalation procedures may not be enough and may actually contribute to overly protracted timeframes.

3.5 The case studies showed that where resolution of complex issues appropriately involves testing a technical position through litigation the lead times to identifying and progressing test cases can be protracted and cause major delays.

3.6 Changes to reduce the risk of delayed resolution will need to assist management of the critical path events that are generic to complex issues and to the

range of possible courses that management of such issues might take. Generic events include early identification; establishing and communicating robust technical views; and sound approaches to confirming risks and behaviours. Others might involve selecting a number of test cases and going through the objection and review and appeal processes, or it may be by seeking declaratory proceedings while the matters are still at the audit stage. These critical path events might also provide a good framework for considering ways of achieving improvements in other agreed areas including communication.

Compliance and risk management strategies — balancing efficiency and differentiation

3.7 In deciding its strategies to address compliance risks involving large populations the Tax Office is faced with striking a balance between administrative efficiency and the need to recognise the individual circumstances of affected taxpayers. There is a danger that leveraged approaches³ adopted to contain Tax Office effort may inadequately differentiate between types of taxpayers involved or may be based on inadequate fieldwork to confirm and distinguish taxpayer behaviours. Lead cases may be selected primarily for their potential to strengthen Tax Office compliance strategies and views of the law, without being representative of the full range of cases to which the outcome will be applied.

3.8 This risk is at its highest where the scale of a compliance issue and the potential effort required to address it cause the Tax Office to look for a highly leveraged ‘silver bullet’ strategy, including the potential for applying anti-avoidance provisions.

3.9 The case studies also show that risk assessments of emerging major issues may not be borne out by field appraisals and subsequent experience. Risk assessments of major compliance issues should be updated regularly to ensure that compliance action is in proportion to the monetary and non-monetary costs and benefits, and relative to other compliance risks.

3.10 A Senior Executive decision-maker should exist for any major compliance activity to lead that activity from the outset. This leader must ensure that risk assessments are updated and that leveraged strategies are based on an adequate sequence of audits that test for a range of taxpayer circumstances, amended assessments and, if necessary, objections and court decisions.

3 Leveraged compliance strategies are where the Tax Office takes action against a number or class of taxpayers without undertaking an individual audit or investigation of each taxpayer, thereby largely avoiding the costs of those actions. Leveraged strategies may be based on surveys of taxpayers or their representatives or a small number of direct audits.

Tax Office values and obligations in a self-assessment system

3.11 Mandatory checks and balances are needed to give the Commissioner and the community the assurance that Tax Office values and obligations in a self-assessment system are being lived out in its management of significant issues.

3.12 The complexity of the tax system requires the Tax Office to consciously test if its expectations of taxpayers' level of compliance are reasonable. The Tax Office acknowledges its obligations in a self-assessment system to provide clear guidance and support taxpayers. The extent to which it has fulfilled this obligation can have a major bearing on compliance and on perceptions of the fairness of its compliance strategies.

3.13 The case studies all showed the importance of early, quality Tax Office advice on its view of the law and its expectations for compliance, and the consequences where such advice was not adequate.

3.14 Changes in this area should help the Tax Office to demonstrate that it has actively considered and taken into account how its own behaviour has factored into significant compliance issues and how that, in turn, is reflected in its compliance approaches (for example, prospective or retrospective approaches).

3.15 Checks are also required to ensure that a cultural tendency to tackle perceived tax avoidance aggressively – appropriate in some circumstances – does not unduly colour resolution strategies or behaviours. This risk is at its highest where the Tax Office labels taxpayers as being engaged in aggressive tax planning or tax avoidance, especially where it is culturally attuned to that perception. The case studies suggest that this can cause positions to become entrenched and resolution delayed.

3.16 Changes in this area need to equip the Tax Office to demonstrate to the community through its approaches that it understands that tax is a complex system. Matters decided differently through several layers of process (sometimes within the Tax Office itself) including the courts do not, when ultimately decided, suddenly become black and white. Rather, this process confirms their complexity, their 'greyness' and the reasonableness of different interpretations. Ensuing compliance treatments need to reflect this complexity. In recognition of the complexity of some issues the Tax Office should consider if it would be fair that matters decided differently through several layers of process should only receive prospective compliance treatment once finally decided.

