Review of the potential revenue bias in private binding rulings involving large complex matters

A report to the Assistant Treasurer

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

Dear Minister

I am pleased to present to you my report on findings and recommendations in respect of the review of the potential revenue bias in private binding rulings (PBRs) involving large complex matters. The report has been prepared under section 10 of the ***Inspector-General of Taxation Act 2003*** (the Act). The review was undertaken in response to a request made by your predecessor. The review was conducted pursuant to section 8 of the Act.

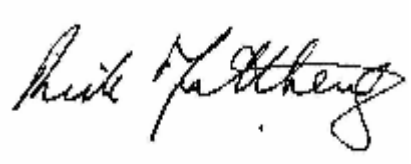
The review found that there was no evidence of undue revenue bias in large complex PBRs. Based on a representative survey, however, around 70 per cent of large business PBR applicants perceived the Tax Office to have a revenue bias in its PBRs. A major cause of these perceptions was identified as being a lack of transparency — taxpayers observed unexplained Tax Office behaviours and in the absence of cogent explanations interpreted those behaviours as being motivated by a revenue bias.

I provided the Commissioner of Taxation with opportunities to make a submission in relation to this report. The Commissioner's submission is set out in one of the appendices to the report.

The Tax Office has welcomed the finding that there was no evidence of undue revenue bias; it has accepted that perceptions of bias exist and that it will need to improve transparency to remove them. The Tax Office has agreed fully with 6 of the 10 recommendations in the report and has partly agreed with the rest.

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



Rick Matthews PSM
Acting Inspector-General of Taxation

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CHAPTER 1 — CONDUCT OF REVIEW

1.1 In August 2004, Treasury's report on Aspects of Income Tax Self-Assessment (ROSA) noted private sector claims that the Tax Office's private binding rulings (PBRs) were revenue-biased. It recommended that the Government ask the Inspector-General of Taxation to review this issue. On 7 February 2005, the then Minister for Revenue and Assistant Treasurer asked the Inspector-General:

> to review and report on whether there is a 'pro-revenue' bias evident in Private Binding Rulings issued by the Commissioner of Taxation under Part IVAA of the ***Taxation Administration Act 1953***.

1.2 During the scoping of the review, the Inspector-General discussed the issue with representatives of industry, tax professionals, business and Treasury. On the basis of these discussions, the Inspector-General limited the review to those systems delivering PBRs sought by large business on complex issues; that is, the systems delivering around 570 PBRs, applied for by around 350 large business applicants, or considered by the Tax Office, during the 2003–04 and 2004–05 financial years. On the basis of the material leading to the recommendations of the ROSA, this area was thought to more likely involve significant amounts of revenue in areas of greater uncertainty. If Tax Office revenue bias was thought to exist, this area would likely evidence any such bias.

1.3 Terms of reference for the review were publicly released on 25 August 2005. They are reproduced in Appendix 1. The review was conducted by David Pengilley, Senior Adviser. Seventeen submissions were received from taxpayer representatives, tax professionals, tax professional representative organisations and the Commonwealth Ombudsman. Inspector-General staff visited the Tax Office's National, Sydney Centrepoint and Casselden Place offices to access documents and interview Tax Office staff. The Tax Office's records for a random sample of 15 PBR cases were viewed. Also, 78 large business PBR applicants were surveyed (by Australian School of Taxation at University of New South Wales (ATAX) researchers under contract by the Inspector-General) in late 2005 and early 2006 to determine their views on the PBR system. A copy of the survey report is reproduced in Appendix 2.

1.4 In November 2005, the Tax Office questioned the Inspector-General's power to access certain documents. Legal advice was jointly sought and the matter was resolved in June 2006. The Tax Office gave the Inspector-General the documents before the legal advice was resolved. However, the delays cut across other priorities and resources were diverted to keep other matters moving. This meant that the review was put on hold until May 2007.

1.5 In finalising this report, the Inspector-General consulted with selected peak industry organisations, Treasury and the Tax Office. The Tax Office's final written submission is set out in Appendix 6.

CHAPTER 2 — OVERVIEW

2.1 This chapter begins by summarising the Inspector-General's key findings and observations, which are discussed in more detail in Chapter 5. This chapter concludes by setting out the Inspector-General's recommendations.

NO EVIDENCE OF UNDUE REVENUE BIAS

2.2 Almost all representations to the Inspector-General acknowledged that there is an inherent revenue bias in the PBR system. The Tax Office has a dual role as impartial rulings administrator and a revenue collector. On this basis it appears that the large business community expects that a tax administrator will have some revenue bias in its rulings system where matters are finely balanced. This is especially so in relation to complex matters. Most, however, did not consider this inherent bias undue. The Tax Office did not agree that there is an inherent bias in the PBR system but did accept that its dual role as collector and administrator can lead to perceptions of revenue bias.

2.3 No submissions to the review brought forward examples of undue revenue bias. Examples that stakeholders reasonably considered to show undue bias were, on examination, the product of interpretations that best promoted the 'policy intent' of the law, as the Tax Office understands it.[1]

2.4 In examining the random sample of cases, the Inspector-General did not attempt to review the Tax Office's interpretation of the law. Rather, the Inspector-General considered whether Tax Office processes and records of internal thinking that led to the PBR surfaced any evidence of an intention to impose more revenue than was open on a purposive interpretation of the law, as the Tax Office understands it. The sample did not exhibit evidence of such intentions.

2.5 Based on a survey of representative large corporate PBR applicants' views, submissions to the review, the proportion of favourable PBRs given, the pattern of external review of the Tax Office's PBR objection decisions, and review of a random sample of Tax Office files undertaken by the staff of the Inspector-General, this review has found no evidence of undue revenue bias.

1 This review distinguishes between the terms 'policy intent' and 'purposive approach to statutory interpretation' — see paras 3. 31 to 3.44 in Chapter 3.

INSUFFICIENT TAX OFFICE TRANSPARENCY AND COMMUNICATION LEADS TAXPAYERS TO CONCLUDE THAT CERTAIN TAX OFFICE BEHAVIOURS ARE MOTIVATED BY A PRO-REVENUE BIAS

2.6 Based on a survey of representative large corporate PBR applicants' views, the perceptions of undue revenue bias were widespread among large corporate internal and external tax advisers — almost 72 per cent of survey participants having these perceptions. These perceptions were based on their interpretation of observed Tax Office behaviours and taxpayer expectations.

2.7 Observed Tax Office behaviours include sometimes taking a strained interpretation of the law, a reluctance to tell applicants that it is discussing with Treasury its concerns over the implications of its view, delays, refusals to rule, requests for applicants to withdraw and conduct generally construed by taxpayers as hindering their rights to obtain and/or challenge Tax Office views.

2.8 However, an examination of Tax Office files (unseen by taxpayers) showed that these Tax Office behaviours were not motivated by a revenue bias. Also, while Tax Office behaviours generated the perceptions of revenue bias, they were not the underlying cause.

2.9 The major underlying causes for PBR applicant perceptions of revenue bias were insufficient transparency and communication by the Tax Office, leaving taxpayers reasonable grounds to conclude that the behaviours were motivated by a pro-revenue bias. A lack of transparency in disclosing the full circumstances and the reasons for Tax Office behaviours leave taxpayers nothing to go on but their own interpretation of what may be happening and what Tax Office behaviours mean.

2.10 The Inspector-General considers that it is generally inappropriate for the Tax Office to engage in certain behaviours — such as asking applicants to withdraw their PBR application — regardless of its motivations and especially in the absence of a full explanation of the circumstances. It is also inappropriate to unduly delay issuing a PBR because the Tax Office is awaiting the resolution of informal or formal dialogue with Treasury. Tax Office implementation of the Inspector-General's recommendations for improving transparency and timeliness should result in a discontinuation of these practices and the other inappropriate behaviours referred to in Chapter 5.

THE TAX OFFICE HAS MADE SUBSTANTIAL IMPROVEMENTS SINCE 2005, HOWEVER, STRONG PERCEPTIONS OF AN UNDUE REVENUE BIAS REMAIN

2.11 The Tax Office has made changes to increase transparency and reduce timeframes in its management of the large business PBR process — for example, the Tax Office says:

- it developed the ***Large business and tax compliance*** booklet, with significant input from the Corporate Tax Association, incorporating key themes of client engagement and timeliness, such as ensuring the early engagement of technical specialists where necessary to resolve complex technical issues, completing case work in the shortest time practicable with minimum inconvenience and

disruption to taxpayers and acting in a professional and courteous manner, demonstrating integrity, fairness and impartiality at all times;

- in relation to its performance on PBRs, it has received positive feedback on its improvements to the PBR system from the top 100 company groups (as part of its client visits programme in which all aspects of its relationship are discussed with senior tax officials), a range of consultative forums and PBR recipients participating in feedback questionnaires;

- it has dedicated advice teams working on PBRs, has cross-fertilised learnings from the positively received Priority PBR process to other PBR work, and has increased senior management focus on monitoring aged case management with one of its senior executives having a specific focus on advice products (including PBRs); and

- it has reduced elapsed timeframes for large business PBRs to an average of 92 days in 2005-06 (just under 65 per cent being completed within 90 days) and 74 days in 2006-07 (just under 70 per cent being completed in 90 days).

2.12 However, recent representations to the Inspector-General from a number of sources demonstrate that perceptions of a pro-revenue bias continue to be strongly held — see for example the Minutes of the National Tax Liaison Group's 28 June 2007 meeting.

A STRAINED TAX OFFICE INTERPRETATION OF THE LAW IS PERCEIVED TO BE MOTIVATED BY A PRO-REVENUE BIAS, BUT THE TAX OFFICE GENUINELY STRIVES TO INTERPRET THE LAW TO SUPPORT THE 'POLICY INTENT', AS IT UNDERSTANDS IT

2.13 In some matters, taxpayers have said that the Tax Office adopted an 'overly legalistic' or a strained interpretation of the law when an alternative construction was more congruent with the text of the legislative provisions and its publicly available extrinsic materials. In these circumstances, taxpayers perceive that the motivating factor for these strained interpretations is a pro-revenue bias.

2.14 On the basis of the Inspector-General's review of case files and communications with Treasury, the Tax Office genuinely strives to provide an interpretation which supports the 'policy intent' of the law, as it understands it. This approach is consistent with the purposive approach to statutory interpretation and is not, of itself, a revenue bias. However, the Tax Office should clearly distinguish interpretations derived from the accepted rules of statutory interpretation and interpretations settled with reference to those extrinsic materials not permissible according to the accepted rules of statutory interpretation. Otherwise the Tax Office's assessment of legal risk of its views being upheld by the courts, and the taxpayer's ability to appraise their chance of success in a legal challenge will be significantly impaired. The latter approach is pragmatic (where transparent) and the Tax Office's view must be reasonably open on the law; but a purposive interpretation need not be the most apparent one on a reading of the text of the law. Also, this Tax Office approach has not always resulted in a favourable outcome for the revenue.

2.15 The Inspector-General considers that increasing tangible signs of objectivity should reduce perceptions of bias arising from concerns that the Tax Office adopts pro-revenue positions in areas of uncertainty by straining the interpretation of legislative provisions. The Tax Office should also clearly state to its officers how they should undertake the process of statutory interpretation, in light of senior public statements that the Tax Office interprets the law to give effect to the 'policy intent'.

NEED FOR GREATER UNDERSTANDING AND TRANSPARENCY IN TAX OFFICE-TREASURY INTERACTIONS ON TECHNICAL MATTERS

2.16 In some matters involving the formulation of precedential Tax Office views, Inspector-General staff observed certain Tax Office behaviours that gave reasonable grounds for perceptions of undue revenue bias. These behaviours included: the Tax Office seeking and to some extent relying on Treasury officials' views of the 'policy intent' as a means to resolve interpretive matters; the Tax Office delaying the issuing of PBRs until discussions with Treasury were finalised (delays sometimes amounting to more than 18 months); and, the Tax Office not telling applicants that Tax Office-Treasury dialogue was active on the technical issues in question. Some stakeholders have argued that these behaviours push the Tax Office to administer the system on an untenable interpretation of the law — legislation by administrative fiat or propping up deficient law.

2.17 A significant proportion of large business PBR applicants supported the Tax Office's discussion of policy and statutory interpretation with Treasury. However, most were unaware whether it had occurred. This is because the Tax Office is reluctant to be open with applicants about the fact that it is in dialogue with Treasury officials. There will occasionally be circumstances when it would not be appropriate to disclose to a PBR applicant that a matter relating to their PBR application is being discussed with Treasury or may be considered by Government, but on objective assessment this will not normally pose a risk.

2.18 Treasury strongly discourages any notion that it has any role in providing advice on the 'policy intent' of already enacted legislative provisions and strongly discourages the use of this term. Once legislation is enacted, the law, together with permissible extrinsic materials (Explanatory Memoranda for example), evidences the only relevant intention for interpreting the law — Parliament's. Parliament's intention is to be determined according to the accepted principles of statutory interpretation. Treasury officials' views on the 'background' to the legislative provisions or what was intended when the law was drafted are, in Treasury's view, unhelpful and should not be relied upon to settle interpretive matters as the Tax Office must come to its own view of the law. This will not preclude Treasury from discussing with the Tax Office whether the better view has been reached by reference to publicly available extrinsic materials and whether the position is consistent with other views the Tax Office has adopted. Treasury input in these discussions is only one of many; any member of the community is open to engage the Tax Office in these types of discussions.

2.19 The Inspector-General considers that in its role as an impartial rulings administrator the Tax Office must come to its own view of the law according to the accepted principles of statutory interpretation. To minimise adverse perceptions of

Treasury's influence on interpretive matters, the Tax Office should come to a view, or possible views, on a case before it approaches Treasury for dialogue on the technical issues in question or the implications arising from the Tax Office's view. The Tax Office should also tell applicants when it is seeking external input on interpretive matters that relate to their PBR requests and the reasons why.

2.20 The potential for continuing misunderstandings should also be addressed by clarifying in the interagency protocol the Tax Office's and Treasury's expectations of each other in relation to interpretive matters and also re-enforcing with Tax Office technical decision makers that discussions on the 'policy intent' for enacted law have no relevance in interpretive matters.

2.21 The Inspector-General also considers that effective operation of the tax system requires a mechanism for significant implications of Tax Office views to be drawn to the attention of the Treasury and where necessary the Government.

2.22 However, the Tax Office should not delay settling its view or issuing PBRs when it is in dialogue with Treasury. By its design, the PBR system gives applicants certainty on a timely basis while minimising any risk to the revenue that an incorrect Tax Office view might have by limiting the application of that view to the applicant.

2.23 There is potential for commercial damage in situations where the Government might respond to Tax Office views by changing the law after the Tax Office has ruled. This may result in an uneven playing field or a need to undo administrative actions — especially where the Government considers the Tax Office's view is not aligned with its policy. However, this risk could be reduced by increasing transparency surrounding the possibility of law change in each particular case, and enacting legislation with transitional provisions providing PBR recipients a reasonable opportunity to reorganise their affairs where the prospective effect of the law change would otherwise be detrimental.

NEED TO INCREASE TANGIBLE SIGNS OF TAX OFFICE OBJECTIVITY

2.24 A significant proportion of large corporates considered that increasing the tangible signs of Tax Office objectivity would reduce perceptions of revenue bias.

2.25 One measure would be to improve Tax Office approaches that can impede mutual understanding of technical views. By not indicating how the Tax Office has considered taxpayers' views or attributed the weight of evidence, taxpayers are left with impressions that Tax Office views are taken to achieve revenue objectives without regard to the cogency of taxpayers' reasoning.

2.26 Providing, as a matter of course, easy, direct communication with the technical decision maker and early opportunities to be heard before adverse decisions are made would also improve taxpayer perceptions of Tax Office objectivity.

2.27 Large businesses expressed concern that they perceived inadequate internal checks against the cultural influences of the compliance function influencing the Tax Office's advice function. This is mainly because the same area that is responsible for

auditing a large business taxpayer is also the area responsible for providing that taxpayer with a PBR. Since these comments were made the Tax Office has sought to confine PBR advice work to specialist staff. However, resourcing demands may necessitate these staff becoming involved in audit work from time to time.

2.28 Perceptions of objectivity could be further increased by providing applicants, before an adverse decision is made, the basis for the likely Tax Office view (including external opinions where relevant), an explanation of why the Tax Office's view is to be preferred over the applicant's, including the weight given to information provided by applicants, and an adequate opportunity to comment. In unfavourable PBRs, the Tax Office should also include a statement of the underlying purpose of the legislative provisions on which the interpretation is based and the source for that view — for example, which materials are relied upon to ascertain that purpose.

NEED TO FURTHER REDUCE TAX OFFICE DELAYS FOR LARGE BUSINESS PBRS

2.29 In combination with certain other Tax Office behaviours, delays in providing PBRs provide reasonable grounds for perceptions of revenue bias.

2.30 Over the last few years, the Tax Office has implemented case management systems which have progressively reduced elapsed timeframes for issuing large business PBRs. However, there are further opportunities to improve the timeliness in providing large, complex PBRs.

2.31 The Tax Office will delay a PBR while the issue is the subject of a contemplated public ruling or other interpretive advice. In these circumstances, the Tax Office may also ask applicants to withdraw their application or may refuse to rule and may direct the applicant to more general non-binding advice. However, if an application falls within the Priority PBR process, the Tax Office says it will issue a PBR notwithstanding the issue being considered in a contemplated public ruling or other interpretive advice.

2.32 The Inspector-General considers that any large, complex PBR should not be delayed because the technical issue being considered is the subject of a developing public ruling.

2.33 Delays are also experienced in escalating precedential matters to Tax Office technical decision makers. Submissions expressed frustration with the negligible influence case officers had over the process or time periods where issues are referred outside of their area. Also, applicants say that 'agreed' or 'negotiated' timeframes between applicants and case officers are generally illusory and that timeframes are changed, in some cases many times, at the sole discretion of the Tax Office backed by the perceived threat of an adverse ruling if the applicant refuses to agree. Tax Office aged case management has improved over time. However, further improvement could be made in those matters where precedential issues are considered.

2.34 These types of delays could be minimised by making Tax Office technical decision makers accountable for communicating directly with the client over the issue

(while keeping the case manager informed of that communication), including the indicated timeframes and reasons for any delays.