3.17 Processes are also needed to demonstrate Tax Office openness to have matters tested in court. Resolving objections on similar cases should not be held up unless the issue is on foot in the courts or action to get it into the courts can be publicly demonstrated. Procedures and positive inducements should be introduced to encourage taxpayers to come forward with cases that require judicial clarification and proceed to hearing without impediment or delay.

Communication and transparency

3.18 The case studies indicate some variance in respect of the Tax Office's directness and timeliness of communication with taxpayers. At the level of principle, all Tax Office compliance strategies need to feature direct and early communication with taxpayers potentially affected by a compliance concern (an exception may be some Serious Non-compliance criminal matters). A reliance on exposing issues to professional bodies through consultation forums or on indirect communication such as speeches and seminars is no substitute for a default approach of direct communication and guidance to both taxpayers and their advisers.

3.19 The Tax Office has already taken the positive steps of allowing taxpayers to attend its Part IVA Panel and to receive position papers on potential Part IVA matters. More can be done in this area to further improve perceptions, transparency and outcomes.

3.20 Transparency and communication would be greatly enhanced if the Tax Office's full agenda of significant technical issues under consideration was made publicly available and easily accessible. Many of the issues are already in the public arena through topics listed on the Public Rulings and Law Administration Practice Statement Programs, via litigation cases (eg court lists) and through the government's legislative program (for introduced measures) or in government releases (for announced measures). Information on around 70 percent of the Tax Office's list of PTIs is currently available from these sources albeit in disparate form. Some PTIs, around 5%, involve interactions with Treasury that may not be suitable for public disclosure. The balance involves technical issues on individual ruling, audit or objection cases.

3.21 A consolidated listing of all significant technical issues that it has under consideration on a 'Technical Issues Agenda' area within the Tax Office website would be a suitable way of making this improvement. Where necessary, the listing could be 'sanitised' to maintain privacy in the same way as published versions of Private Binding Rulings are. Making this agenda public would improve transparency around the Tax Office's agenda and its performance in resolving issues against benchmark timeframes, as well as enriching dialogue with the professional and business tax community.

3.22 The case studies also underscored the importance of the Tax Office ensuring that taxpayers are clear about their situation and that Tax Office advice is up-to-date. For example, publications, such as the Taxpayers Charter booklet dealing with audit should clearly set out when a taxpayer is under audit.

3.23 Taxpayer uncertainty would be reduced if the Tax Office promptly withdrew or flagged taxation rulings, taxation determinations or other interpretative decisions where it has changed or is uncertain with its view of the law.

CHAPTER 4 — CHANGES AGREED TO IMPROVE THE TAX OFFICE'S ABILITY TO IDENTIFY AND DEAL WITH MAJOR, COMPLEX ISSUES WITHIN REASONABLE TIMEFRAMES

4.1 Using the summary of systemic issues distilled from the case study reviews, the Inspector-General and the Tax Office have worked together to identify areas for improvement and agree specific changes as follows.

AREAS AGREED FOR IMPROVEMENT AND CHANGE

- A. There needs to be clear guidance for Tax Office staff and the community on what timeframes the Commissioner expects to be achieved in resolving complex issues, noting the income tax and other tax time-cycles that taxpayers must work within. Corporate time limits or performance standards need to be set for the Tax Office to conclude its view of how the law applies in respect of priority technical issues (PTIs) and other issues requiring precedential views.**

The Tax Office agrees that there is a need for standards for the timeframes allowed to reach a considered ATO technical view of the law for all PTIs.

The Tax Office will implement and work to a benchmark maximum of six months for establishing the Tax Office view. If at the outset of identifying or progressing a PTI it is clear that it will take longer than six months to establish the Tax Office view, a business case will need to be made and agreed by the relevant Band 2 SES officers.

The Tax Office will continue to improve the current processes for PTIs and ensure that agreed timeframes (including significant milestones) are in place when those PTIs are registered. In addition, approval from the relevant Band 2 SES officers in both the Law Sub-plan and relevant Risk area will be required during the resolution of a PTI before those agreed timeframes are extended.

For public rulings and LAPS, the Tax Office's programs on www.ato.gov.au reflect the agreed delivery timeframes for those products including the issuing of drafts in the case of public rulings. The Tax Office processes governing the development of both products requires referral to and approval from the relevant Band 2 SES officer for existing timeframes to be varied.

The rulings program also indicates the Tax Office's 'target' timeframes for the development of taxation rulings and determinations across the different subject areas. Exceptions to these targets (for example, to allow additional consultation with industry) are advised on the program. The 'target' timeframe for a LAPS is six months from notification on the program with an additional three months allowed when public consultation is involved.

AREAS AGREED FOR IMPROVEMENT AND CHANGE (CONTINUED)

- B. Ways to increase early top management awareness and hands on management of complex issues that are unresolved for unreasonable periods of time need to be developed. Circuit-breakers are needed to cut across processes and procedures where they are not leading to the timely establishment of the Tax Office technical view.**

The Priority Technical Issues Committee (PTIC) process, under the leadership of the Chief Tax Counsel, regularly monitors the progress of all PTIs and governance of the PTI process.

The Tax Office has now introduced a 'top down' intervention mechanism in the management of major/complex issues, including PTIs, when it becomes apparent that a significant milestone will not be met.

The intervention is by the relevant existing SES Band 2 officers in both the Law Sub-plan and Risk areas, such as a Deputy Chief Tax Counsel, or the Chief Tax Counsel and the Deputy Commissioner responsible for the issue as part of the PTIC process which meets every six to eight weeks. If necessary/appropriate, issues can be further escalated to the relevant Second Commissioners.

- C. To assist management of the events that are critical to timely resolution of complex issues, the Tax Office should improve project management capability for large complex issues, and introduce initiatives to ensure that compliance actions are fair and based on a contemporary appraisal of the factors that have led to the issue.**

Improving project management capability is important to the Tax Office. Project plans are required for the resolution of all PTIs. In addition to the PTI Committee process mentioned under 'Area B' above, there are regular call-overs to monitor progress of resolution of PTIs against project plans.

In addition to improvements to assist officers in their planning for the development and delivery of public rulings and LAPS, the Tax Office is developing further assistance for officers in both the Law Sub-plan and the relevant Risk areas to improve the management and timeliness of resolution of PTIs. The main assistance is aimed at improving their project management capability by providing assistance with project plans that must be completed on registration of a PTI. Achievements against these plans are subsequently monitored through the PTIC and related call over processes to ensure milestones are met. Where there is risk that a significant milestone will not be met, the SES Band 2 officers will intervene as outlined above.

Risk owners for major compliance activities will ensure that:

- adequate field work is undertaken to identify the issue and differentiate categories of taxpayers' circumstances;*
- direct communication takes place with affected taxpayers and/or their advisers;*
- regular reappraisal is made of compliance and revenue risk and costs, and*
- the quality of information provided to taxpayers to help them meet their obligations is tested before a compliance strategy is designed and commenced.*

AREAS AGREED FOR IMPROVEMENT AND CHANGE (CONTINUED)

D. More needs to be done to reduce the time taken to identify and progress test or lead cases including increasing Tax Office efforts to identify a suitable lead case on an issue, and offering inducements encouraging taxpayers to come forward.