2.35 Tax Office information requests were sometimes considered a Tax Office tactic to deliberately delay making a ruling or to improve Tax Office performance statistics (an information request will 'stop the clock' for the Tax Office's reporting purposes). Applicants perceive a need for Tax Office discipline in limiting information requests to those directly relevant to resolving the technical issues in question in the PBR request. Extending the priority PBR procedure of providing cogent reasons for requesting further information would also improve taxpayer perceptions. Performance on elapsed timeframes from receiving the application should also be reported as a key performance indicator. This would help to eliminate perceptions that additional information requests are made to improve Tax Office statistics.

RECOMMENDATIONS

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:

Increasing transparency, improving communication and more clearly demonstrating objectivity:

1. 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. [***Tax Office response***: Agree in part]

2. 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. [***Tax Office response***: Agree in part]

3. Where an understanding of purpose is a factor in the decision in large business unfavourable PBRs, including a statement of the underlying purpose of the legislative provisions on which the interpretation is based and the source for that purpose (for example, how the legally permissible extrinsic materials have been relied upon to ascertain that purpose and in concluding its view). [***Tax Office response***: Agree]

RECOMMENDATIONS (CONTINUED)

4. More widely adopting the key principles of the Priority PBR process in relation to large business PBRs:

   - Centralised point of reference (process owner) responsible for marshalling resources and taking remedial action to ensure cases are not delayed;
   - Alignment of taxpayer and Tax Office priorities;
   - Front end engagement of all expertise to avoid sequential processing; and
   - Taxpayers and Tax Office working together to clarify the ruling.

[***Tax Office response:*** Agree]

5. Increasing transparency, improving communication and more clearly demonstrating objectivity in relation to PBR technical decision making by:

   - before an adverse decision is made, communicating to the applicant the basis for the likely Tax Office view (including external opinions where relevant), an explanation of why the Tax Office's view is to be preferred over the applicant's, indicating the relevance of information provided by the applicant, and providing the applicant an adequate opportunity to comment;
   - vetting requests for additional information and (if requested) providing reasons why the information is relevant and identifying the specific aspect of the technical issue that turns on the requested information;
   - if requested by the applicant, providing applicants with written reasons for delay if the PBR has not issued after 3 months, including contact details for the relevant LB&I segment leader, CoE Manager and Deputy Chief Tax Counsel;
   - where necessary, engaging recognised independent external subject specialists to supplement Tax Office capability to respond to large, complex PBRs; and
   - where requested by the PBR applicant, ensuring that the Case Manager provides the applicant with a free and quick flow of direct contact with those technical decision makers (whether in TCN, CoE or LB&I) that determined, or are determining, the technical issues relating to the application.

[***Tax Office response:*** Agree]

RECOMMENDATIONS (CONTINUED)

6. Ensuring that tax officials involved in interpretive matters are aware of the accepted principles of the purposive approach to statutory interpretation (including the accepted materials to ascertain that purpose) and that they should not rely on advice of what policy developers or legislative drafters intended. [***Tax Office response***: Agree]

Clarifying interagency interactions

7. 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:

   - that PBRs should not be delayed because the technical issues relating to those PBRs are the subject of discussions with Treasury; and
   - that in relation to interpretive matters, the Tax Office may invite comments on the purpose or object of the legislative provisions in question, while recognising that any Treasury comments are not determinative.

[***Tax Office response:*** Agree **in part**]

Adhering to formal interagency processes

8. Ensuring that the Tax Office follows the formal protocol processes in every case where 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). [***Tax Office response***: Agree]

Further reducing delays in large business PBR processes

9. Issuing PBRs irrespective of whether the matter involves consideration of a technical issue that is the subject of a developing or contemplated public ruling. [***Tax Office response***: Agree]

10. Reporting achievements against performance standards and elapsed timeframes of PBRs in Tax Office annual reports. [***Tax Office response***: Agree in part]

2.36 The Tax Office has welcomed the finding that there was no evidence of undue revenue bias; it has accepted that perceptions of bias exist and that it will need to improve transparency to remove them. The Tax Office has agreed fully with 6 of the 10 recommendations in the report and has partly agreed with the rest.

2.37 The Tax Office's full response to these recommendations is contained in Appendix 6 to reduce duplication and the length of the report.

CHAPTER 3 — BACKGROUND

3.1 This chapter discusses some of the main concepts and processes referred to in other chapters of the report.

Self assessment, voluntary compliance and certainty

3.2 The Australian system of self assessment relies on taxpayers' 'voluntary' compliance. Taxpayers 'self assess' by lodging returns which are accepted by the Tax Office at face value. The Tax Office subsequently verifies the accuracy of this information on the basis of its risk management framework.

3.3 This system relies on taxpayers and their advisers having a good understanding of the tax laws. It is generally thought that the more taxpayers understand their obligations, the more likely they are to comply. However, business arrangements have become increasing complex and the tax laws more comprehensive to deal with them. Business seeks to reduce its tax risks and opportunity costs through reliable tax advice. The Tax Office plays a significant role in providing advice on the interpretation and application of the tax laws in this respect. The Tax Office says that it wants to encourage big business to seek tax advice as part of its governance processes, including applying for private binding rulings (PBRs).

3.4 The PBR system is one of the formal mechanisms through which the Tax Office provides advice to taxpayers. It is the major mechanism in Australia's self assessment system to give to individual taxpayers certainty of tax treatment concerning their specific circumstances.

The PBR system aims to reduce uncertainty

3.5 The PBR system aims to reduce uncertainty in the law by providing protection to taxpayers who act in line with Tax Office binding advice.

3.6 A PBR is the Tax Office's written opinion of how it will apply the income tax laws to a rulee's completed or proposed transactions. Where the Tax Office has issued a ruling that applies to a taxpayer, the taxpayer is not liable to pay more tax than the ruling requires, even if the ruling turns out to be wrong. The Tax Office is bound by its view in the ruling where the rulee discloses all material facts in the application and implements the arrangement in accordance with the PBR. A PBR will only bind the Tax Office to the particular rulee who receives it. It does not bind the Tax Office in respect of any other taxpayer. This form of Tax Office binding advice thereby reduces applicants' risks and opportunity costs, but also limits the risk to the tax system if the ruling turns out to be wrong.

3.7 From 1992 until 2006, the PBR system was provided by Part IVAA of the ***Taxation Administration Act 1953*** (TAA 1953). New rules governing PBRs became law

from 1 January 2006 (see Division 359 of Schedule 1 to the TAA 1953). Generally, any PBRs that are made from 1 January 2006 will be covered by the new rules.

3.8 The changes to the PBR system came about as a result of the Review of Income Tax Self Assessment (the ROSA review). This review was undertaken by the Treasury on request of the then Treasurer in November 2003. Treasury was asked to examine aspects of Australia's self assessment system for income tax to determine whether the right balance was struck between protecting the rights of individual taxpayers and protecting the revenue for the benefit of the whole Australian community. Treasury publicly released its report in August 2004. As a result certain legislative and administrative changes were made, including changes to the PBR system.

3.9 The explanatory memorandum to the ***Tax Laws Amendment (Improvements to Self Assessment) Act (No. 2) 2005*** explained the rationale for the changes to the PBR system:

> 3.4 Since 1992, the tax law has made certain categories of ATO advice, called rulings, binding on the ATO…
>
> 3.5 The Report recommended that the current system be expanded in scope and effectiveness to provide protection in a wider range of circumstances (Recommendation 2.1). …
>
> 3.10 Among a range of improvements, the Report recommended:
>
> - expanding the category of matters on which private rulings can be provided (Recommendation 2.11);
> - providing an avenue for review where an application for a private ruling has not been determined within 60 days (Recommendation 2.15);
> - allowing the Commissioner to make reasonable assumptions in dealing with a private ruling request (Recommendation 2.16);
> - allowing the Commissioner to consider information other than that supplied by the applicant in making a private ruling, provided the applicant is informed (Recommendation 2.17);
> - clarifying the rules where rulings are inconsistent (Recommendation 2.19);
> - allowing the Commissioner to take account of additional information supplied after making the private ruling application (Recommendation 2.21); and
> - allowing future trustees of a trust estate to rely on private rulings obtained by their predecessors (Recommendation 2.22).

PBR applications

3.10 An application for a PBR must be in a form approved by the Commissioner. The Tax Office provides a standard form that specifies the requirements of an application. However, the Commissioner will not insist that this form be used. All that

is required is that the request be in writing and provide the necessary information, including copies of all relevant documents.

3.11 The Commissioner makes a PBR by preparing a written notice of it and serving it on the applicant. The ruling will identify the taxpayer, relevant scheme and provisions to which it relates.

3.12 The Commissioner may rely on assumptions and information not provided in the application. If the applicant provides the Tax Office with new information that indicates that the proposed arrangement will be entered into in a way that is materially different from that described in the original application, the Tax Office will treat this as a new ruling request. It will then ask the applicant to withdraw the earlier request, or the relevant parts of the earlier request.