The Tax office is committed to clarifying the law through litigation of contentious areas of the law. Our test case litigation program is designed to do this. As well as considering applications for test case funding from taxpayers, we will continue to proactively seek significant or contentious lead cases and, because of the public interest in having the law clarified, fund them as part of our test case program. This will include:

- generally offering test case funding where the Commissioner appeals against an AAT decision or seeks special leave to appeal to the High Court⁴;*
- given the nature of the issues covered by the test case program, funding will generally be extended to appeals against funded decisions, at least to the Full Federal Court. Where cases are approved for funding in state or territory courts, funding will generally extend to the Court of Appeal or equivalent in the relevant Supreme Court. In contrast to the current test case funding arrangements, a fresh application for funding will not usually be needed but a decision on funding will be made by taking into account the nature of the issue being tested on appeal.*
- contacting all taxpayers that we have identified as having objections lodged on a legal issue and seeking their willingness to be part of the test/lead case process and including the likely factual matrix needed to test the legal issue;*
- resolving objections from taxpayers who have suitable cases and encouraging them to come forward as a test case;*
- publicly announcing that a test case is being sought describing the issue to be clarified and why; and*
- seeking NTLG/professional body assistance to publicise the fact that a test case is being sought.*

An ongoing challenge is to identify, and obtain agreement from, taxpayers to be test cases where there is no application from a taxpayer for test case funding.

The Inspector-General has raised concerns in relation to the need for new procedures to accelerate and encourage the identification and progression of test cases. In response to those concerns the Tax Office will increase the existing 50 per cent GIC remission concession (currently available for disputed tax debts where taxpayers enter into a 50/50 arrangement⁵ by paying a minimum of 50 per cent of the tax in dispute) from 50 per cent to 75 per cent where a test or lead case funded as part of the test case program is involved.

4 See Page 8 of our *Test Case Litigation Program* booklet (NAT 4556-04.2005).

5 As explained in Chapter 28 of PSLA 2006/11 *ATO Receivables Policy*.

AREAS AGREED FOR IMPROVEMENT AND CHANGE (CONTINUED)

It would not be expected that penalties would generally be imposed in test cases. Penalties may, however, be imposed in certain lead cases for widely marketed schemes. It would not be appropriate to remit penalties in such cases merely because a case is the first case to be litigated.

It is generally easier to get agreement from taxpayers to be test cases where there is agreement on the facts of the case. We will continue to seek agreement on facts where possible in those cases which we believe would be suitable to test a contentious area of the law.

Once identified we seek to fast track test cases through the court. This involves the necessary cooperation of taxpayers and the court. New Federal Court directions for tax litigation should enable more timely progress of cases, particularly test or lead cases.

We are currently revising our test case funding guidelines which explain our approaches to law clarification through litigation of contentious issues. The revised guidelines will include the relevant approaches agreed in this report.

- E. Transparency and communication would be greatly enhanced if the Tax Office's full agenda of significant technical issues under consideration was made publicly available and easily accessible. A consolidated listing of all significant technical issues that it has under consideration on a 'Technical Issues Agenda' area within the Tax Office website would be a suitable way of making this improvement.**

The Tax Office website currently has information on significant technical issues through the publicly available rulings and LAPS programs. The ATO also provides a list of Strategic Litigation issues to the NTLG on a regular basis.

Within the next two years (in recognition of current major Tax Office IT commitments) the Tax Office will work towards consolidating its information on significant technical issues (generally all PTIs) into one reference area on the Tax Office's web site with links to other relevant areas such as the Public Rulings and LAPS Programs. Some issues may not be included due to confidentiality considerations.

AREAS AGREED FOR IMPROVEMENT AND CHANGE (CONTINUED)

- F. To avoid uncertainty, draft or all final public advice products (including taxation rulings, determinations, interpretive decisions, Practice Statements, Fact Sheets and publications), should be promptly withdrawn or appropriately flagged as soon as the Tax Office has changed its view of the law, or where a court decision has raised the need for review. This should occur as soon as the change or need for review is identified, even if a replacement or fully updated product is not immediately available.**

The Tax Office recognises the need to ensure the public advice and guidance it provides represents the current Tax Office view. It recognises the importance in a self-assessment system of taxpayers having access to advice and guidance about the application of the laws administered by the Commissioner.