3.13 The Tax Office will allow its officers to have pre-ruling discussions with applicants. However, it places restrictions on the indicative advice its officers can give:

> 8. Subject to the limited exception described in paragraph 18 below, officers should not provide indicative oral technical advice. …
>
> 18. It may be appropriate in exceptional cases, where we have not finalised our position on the interpretive issues, to provide indicative oral technical advice. However, the provision of indicative oral advice should occur only where there is:
>
> - a substantial and time-dependent business need;
> - a very low risk of a different view being taken;
> - appropriate documentation and transparency; and
> - involvement of appropriate Tax Office staff.
>
> 19. The provision of indicative oral technical advice which is positive (favourable) to the person is also subject to approval at the following SES levels: CoE manager or Senior Tax Counsel where there is no precedent [see paragraph 3.20 below]; and Business Line SES where there is a precedent. Furthermore, the provision of such advice is subject to the clear notification and acknowledgment that the preliminary position is not binding and is subject to further consideration.
>
> 20. Where indicative oral technical advice is provided in connection with a request for written advice, a record of the indicative advice must be attached to the TDMS case record.[2]

Grounds for refusal to rule

3.14 The Tax Office must comply with an application to make a ruling, subject to certain exceptions.

2 Law Administration Practice Statement, ***PS LA 2002/17***.

3.15 For rulings made before 1 January 2006, the Commissioner may decline, among other grounds, if, in the Commissioner's opinion, it would be unreasonable to comply or attempt to comply having regard to the extent of the Commissioner's resources or any other matters the Commissioner considers relevant.[3]

3.16 From 1 January 2006, the grounds for declining to provide a ruling were changed. Now, the Tax Office may decline, among other grounds, to make a private ruling if it considers that making the ruling would prejudice or unduly restrict the administration of a taxation law.[4]

3.17 The Commissioner is also not required to give a PBR if the applicant is being audited in relation to the arrangement that is the subject of the application. The Tax Office may also refuse to rule where applicants have not provided requested additional information within a certain period and after a reminder to provide that information (see Practice Statement PS LA 2003/4).

Internal Tax Office processes

3.18 Tax officials must follow the Tax Office's Provision of Advice Manual which sets out the manner in which written binding advice must be prepared and given to taxpayers.

3.19 The Tax Office says that there must be an existing Tax Office interpretation of the law — a precedential view — before a PBR can be made:

> A private ruling is only provided if there is a clear ATO view of the relevant law. If there is no clear ATO view, the issue must be escalated in accordance with the usual escalation processes. The aim of the escalation process is to establish an ATO view to enable a private ruling to be given.[5]

3.20 A precedential Tax Office view is the settled Tax Office view of the law in relation to a particular interpretive issue that has been determined by a tax official in either the Tax Counsel Network (TCN) or the relevant Centre of Expertise (CoE). Precedential Tax Office views are set out in publicly issued rulings, publicly issued draft rulings, ATO Interpretive Decisions (ATOIDs) and other documents listed in the schedule to the Tax Office's practice statement, ***PS LA 2003/3***. Precedential Tax Office views may only be created by the CoEs, TCN and International Tax Counsel.

3.21 An ATOID must be settled and cleared before the PBR can be issued. An ATOID must, subject to certain exceptions, be prepared for each decision on an interpretive issue for which there is no precedential Tax Office view. ATOIDs are technically cleared by the CoE area and escalated to TCN where necessary.

3.22 The Tax Office established the CoEs and the ATOID system to improve consistency in technical decision making by taking a corporate approach to the creation of precedential Tax Office view. These approaches have been effective in addressing

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3 Repealed para 14ZAN(j) of the TAA 1953.
4 Subsection 359-35(2) of Schedule 1 to the TAA 1953.
5 Para 56 of Practice Statement ***PS LA 2001/4***.

past Australian National Audit Office criticisms of a lack of consistency in the PBR process. Where no precedential view exists as a basis for responding to a PBR application, the issue must be escalated to the CoEs.

3.23 For large business taxpayers, PBRs are considered and prepared by the Large Business and International Business Line (LB&I). The same Tax Office area that is tasked with conducting compliance activities, including audits, on the relevant taxpayer will deal with the PBR application. The Tax Office has sought to confine PBR advice work to specialist staff. However, resourcing demands may necessitate these staff becoming involved in audits from time to time. LB&I areas are currently based on the break-up of taxpayer industry segments — for example, the financial services industry or the manufacturing industry.

3.24 LB&I officers must follow the Tax Office's Practice Statement ***PSLA 2003/3*** in dealing with interpretive issues arising in PBR applications. They must search for, identify and follow relevant precedential Tax Office views or escalate the issue.

3.25 If LB&I officers consider that the outcome would be incorrect or unintended if the precedential view was applied, the reasons for that conclusion must be documented and the matter must be escalated.

3.26 Where matters are referred to a CoE that CoE is accountable for its work including any resulting delays.[6] However, LB&I officers will generally retain 'case ownership' of the PBR application while the referred issue is being considered by the CoE. 'Case ownership' includes the responsibility for:

- management of the case including coordination where input is required from other areas of the Tax Office and follow-up where timeframes have not been met;
- managing taxpayer relationships; and
- authorising the advice that issues to the PBR applicant.[7]

3.27 Certain precedential technical issues of higher priority are escalated to the TCN for resolution. The TCN comprises the Tax Office's senior technical officers who are tasked to work, amongst other things, on 'Priority Technical Issues' (PTIs). The PTI process carves out from the mainstream technical escalation and resolution processes the highest priority technical issues, according to the Tax Office's risk management policies. PTIs generally require resolution by way of the formulation of the Tax Office view of the law, amongst other things. They may also require the need for legislative change to be communicated to the Tax Office Executive, Treasury and the Government.

3.28 Internal Tax Office processes determine whether an issue is a PTI. This includes agreement by the 'senior executive staff risk owner' (in LB&I this will normally be the Assistant Commissioner of the relevant industry segment area) and either a Deputy Chief Tax Counsel or the senior executive staff from the relevant CoE,

6 Para 13.
7 Law Administration Practice Statement, ***PS LA 2004/4***, para 9.

depending on whether the matter requires the formulation of a precedential Tax Office view or not. The level of priority is determined by assessing the risk and potential consequences of the issue (including the consequences for the revenue) and the importance that the resolution of the technical issue has to the mitigation strategy for the risk.

3.29 Once a PTI is agreed as such, TCN and/or CoE resources are allocated to work on the issue. The LB&I industry segment area will remain responsible for managing the timeframes and applicant contact. A PTI is recorded on a register. This record is not normally linked to any identifiable taxpayer information, including PBR applications.

3.30 Authorising officers in Tax Office business lines must check that the precedential decision cited by the case officer is appropriate and applicable to the circumstances of the case. PBR approving officers in LB&I are senior executive staff (generally Assistant Commissioner or above) or internally professionally accredited. The Tax Office assures itself that this process is working through its technical quality review (TQR) process (see Appendix 3).

Tax Office interpretation of the law

3.31 Arriving at a precedential view of the tax law for a PBR involves the Tax Office's interpretation of the law and its application to the facts relevant to the PBR application.

3.32 Section 15AA of the ***Acts Interpretation Act 1901*** effectively requires the Tax Office to take a purposive approach to interpretation; that is, to interpret the tax law in a way that promotes Parliament's purpose or object underlying the legislative provisions. The purposive approach to statutory interpretation is favoured by the Australian judiciary today, albeit with arguably different nuances in application. Generally, this approach seeks to interpret the law from the text of the legislation itself in the context in which the words appear with regard to the relevant extrinsic materials, where permissible — that is to confirm the ordinary meaning conveyed by the text of the provision; or to determine the meaning of the provision where the provision is ambiguous or obscure or where the ordinary meaning leads to a result that is manifestly absurd or unreasonable. However, administrative agencies must make reasoned decisions in individual cases in an environment of uncertainty and risk. Where ambiguity remains after reading the text of the law and the permissible extrinsic materials, an administrator may obtain input as widely as possible and refer to materials which would not be accepted according to the rules of statutory interpretation to obtain guidance — such as the policy developers and drafting instructors' files. There is no legal prohibition against doing so and this material may provide a pragmatic resolution of the ambiguity. However, relying on this material imports a substantial degree of legal risk. This is because if the matter were contested in court, the court would be unlikely to consider such material relevant. Also, a citizen receiving an unfavourable administrative ruling may also be misled where it believes the administrator's general assurances that it applies the purposive approach to statutory interpretation when in fact the administrator is relying on extrinsic materials which would not be considered relevant by a court.

3.33 Tax officers generally refer to the purposive approach to statutory interpretation as 'giving effect to the policy intent of the law'. This terminology can lead the Tax Office into error because it confuses an accepted process for determining legislative intent (Parliament's underlying purpose for the legislative provisions) with Government policy (as evidenced, for example, by drafting instructors' or policy developers' views on what was intended before the legislation was presented to Parliament). The Government's intended policy for legislative measures becomes irrelevant once those laws are enacted.

3.34 Under the purposive approach to statutory interpretation, the Tax Office has some scope to strain the words of the law to support a statutory construction that gives effect to the underlying purpose of the laws. A purposive interpretation is to be preferred even if a less strained interpretation is possible.[8]

3.35 This scope to strain the words of legislative provisions gives rise to a spectrum of interpretive tensions between the underlying purpose of legislative measures and statutory constructions that are open on a reading of the law.

3.36 The scope for straining the law to deliver an underlying purpose is generally limited by whether the interpretation is open on a reasonable reading of the words of that law. Where these limits are reached, legislative amendment is the better method to give effect to Parliament's intent. However, there are differences of opinion as to where these limits lie when applied to particular circumstances.