The Tax Office agrees that once it concludes that its view has changed, the existing public advice or guidance should be withdrawn immediately and the Tax Office should clearly indicate whether replacement advice or guidance is required.

Where the existing view is merely being reconsidered due to possible uncertainty, the existing advice or guidance would not normally be withdrawn. Where there is a change to a general administrative practice that is less favourable for taxpayers and that change is not communicated by way of a public ruling, the Tax Office will not necessarily amend assessments that were raised consistently with a practice in place at the time of the assessments. As a general rule the Tax Office will amend assessments only where tax avoidance is involved or the practice has been exploited in an unintended way. (See para 32 of PS LA 2008/3.)

The Tax Office's views about the provision of advice and guidance are now comprehensively explained in PS LA 2008/3 – Provision of advice and guidance by the Tax Office.

- G. See also Appendix 3 – Recommendations of the Inspector-General's review into the potential revenue bias in private binding rulings involving large complex matters – for further agreed recommendations relevant to issues raised in this report. Full information on these recommendations and the Tax Office's full response to them are available from the Inspector-General's website at www.igt.gov.au.**

APPENDIX 1 — TERMS OF REFERENCE

The Terms of Reference for the case study phase of this review were as follows.

In accordance with subsection 8(1) of the *Inspector-General of Taxation Act 2003*, the Inspector-General conducts the following review on his own initiative.

1. Within each and across all the following three case studies the Inspector-General will identify issues which, when addressed, will improve the Tax Office's handling of major, complex issues into the future:
 - research and development syndication arrangements;
 - living away from home allowances (LAFHAs); and
 - service entity arrangements.
2. Each case study will focus on:
 - (a) the timeframes to identify and deal with the issue;
 - (b) the nature and cause of those timeframes, and if they were reasonable in the circumstances;
 - (c) the extent and cause of uncertainty to affected taxpayers, including any initial Tax Office guidance or representations;
 - (d) the Tax Office's approaches to the issue, the reasons for them, and if they were reasonable in the circumstances, including:
 - (i) its compliance, legal and resolution approaches; and
 - (ii) its communications with members of the community; and
 - (e) the adverse impacts and costs that the Tax Office's approaches and timeframes may have had on businesses and other areas of the community.

The Inspector-General foreshadowed that a further report drawing together consistent themes from the three case studies (the fourth report) would be prepared in due course as a vehicle for introducing changes aimed at delivering broader systemic improvements. The report on each case study (<http://www.igt.gov.au/content/reports.asp?NavID=9>) made recommendations to address issues regarding the case study itself. The case studies also identified issues for consideration in this fourth report.

APPENDIX 2 — TAX OFFICE'S CURRENT APPROACHES

This Appendix outlines the Tax Office's current approaches to the management of major, complex issues with specific attention being given to the management and resolution of priority technical issues (PTIs).

As mentioned in Chapter 1 of this report, tax professionals and certain sectors of the Community have expressed concerns that the Tax Office takes too long to come to grips with and satisfactorily resolve major, complex issues.

Resolving major, complex issues in a timely manner presents an important challenge for the Tax Office. We aspire to do so as part of our commitment to instil community confidence and encourage high levels of voluntary compliance with Australia's tax and superannuation laws. Success in achieving this commitment depends on taxpayers knowing and, more importantly, understanding and complying with their legal obligations.

The Tax Office has been proactive in dealing with stakeholder concerns and has instituted specific initiatives to improve the active management of our major risks and resolution of important technical issues to improve timeliness.

Whilst we recognise that there are always different approaches through which we can improve the way we do our work (for example, identifying and implementing best practices; recognising and adapting to changing technology and work environments), the initiatives discussed below together with the changes agreed as outlined in Chapter 4 of this report provide a platform for a robust and sustainable management framework for the identification and timely resolution of major, complex issues.