Implications of Tax Office interpretations

3.37 Most Tax Office precedential interpretations expressed in ATOIDs and PBRs do not have any implication other than increasing certainty in the tax system as intended.

3.38 However, while the Tax Office needs to protect its integrity as the independent administrator of the tax laws, it does not operate in a vacuum. The Tax Office operates within the framework of the Executive arm of Government and is a party to formal protocols and processes agreed with the Treasury. This framework requires the Tax Office to consider if its view has any implications such as impacts on taxpayers, revenue, administration, questions of interpretation, compliance and operational issues.

3.39 These processes enable the Tax Office to generate formal advice when it identifies significant issues that need to be drawn to the attention of the Treasury or Government, such as problems in the operation of the tax system like anomalies or unintended consequences of legislation. They enable the Tax Office to make specific recommendations to change a policy approach or law design in these circumstances.

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8 See also, the scope provided by the general administration powers under the tax laws to correct practical or unintended consequences, D'Ascenzo, 'The Way Forward — Some Trans Tasman Comparisons, New Zealand Inland Revenue Department Strategic Planning Forum', Speech given by the Second Commissioner of Taxation, Australian Taxation Office, 25 March 2003; see also Treasury's comments that the Commissioner's discretion is broad enough to make judgments on matters not spelt out in statutes, ROSA report, pp 72-73.

3.40 The relevant paragraphs of the inter-agency processes state:

> When Should Formal ATO Advice Be Provided? …
>
> 9. Formal advice may be generated when the ATO identifies significant issues that need to be drawn to the attention of the Treasury or Government, such as where the ATO identifies problems in the operation of the tax system like anomalies or unintended consequences of legislation. …
>
> What should be covered in Formal ATO Advice? …
>
> 14. In cases where the ATO is making a specific recommendation to change a policy approach or law design, it is highly desirable that the ATO advice is comprehensive. In such cases the ATO will provide a full assessment of all the impacts and this advice should be expressed in the form of an Administrative Impact Statement. The Administrative Impact Statement should include the ATO's understanding of client impacts, revenue impacts and ATO administration impacts, including such things as questions of interpretation, compliance and operational issues. Usually the ATO advice will be in the form of a recommendation with a full assessment of all the administrative impacts should the recommendation not be acted upon.[9]

3.41 In clarifying its part in these arrangements, the Treasury states that:

> In the process of designing new tax law, the protocol states that Treasury will provide the Tax Office with clear statements of the Government's policy intent. The Government determines the policy intent of its proposed legislation and this is reflected in the early stages in such material as press releases and budget statements. What Treasury provides the Tax Office with is a consolidated précis of these governmental statements placed in the relevant context and providing the appropriate background and the rationale for a policy decision.
>
> In relation to pre-existing (that is, enacted) law, the protocol states that the enacted law itself is ultimately the statements of intent of the Parliament, and that the Tax Office has the exclusive role of determining the official interpretation of the law. In these cases, Treasury does not provide statement of policy intent, but, where matters are uncertain, may engage in dialogue with the Tax Office in terms of the implications of its view in interpreting and administering the law.[10]

3.42 On the surface, Treasury's views on the policy intent in relation to enacted law might be seen as very useful to the Tax Office in forming a purposive interpretation of a tax law. However, the Treasury considers that once the tax laws are enacted, there is little useful scope for Treasury officials to comment on the policy behind what Parliament enacted:

> Statements by Treasury officials as to the supposed intent behind a measure are likely only to confuse the issue, especially if the view expressed could be argued to differ in any way from the expressed view of the ATO. As the enacted law is the primary statement of intent of the Parliament and, as administration and interpretation are matters for the ATO, and

9 Law Administration Practice Statement, ***PS CM 2003/14***, 9 May 2003.
10 Treasury correspondence to Inspector-General of Taxation, 1 November 2006.

> ultimately the Courts, Treasury officials should stay well clear of what might have been meant once Royal Assent has been granted. …
>
> … until the ATO (or, in some cases, a Court) has officially decided on the interpretation, the processes to revisit a provision cannot usually be commenced. Governments usually don't change laws on mere speculation or for greater clarity, in non-vital situations — there are many more pressing issues that demand Parliament's attention.[11]

3.43 In ***Collector of Customs v Savage River Mines***[12] the Full Federal Court opined that:

> Direct evidence from a public servant as to the policy of legislation is unlikely to be helpful in the process of statutory construction. It is difficult to envisage any circumstances in which such evidence could rise above the level of one person's opinion on the matter.[13]

3.44 In light of Treasury's position, this Federal Court dictum and section 15AB of the ***Acts Interpretation Act 1901*** it is clear that Treasury's advice is not a legitimate extrinsic source to aid purposive interpretation and cannot be relied upon as such by the Tax Office.

Priority rulings process

3.45 From late May 2005, the Tax Office implemented an administrative system to expedite large, complex PBRs that involved the formulation of precedential Tax Office views. The reason it was implemented was:

> because ruling applications that meet the specified criteria are at greater risk of being delivered outside timeframes required by the taxpayer, as they invariably require input from a range of Tax Office specialists and/or involve legal issues that do not have a precedent. Delays can have the effect that corporate Boards are unable to obtain the necessary assurance in relation to the management of the tax risk associated with significant transactions. It is appropriate, therefore, that different processes be put in place for certain categories of rulings to ensure that the Tax Office is able to deliver on our Taxpayers' Charter commitment.[14]

3.46 This process aims to deliver certain types of PBRs in timeframes that are consistent with the applicant's business needs. It does this by streamlining Tax Office processes, improving real-time communication between the Tax Office's and the applicant's technical experts and ensuring a sound understanding based on all relevant information and considered arguments (including the contrary positions) are obtained from the applicant at first instance.

3.47 The criteria for entry into this streamlined process are more restrictive than those for the mainstream PBR process. Amongst other things, these criteria include that

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11 McCullough, P, General Manager, Individuals and Entities Tax Division, The Treasury, Address To 1st National Consolidation Symposium, 3-4 February 2003.
12 (1988) 79 ALR 258 at 263.
13 As quoted in Pearce, 'Statutory Interpretation in Australia', Butterworths, 2001, 5th Ed. para 3.17.
14 Law Administration Practice Statement, ***PS LA 2005/10***, para 23.

the matter is time sensitive, the PBR will operate prospectively, the matter is of major commercial significance requiring consideration at corporate Board level, the tax outcome is a critical element of the transaction and complex law and facts need to be analysed.

3.48 A separate unit in the LB&I business line acts as 'the corporate Process Owner for priority PBRs'. Its' power includes the authority to marshal necessary Tax Office resources and take remedial action if delays are expected. Relevant technical experts are required to be available to work on the case until its expected completion date. These technical officers may have direct contact with the applicant's representatives.

3.49 A PBR application under this process is case-managed by a senior tax official experienced in written advice work. That case manager is responsible for managing the case to completion. That case manager will identify and engage relevant TCN and CoE officers immediately. TCN and CoE officers will work with the case manager to identify and resolve issues and will assist in determining the information required from the taxpayer.

3.50 The Case Manager must arrange a pre-lodgment meeting with the applicant's representative, TCN and CoE officers:

> The purpose of a pre-lodgment meeting is to facilitate the lodgment of a valid ruling application that accurately describes the arrangement to be ruled upon and, as far as practicable, identifies all information that is likely to be required. Officers at the meeting should outline any particular areas of concern to enable these to be addressed in the proposed application. They may discuss the Tax Office's general view in relation to the relevant area of law, but should take care not to give any indication of what the Tax Office's view may be in relation to the proposed application.[15]

3.51 An ATOID does not need to be published before the issue of a priority PBR.

3.52 The Tax Office aims to finalise priority PBR applications within 28 days of receiving all relevant information, within 90 days of elapsed time, or as otherwise negotiated with applicants.

Objecting to a PBR and failure to make a ruling

3.53 A PBR rulee may object to their PBR in the same way an objection under Part IVC of the TAA 1953 is made against an assessment. However, a rulee may not object, amongst others, where there is an assessment for that taxpayer for the income year to which the ruling relates.

3.54 A PBR rulee may appeal against a Tax Office PBR objection decision. This appeal may be heard by the Administrative Appeals Tribunal or the Federal Court. Further appeal may be made by either party to the higher courts of appeal.

3.55 Under the new laws (for PBR applications received or rulings made after 1 January 2006), a PBR applicant may, subject to certain timeframes and procedural

15 Law Administration Practice Statement, ***PS LA 2005/10***, para 15.

steps, object to the Tax Office's failure to make a ruling. The PBR applicant must lodge a draft ruling with the objection. This objection is also dealt with under Part IVC.

3.56 The table on the following page breaks up the outcomes of external review of PBR objection decisions concerning PBRs issued during the 2003-04 and 2004-05 years.

Table 1: Post-1 July 2003 external review of Tax Office PBR objection decisions

Outcome of external review of PBR objection	Date at which the Tax Office issued the PBR	Jurisdiction			Totals
		AAT	Federal Court	Full Federal Court	
Affirmed	Before 1 July 2003	**1**	**2**	**1**	4
	During 1 July 2000 — 30 June 2005	**3**	**0**	**0**	3
	After 30 June 2005	**0**	**1**	**0**	1
	Total affirmed	4	3	1	8
Set aside	Before 1 July 2003	**0**	**0**	**2**	2
	During 1 July 2003 — 30 June 2005	**1**	**1**	**1**	3
	After 30 June 2005	**0**	**0**	**0**	0
	Total set aside	1	1	3	5

Source: www.austlii.edu.au.

PBR numbers

3.57 The Tax Office received a combined total of almost 32,000 private ruling requests and written binding advice requests for the 2003–04 and 2004–05 years, with almost 26,000 of those requests being finalised during that period.[16]

3.58 Only around 2 per cent of these applications were large business PBR applications and within the scope of this review. Of these, over the 2003-04 and 2004-05 years around 20 per cent required the Tax Office to formulate a precedential Tax Office view. This proportion is significantly greater than for small business and individual PBR applicants.

3.59 Further break-up of the numbers is given in Appendix 3.

'Revenue bias'

3.60 Since the PBR system was first enacted in law in 1992, some in the private sector have claimed that the Tax Office's rulings have been revenue-biased.

3.61 There is no precise definition of the term 'revenue bias'. It is a generic term used to describe a range of repeated behaviours stemming from an institutionalised way of thinking. At one extreme it is asserted the mere fact that the Tax Office has a role in collecting the revenue calls into question its ability to impartially interpret the law. At the other extreme it is asserted that a revenue bias will only exist where the view taken in the PBR is wrong at law and overtly designed to impose a greater liability.

16 Table 1.1 in the Commissioner of Taxation's ***Annual Report 2003–04*** and ***Annual Report 2004–05***.

3.62 Submissions indicated four main factors, any of which purported to evidence revenue bias:

> 'The ATO rules in the revenue's favour where an alternate & better view would've imposed less tax'.
>
> 'The ATO refuses to rule or delays where a PBR involves a significant amount of revenue'.
>
> 'Taxpayers withdraw or do not apply for PBRs because they have no confidence in the ATO's ability to determine PBRs objectively'.
>
> 'There is no mechanism minimising a natural revenue bias inappropriately influencing technical decision making'.

Scope for revenue bias' existence

3.63 The Tax Office says that it is not aware of any systemic undue revenue bias. It asserts that processes and procedures do not reflect an undue revenue bias. However, it does consider that there is potential for an undue revenue bias to exist in 'cutting edge areas', areas where a precedent is being set and that precedent may give rise to a 'tax industry' — one such area being the finance area. But it denies that there is an undue revenue bias: views are taken to give effect to the 'policy intent' of the law and to reduce taxpayer compliance costs.[17]

3.64 A revenue bias may exist in 'settled' areas of the law also. However, these areas are not generally contested by the private sector in relation to the PBR system. The fertile territory for revenue bias was thought to be in novel areas. Submissions also claimed that a revenue bias was evident in many public rulings. These rulings are outside the scope of this review.

3.65 There is greater scope for a revenue bias where the Tax Office perceives significant risk to the revenue. A greater opportunity for a revenue bias also exists where either the Tax Office is considering a precedential view or the underlying purpose of the law cannot be found from publicly available materials with certainty.

Other relevant matters

3.66 Submissions that argued the existence of an undue revenue bias were generally made in the context that they perceived the Tax Office 'hitting large business harder'. In the large business area the same tax officials who audit the companies also provide their PBRs. (The Tax Office has sought to confine PBR advice work to specialist staff. However, resourcing demands may necessitate these staff becoming involved in audits from time to time.) In 2004-05, liabilities from active compliance activities ('audit') in the large business area increased a further $1.5 billion from previous year. In that year, audit collections from large business rose by 4 per cent. The Commissioner also raised the intensity of verification activities in its 2005-06 compliance program — for example, he sent letters to boards of companies highlighting factors to consider in

17 See for example, Australian Taxation Office, ***Large Business Tax Compliance*** 2006**,** Canberra, 2006, p 10.

weighing tax risks. Representatives of these companies publicly reacted to these letters.[18]

3.67 The Tax Office says that it has a responsibility to ensure that taxpayers as a whole will not forgo the amounts intended to be payable under law. This is because the Tax Office is bound by the PBR and cannot later retract a view expressed in it on assessment. The Tax Office also considers that it must be consistent in its technical views or else it will be criticised for inconsistency if it adopts an anti-revenue view in one PBR but then later changes its view in other like circumstances.

18 See for example, newspaper articles in the Australian Financial Review, 15 April 2004, Buffini, 'Directors slam Tax Office over tax planning pressure', p. 1 and Evans, 'Directors leery of tax missive', p 63; see also Richards, 'Think of anti-tax avoidance implications, Tax Office tells boards of directors', ***Law Society Journal*** May 2005, p 38.

CHAPTER 4 — THE VIEWS OF BIG BUSINESS PBR APPLICANTS

4.1 In late 2005, the Inspector-General engaged ATAX researchers from the University of New South Wales to survey a representative sample of big business PBR applicants. The researchers sought the views of both internal and external advisers, in a range of industry groups, in relation on a range of taxation matters. Their PBR applications were made or considered during the 2003-04 to 2004-05 financial years. A copy of the ATAX researchers' report is reproduced in Appendix 2.

4.2 The ATAX researchers consider the views to be representative of all large business PBR applicants.

4.3 Set out on pp 10-33 of the survey report are a number of descriptive findings (the frequency of various responses to each of the survey questions) and analytical findings (testing of responses for significant relationships and the drawing of statistical and analytical generalisations).

4.4 The report also comments on areas of Inspector-General interest (pp 34-36 of the survey report).

4.5 Drawing on these findings and comments, the Inspector-General makes the following conclusions concerning the views of big business PBR applicants:

- There is a widespread belief that the Tax Office has a revenue bias in PBRs. Big business believes that this perceived bias needs to be addressed.
- There is a general link between PBR outcomes and whether PBR applicants agreed with the Tax Office's reasoning.
- An unfavourable ruling will deter big business from implementing the proposed arrangement. This is despite the changes to remove the penalty for failing to follow a PBR. A significant proportion would withdraw their application because of a probable unfavourable ruling.
- A perception of revenue bias tends to deter big business from making PBR applications unless it is necessary.
- Many believe the existing Tax Office control mechanisms are inadequate. They believe that increased technical capacity and a changed Tax Office culture would reduce the potential for a revenue bias.
- A significant proportion of big business applicants believe that the perception of revenue bias could be addressed by increasing independence in making rulings, increasing dialogue, changing Tax Office culture and increasing tangible objectivity measures.

- Big business considers that the Tax Office should place greater reliance on applying the law, rather than policy intent. There was strong support for the Tax Office to discuss both the policy intent and the application of the law with Treasury.

- Big businesses' opinions on PBR timeframes are mixed. Although many say the PBR process is timely, a significant proportion experience unreasonable delays. Many were unsure if the priority rulings process would improve timeliness, but an overwhelming majority said they would use the process for complex matters.

4.6 These conclusions are discussed below.

Widespread belief that the Tax Office has a revenue bias in PBRs that needs to be addressed

4.7 Almost three-quarters of survey participants believed that the Tax Office has a revenue bias in PBRs. This was based on their personal experience and expectations. Examples of personal experience included Tax Office requests for details of the revenue involved and perceiving the Tax Office to interpret the law inconsistently and in a manner thought to evidence a revenue bias. Examples of expectations included the belief that there is an adversarial Tax Office culture of adopting a default position in 'grey' areas to protect the revenue. More examples are provided in pp 24-25 of the survey report.

4.8 Views were held irrespective of the outcome of their PBR or the industry to which the applicant belonged. The perception of bias was not statistically related to:

- the representative capacity of the survey participant;
- their industry type;
- the treatment of the PBR or its outcome;
- whether the PBR experienced unreasonable delay;
- the complexity, subject matter or precedential nature of the issues;
- whether pre-application discussions had taken place; or
- the level of participants' satisfaction.

4.9 Almost all of those that perceived a bias believed that the bias needed to be addressed.

Link between PBR outcomes and agreement with the Tax Office's reasoning

4.10 The ATAX researchers found that there was a link between those participants who disagreed with the Tax Office's reasoning and those who received an unfavourable outcome. However. the researchers also observed that although more than three-quarters believed the Tax Office's reasons were generally clear, the level of

agreement with reasons was low (about half of participants) when considering the number who had only received favourable PBRs (two-thirds).

Probable unfavourable ruling deters big business from implementing the proposed arrangement

4.11 More than three-quarters of participants said that an unfavourable ruling would deter the business from the proposed course of action. About one-third of applicants who withdrew their PBR application did so because they feared a probable unfavourable ruling.

4.12 Recently the law was changed to repeal the 25 per cent penalty for not following a PBR.[19] Two-thirds of those participants that were aware of this change said that it would not influence the deterrent effect of an unfavourable ruling.

Perception of revenue bias deters big business from making PBR applications unless it is necessary

4.13 More than three-quarters of participants said that they had considered making a PBR application but then did not apply. About one-third of these participants did not apply because they did not have confidence in the Tax Office to make an unbiased decision. This is supported by the ATAX researchers' finding that there was a statistically significant correlation between the number of rulings applied for and the perception of bias. The most likely explanation was that the stronger the perception of bias, the less likely the taxpayer would apply for a PBR. Many said that taking a reasonably arguable position was a preferable alternative unless a PBR was necessary.