Current risk framework and controls for resolving complex issues

Our risk management processes

In recognition of the importance of having senior officers leading and dealing with complex and difficult issues, the Tax Office has created case leadership roles for several Band 1 and Band 2 Senior Executive Service (SES) officers. Their roles include:

- involvement at the planning stage of client risk reviews and audits, to identify issues early and establish appropriate project plans;
- involvement with the Tax Office's complex and most difficult requests for advice, to help identify technical issues early; and
- working with business line (BSL) case management teams to help identify and resolve 'blockers' and to ensure the work is being actively managed. In addition, their roles encompass identifying best practice for managing complex and difficult issues that can be implemented more broadly within the Tax Office.

Managing compliance risks is a major focus for each BSL and dealt with through Risk Management Committees or similar committees. These committees agree on the strategic risks for their respective markets and develop and review the implementation of the risk mitigation strategies relating to major risk areas.

Part of developing an effective risk mitigation strategy is the need to manage the compliance risk whilst a Tax Office view on the technical issue is being developed. Depending on the issue and the nature of the risk, issuing a Taxpayer Alert might be one way in which the Tax Office communicates, in a timely way, areas of major risk. Other Tax Office initiatives include ensuring:

- there are dedicated risk and strategy teams to oversee the development and management of end-to-end treatment strategies;
- networks operate within and across BSLs to support staff in their compliance work; and
- regular governance sessions occur within BSL industry and subject segments to increase awareness of taxpayer imperatives.

Several BSLs have developed networks that aim to support, both at a technical and practical level, compliance and advice teams. Examples of these networks include the Tax Technical Network in Micro Enterprises and Individuals (ME&I), an advice network, an administration and access network (all of Tax Office), a Mergers and Acquisitions network, a Part IVA network and a transfer pricing network in Large Business & International (LB&I).

These internal Tax Office networks are also complemented by the existence of numerous consultative forums such as the National Tax Liaison Group and its subcommittees, the Small Business Advisory Group and the recently established Large Business Advisory Group.

Managing and resolving Priority Technical Issues

Our current risk management framework often results in issues whereby the underlying compliance/revenue risk identified involves a technical or interpretative issue which requires resolution. Resolution is mainly achieved through concluding a Tax Office view of the application of a relevant provision(s) in the tax or superannuation laws. The resolution of a PTI can involve one or more strategies including the issue of a public ruling or a law administration practice statement (LAPS), through litigation or through advice to Treasury.

The PTI management procedures for tax officers in both the Compliance area that 'owns' the compliance risk and the Law area which has responsibility for resolving the underlying technical issue are outlined in Law Administration Practice Statement PS LA 2003/10 Management of 'Priority Technical Issues'. The procedures, which include the allocation of a priority 1, 2 or 3 to each PTI, are designed to ensure that processes for identification and resolution of PTIs are aligned with the Tax Office Risk Management Policy and corporate strategies and processes to address risks.

PTIs can also arise from audits and private ruling requests and, in these situations, the Tax Office view is usually communicated to a taxpayer in an audit position paper or a private ruling. In relation to public rulings, LAPS and other publications, a Tax Office view is taken

to have been formed when a draft ruling, LAPS or publication issues or if no draft is to issue, the final product.⁶

It is quite common for a PTI to have several strategies in play. For example, a LAPS or a public ruling could be used to mitigate an underlying compliance risk. Also, it may take some time after a PTI has been identified and registered for the Tax Office to conclude which strategy is the most appropriate to resolve the underlying technical issue.

PTI improvement initiatives

The Tax Office's PTI Committee (PTIC) was mentioned in Chapter 4 as one source for 'top down' intervention, as required, to improve the timeliness of resolution of PTIs.

Over the past 18 months, PTIC has focused on those PTIs, which are over six months old and where a Tax Office view of the relevant provision has not yet been established. PTIC's governance has been complemented by the improvements outlined in Chapter 4 of this report and other improvement initiatives such as:

- regular PTI callovers both within and across BSLs in addition to the PTIC processes mentioned above
- improved integration and management by PTI owners and BSL SES risk owners of their respective areas in Compliance and Law
- introducing efficiencies and dedicated senior officers (at the SES Band 1 and Band 2 levels) into the public rulings development process
- improving and streamlining public ruling panel processes to make efficient use of panel time and expedite the finalisation of rulings. This includes pre-panel discussions between internal panel members and the ruling team and allowing external members additional time to consider panel papers and provide initial comments prior to the meeting, and
- having a suite of project plan templates to assist tax officers in developing the different resolution strategies/treatments for PTIs.