Belief that existing Tax Office control mechanisms are inadequate — increased technical capacity and a changed Tax Office culture needed

4.14 About one-half of participants did not believe that the Tax Office had adequate assurance measures and controls to minimise the potential for revenue bias. Just under half were unable to suggest changes. However, one-fifth believed a change was needed to the perceived culture of revenue mindset and associated processes. About one-fifth believed greater internal and external review, technical capacity or understanding was needed.

19 Subsection 284-75(4) of Schedule 1 to the TAA 1953 (the provision for a tax shortfall resulting from a failure to follow a private binding ruling) repealed by ***Tax Laws Amendment (Improvements to Self Assessment) Act (No. 1) 2005***.

Belief that perceptions of revenue bias could be addressed by increasing independence in making rulings, increasing dialogue, changing Tax Office culture and increasing tangible objectivity measures

4.15 About one-quarter of participants believed that greater independence in making rulings, including independent review, would minimise the perceptions of revenue bias. About one-fifth believed that a change in Tax Office culture was needed to achieve this.

4.16 Although about one-fifth believed that increased dialogue would minimise the perceptions of revenue bias, it may not reduce the level of perceived revenue bias overall. This is because two-thirds of participants said that they discussed the technical aspects of their application with the Tax Office before applying. These discussions were not statistically related to the existing perceptions of revenue bias.

4.17 However, increased dialogue may increase the level of confidence in the Tax Office's technical issue resolution. It would demonstrate that the Tax Office has understood the applicant's position and is better placed to address that position through its ruling.

4.18 About 15 per cent of participants believed that tangible signs of objectivity needed to be increased. Over three-quarters of participants said that the Tax Office's reasons were clear. Some said that the reasons were clear because they provided the Tax Office with the reasons and the Tax Office 'cut and paste' this into the ruling. However, about two-thirds did not think that the Tax Office had fully considered the material that the applicant had provided. Further, one-third thought that the Tax Office had asked for irrelevant material while the application was being considered.

Belief that greater reliance should be on applying the law, rather than policy intent — Tax Office should discuss both application of the law and policy intent with Treasury

4.19 About one-quarter of participants believed the Tax Office relied on the application of the law and about half believed the Tax Office relied on policy intent. However, about half believed the Tax Office should place greater reliance on the application of the law rather than policy intent, whereas about one-quarter believed the Tax Office should place greater reliance on the policy intent.

4.20 More than three-quarters of participants said the Tax Office should discuss the policy intent and the application of the law with Treasury. However, about one-fifth were concerned that these discussions might cause delay.

Opinions on timeframes are mixed

4.21 Opinions on timeframes are mixed. About half of participants said that the PBR process was timely. However, just under a half said that their applications had experienced unreasonable delay.

4.22 Overall, about two-thirds of participants said that they were satisfied with the Tax Office's service. This was not related to the outcome they received. About two-thirds said that they were adequately advised of the progress of their application. However, there were comments that applicants initiated contact with the Tax Office on this point.

4.23 Over a quarter of participants said that they had considered applying for a PBR but did not because they expected the Tax Office to delay the application. Just under one-third of participants had withdrawn PBR applications, with just under half of these withdrawals because the participant considered that the Tax Office appeared unwilling or unable to rule.

4.24 Most participants were aware of the priority PBR process. More than three-quarters said that they would use that process for complex rulings. However, half remained unsure if it would improve timeframes. There were some comments also that it might be unwieldy in terms of requiring Board involvement.

CHAPTER 5 — INSPECTOR-GENERAL FINDINGS AND OBSERVATIONS

5.1 This chapter discusses the basis for the Inspector-General's findings, observations and recommendations set out in Chapter 2.

NO EVIDENCE OF UNDUE REVENUE BIAS

Inherent revenue bias

5.2 Almost all representations to the Inspector-General acknowledged that there is an inherent revenue bias in the PBR system. The Tax Office has a dual role as impartial rulings administrator and revenue collector. On this basis it is expected that a tax administrator will have some revenue bias in its rulings system where matters are finely balanced. This is especially so in relation to complex matters.

5.3 Tax officers are perceived to be biased in their interpretation of the law by the mere fact of being imbued with the revenue authority's administrative and revenue collection culture. Most people who made representations, however, did not consider this inherent bias as undue. The Tax Office did not agree that there is an inherent bias in the PBR system but did accept that its dual role as collector and administrator can lead to perceptions of revenue bias.

Undue revenue bias

5.4 Based on a survey of representative large corporate PBR applicants' views, submissions to the review, the proportion of favourable PBRs given, the pattern of external review of the Tax Office's PBR objection decisions, and review of a random sample of Tax Office files undertaken by the staff of the Inspector-General, this review has found no evidence of undue revenue bias.

5.5 No submissions to the review brought forward examples of undue revenue bias. Examples that stakeholders reasonably considered to show undue bias were, on examination, the product of interpretations that best promoted the 'policy intent' of the law, as the Tax Office understands it.[20]

5.6 The Inspector-General examined a random sample of Tax Office files comprising 15 of the around 570 large business PBR applications made or considered during the 2003-04 and 2004-05 income years. These included a number of cases in which applicants withdrew or the Tax Office refused to rule. In examining the random sample of cases, the Inspector-General did not attempt to review the Tax Office's

20 This review distinguishes between the terms 'policy intent' and 'purposive approach to statutory interpretation' — see paras 3. 31 to 3.44 in Chapter 3.

interpretation of the law.[21] Rather, the Inspector-General considered whether Tax Office processes and records of internal thinking that led to the PBR exhibited any evidence of an intention to impose more revenue than was open on a purposive interpretation of the law, as the Tax Office understands it.

5.7 The records indicated that tax officials thought the views taken were the better views of the law, according to their understanding. There was no record that views were taken, ruling requests were refused or delays were made for the purpose to impose more tax than otherwise payable on a better view of the law, in tax officials' opinions. Also, very few records relating to PBR applications contained details on the revenue involved in the arrangements.

5.8 During 2003-05, the proportion of favourable PBRs requiring a Tax Office precedential view (48 per cent) compared against the proportion of favourable PBRs requiring non-precedential views (43 per cent) did not indicate a revenue bias. This five percentage point difference amounts to a six case difference.

5.9 Also, the pattern of decisions relating to external review of the 13 Tax Office PBR objection decisions for the relevant period does not indicate a systemic revenue bias. More Tax Office PBR objection decisions were affirmed on external review than set aside, but, there were more Full Federal Court decisions that set aside PBR objection decisions than affirmed them (see Table 1 in Chapter 3). However, the numbers are too small to draw any firm conclusions as to whether or not this latter point evidenced an undue revenue bias.

5.10 While submissions to the review and the survey undertaken as part of this review did not bring to the surface any direct evidence of undue revenue bias, they did provide evidence of circumstances that gave rise to perceptions of revenue bias.

5.11 These perceptions are important because a perception of an undue revenue bias adversely affects taxpayers' confidence in the Tax Office's administration. This, therefore, adversely affects compliance.

> Fairness and professionalism are important because the literature of the social psychology of procedural justice shows that when people believe they are treated fairly, they are more likely to comply with the law.[22]

WIDESPREAD PERCEPTIONS OF REVENUE BIAS

5.12 Based on a survey of representative large corporate PBR applicants' views, the perceptions of revenue bias are widespread among large corporate internal and external tax advisers. These perceptions are not limited to any particular industry

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21 It is doubtful that any Inspector-General view that a better view of the law was available to the Tax Office but not adopted would be accepted as evidence of a revenue bias. Also, the Inspector-General considers that submissions to the review would have surfaced any clear examples of biased Tax Office interpretations.

22 Professor John Braithwaite 1 'Through the eyes of the advisers: A fresh look at tax compliance of High Wealth Individuals', Contract Paper prepared for the Interim Review of the HWI Taskforce, p 14; as quoted in the Senate Economics Committee, ***Inquiry into the Operation of the Australian Taxation Office***, Canberra, 2000, p 9.

group (see Chapter 4 and Appendix 2 — survey report). Perceptions of revenue bias are not due to unfavourable rulings.

5.13 The survey report identified why large business PBR applicants' perceive a revenue bias. Their perceptions were based on their interpretation of observed Tax Office behaviours and taxpayer expectations. The Inspector-General provided a copy this survey to the Tax Office in January 2006.

5.14 Submissions indicated that PBR applicants interpreted certain Tax Office behaviours as motivated by a revenue bias:

- the Tax Office sometimes takes a strained reading of the law;
- the Tax Office is reluctant to tell applicants that it is discussing with Treasury its concerns for wider implications of its view; and
- the Tax Office sometimes asks applicants to withdraw rulings, refuses to rule and delays issuing a ruling.

UNDERLYING CAUSE OF PERCEPTIONS OF REVENUE BIAS

5.15 In the absence of cogent explanation, taxpayers generally interpreted these Tax Office behaviours as:

- the Tax Office is 'clinging to a theoretical right to support a revenue friendly view';
- issues are resolved behind closed doors without the opportunity to implement change quickly; and
- the Tax Office is reluctant to be bound by its view and is seeking to wear down the applicant by avoiding resolution of the issue.