These initiatives have resulted in a significant reduction in both the number of PTIs on hand and those PTIs which are over six months old and without an ATO view.

Over the two years to 30 June 2008, the number of PTIs in this category has reduced from 70 to 26 issues. During that time, the PTI stock has reduced from 273 at 30 June 2006 to 202 issues at 30 June 2008 and over 300 PTIs have been finalised.

6 Where litigation or advice to Treasury/Government is involved, timeframes for fully resolving the issue depend on processes that are sometimes outside the Tax Office's control. Also, PTIs involving litigation as a resolution strategy have a concluded Tax Office view as the basis from which the litigation will proceed.

APPENDIX 3 — RECOMMENDATIONS OF THE INSPECTOR-GENERAL’S REVIEW INTO THE POTENTIAL REVENUE BIAS IN PRIVATE BINDING RULINGS INVOLVING LARGE COMPLEX MATTERS RELEVANT TO THE CASE STUDY REVIEW FINDINGS

Recommendation	Tax Office’s response
<p><i>The Inspector-General recommends that the Tax Office should act to reduce the widespread perceptions of revenue bias among large business PBR applicants by implementing the following:</i></p>	
<p>1. <i>Informing taxpayers when it sees a need for external input, including from the Treasury, on interpretive matters that relate to their PBR applications and the reasons why.</i></p>	<p>Agree in part.</p> <p>The Tax Office agrees to inform taxpayers when it sees a need for external input including from Treasury. In general, this is already happening as a consequence of the improvements to communication that we have put in place since the focus years of the Report. However, where the external input is from Treasury, it would not be appropriate to disclose the reasons why as we consider such communications to be confidential.</p>
<p>2. <i>Informing taxpayers of the outcomes of external input, including from the Treasury, and internal deliberations on matters that affect them, especially where an unfavourable ruling is likely.</i></p>	<p>Agree in part.</p> <p>We will keep applicants informed about the progress of rulings, including when it becomes necessary to obtain advice from external or other internal sources, however it would not be appropriate to disclose the nature or outcomes of discussions with Treasury as we consider such communications to be confidential.</p>
<p>7. <i>Clarifying, preferably in its interagency protocol, the Tax Office’s and Treasury’s expectations of the purpose and nature of their interactions on technical matters that relate to already enacted law. This clarification should include:</i></p> <ul style="list-style-type: none"> • <i>that PBRs should not be delayed because the technical issues relating to those PBRs are the subject of discussions with Treasury;</i> • <i>that in relation to interpretive matters, the Tax Office may invite Treasury comments on the purpose or object of the legislative provisions in question, while recognising that any Treasury comments are not determinative.</i> 	<p>Agree in part.</p> <p>The Tax Office and Treasury are working together to clarify our interactions in respect of interpretation of the enacted law. A revised protocol will be published when it is complete.</p> <p>We agree that no PBRs should be delayed because of discussions with Treasury on technical issues; however there may be rare cases where the implications of an interpretation are of such significance that they require consideration of a policy response.</p>

Recommendation**Tax Office's response**

8. *Ensuring that it follows the formal protocol processes in every case that it sees a need for dialogue with Treasury on potential implications of its view of the law. This would include providing a comprehensive administrative impact statement (including details on how it will administer the law if there is no law change).*

Agree.

We already have a formal process for providing advice of this type to Treasury, which includes a standard minute that requires a statement of the impacts on taxpayers as well as our administration, revenue effects, if any, and how we will administer the law if there is no law change. This formal process is mandated in the Tax Office by a practice statement, PS CM 2003/14, which was reviewed and reissued in 2007. We will ensure conformance with this process.