5.16 However, an examination of Tax Office files (unseen by taxpayers) showed that these Tax Office behaviours were not motivated by a revenue bias. Also, while Tax Office behaviours were the reasons for perceptions of revenue bias, they were not the underlying cause.

5.17 The major underlying causes for PBR applicant perceptions of revenue bias were insufficient Tax Office transparency and communication about its behaviours, leaving taxpayers grounds to reasonably conclude that the behaviours were motivated by a pro-revenue bias.

5.18 Had the Tax Office not exhibited these behaviours or been sufficiently transparent in its dealings with affected taxpayers, it is unlikely that perceptions of revenue bias would be as strongly held or as widespread.

5.19 These Tax Office behaviours, taxpayers' perceptions of them, the motivations of these behaviours and action to address continuing perceptions are discussed below.

The Tax Office sometimes takes a strained reading of the law which is not seen to be supportable either on the text of the law or the publicly available extrinsic materials

5.20 In some matters, taxpayers have said that the Tax Office adopted an 'overly legalistic' or a strained interpretation of the law when an alternative construction was more congruent with the text of the legislative provisions and its publicly available extrinsic materials. In these circumstances, taxpayers perceive that the motivating factor for these strained interpretations is a pro-revenue bias.[23]

5.21 An understanding of the requirement for the Tax Office to take a purposive approach to statutory interpretation (see Chapter 3 for background) is important to appreciating why, in some circumstances, the Tax Office interpretation may be more strained than the interpretation favoured by the taxpayer. This is because the scope to strain the words gives rise to a spectrum of interpretive tensions between the underlying purpose of legislative measures and statutory constructions that are open on a reading of the law. The less congruent these two factors appear in particular circumstances, the more difficult it becomes for the Tax Office to persuade the applicant of its views and the more likely perceptions of revenue bias will arise.

5.22 Applicants are more likely to perceive that an undue revenue bias has influenced technical decision making where the Tax Office ruling is inconsistent with an applicant's understanding of the underlying purpose of the legislative provisions in question. The Tax Office's view must be reasonably open on the law; but a purposive interpretation need not be the most apparent on a reading of the text of the legislative provisions.

5.23 On the basis of the Inspector-General's review of case files and Tax Office-Treasury communications, the Tax Office genuinely strives to provide an interpretation which supports the 'policy intent' of the law, as it understands it. This approach is consistent with the purposive approach to statutory interpretation and is not, of itself, a revenue bias. However, the Tax Office will consider material that is irrelevant according to the rules of statutory interpretation — for example, referring to material arising during the policy development or drafting of the law such as Treasury's institutional view of the 'policy intent' as at the time the law was enacted. Although this material is irrelevant according to the rules of statutory interpretation, it allows the Tax Office to make more informed and pragmatic judgements in particular cases — especially where it is in the taxpayer's favour. But, it can lead the Tax Office into errors of law where the 'policy intent' and the text of the law (including its extrinsic materials, where permissible under the rules of statutory interpretation) are at odds. The Tax Office's assessment of legal risk of its views not being upheld by the courts will be significantly impaired if it does not clearly distinguish interpretations derived from the accepted rules of statutory interpretation and interpretations settled with reference to those extrinsic materials not permissible according to the accepted rules of statutory interpretation. This pragmatic approach, however, is not evidence of a revenue bias because this Tax Office approach has not always resulted in a favourable outcome for the revenue.

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23 See for example, the tax professional bodies' views in Agenda item 2, 'Design Topics — Tax Office approach to the Interpretation and Application of the tax laws', NTLG Agenda for meeting on 28 June 2007.

5.24 The Tax Office has publicly stated that it interprets the law according to the 'policy intent'.[24] Although this phrase may be a short hand term for the purposive approach it may lead lower level officers into error. This is because interpretive tasks may be carried out by relying on 'policy intent' which is evidenced in impermissible extrinsic materials (according to the accepted rules of statutory interpretation) before looking to the underlying purpose of the provisions as evidenced by the text of the law. The Tax Office should clearly state to its officers how they should undertake the process of statutory interpretation in light of senior public statements that the Tax Office interprets the law to give effect to the 'policy intent'.

5.25 The Inspector-General considers that increasing tangible signs of objectivity should reduce perceptions of bias arising from concerns that the Tax Office adopts pro-revenue positions in areas of uncertainty by straining the interpretation of legislative provisions.

Tax Office requests for taxpayers to withdraw rulings, refusals to rule and delays

5.26 In circumstances where the purpose of the legislative provisions is not readily identifiable or misaligned with a reasonable reading of the law, the Tax Office will discuss the issues with Treasury. In these circumstances, the Tax Office will generally await resolution of these discussions with Treasury before ruling — for example, Inspector-General staff observed one matter where the Tax Office was reluctant to rule notwithstanding it had arrived at a view that an interpretation supporting Treasury's advised 'policy intent' of the provisions were 'clearly arguable [even if they are not without some difficulty]'. In this matter, the Tax Office noted that there was a 'real risk that the Courts might not prefer our view' and that a plain reading of the law did not support that view. However, the Tax Office said it 'could not prefer [the taxpayer representative's] proposed interpretations over reasonably available ones that delivered the policy intent as advised'.

5.27 This behaviour generally resulted in delaying the ruling, refusing to rule and/or asking the applicant to withdraw their application unless they wanted to receive an unfavourable ruling — for example, in a case related to the matter above the applicant withdrew their application after eight months of delay. In another case, the Tax Office delayed the resolution for five months while the technical matter was being resolved with Treasury. During this period the Tax Office asked the applicant to withdraw its PBR application three times.

5.28 Inspector-General staff also observed circumstances where the Tax Office did not tell taxpayers that the reasons for its reluctance to rule or the delays was that it did not want to rule while it was discussing with Treasury the implications of its view. The ATAX survey report also indicates that taxpayers are generally unaware of whether the Tax Office has discussed the technical matters with Treasury (see Table 34 of the survey report).

24 See for example, Australian Taxation Office, Large Business Tax Compliance 2006, Canberra, 2006, p 10.

5.29 The potential consequences of this lack of transparency include significantly increased compliance costs for those taxpayers disputing the interpretation and the costs of litigation. It also results in an erosion of public confidence in the Tax Office's ability to administer the PBR system impartially.

5.30 Although these Tax Office behaviours can sometimes be to avoid giving an unfavourable ruling to PBR applicants, applicants were generally unaware of this.

5.31 Delays may also be experienced in cases involving technical uncertainty but where no referral of the issue is made to Treasury — for example, in one case the Tax Office spent almost 11 months in considering the issues, including 4 months as a PTI and almost 5 months in the LB&I and CoE areas considering the issues.

5.32 The Inspector-General has précised the following case study from publicly available material to illustrate Tax Office behaviour where it is reluctant to make a ruling if a prevailing interpretation of the law does not give effect to the 'policy intent' of the law, as the Tax Office sees it. The example shows how the Tax Office may ask taxpayers to withdraw applications and might adjust ruling dates to negate objection rights. These behaviours colour private sector perceptions of its intentions.

CASE STUDY — INDOOROOPILLY CHILDREN SERVICES (ABC)[25]

On 13 February 2003, ABC and the franchisee employees applied to the Commissioner … for a private ruling that its issue of shares would not give rise to FBT to it or the franchisee employees, and that the employees would be liable to tax if and when the trustee distributed ABC shares to them.

The ruling application on the FBT issue was expressed to relate to the following six FBT years ending 31 March 2008.

[A ruling along these lines would have been consistent with the Federal Court's judgment in the Essenbourne case (decided in 2002) with which the Commissioner expressed disagreement on 14 March 2003 (a month after ABC applied for the PBR). The Commissioner did not appeal the Essenbourne outcome but said he wanted to test it in future cases.]

… six months after ABC's ruling application was lodged [the ATO] advised ABC of a 'very recent high level policy change' that required the ruling application to be reassigned to a Centre of Expertise. [The ATO] asked for ABC to send in its application again, which it did.

In September 2003 the ATO informed ABC's advisors that any ruling would be negative and they preferred not to issue a ruling at all. They asked ABC to withdraw their ruling application. … In October 2003 ABC rejected the Commissioner's request to withdraw its application.

… A week or two later [a negative private ruling was issued to ABC]: FBT was payable and the employees had to pay tax when they received their shares. … the private ruling … was made in respect of the year of income ended 30 June 2004, not the FBT years ended 31 March 2008 that were requested.

25 Quoted from Robertson M, A disregard of the law — ***Commissioner of Taxation v Indooroopilly Children Services (Qld) Pty Ltd***, Taxation in Australia Vol. 41 No. 11, June 2007, pp 635-643.

CASE STUDY (CONTINUED)

In December 2003 the taxpayer objected to the ruling under Part IVC of the TAA. Throughout 2004 the Commissioner continued in his attempts to have Essenbourne (and Walstern) overturned.

… Over one year after [ABC's] objection was lodged, in January 2005, the Commissioner disallowed the objection. He highlighted that it was a ruling for the year ended 30 June 2004. … a deliberate ruling on a proposed arrangement for a year that has already passed is non-justiciable, a fortiori where it is a year of income not an FBT year … So ABC was left without any recourse to the courts.

ABC raised this matter with the Commissioner.

In May 2005 the Commissioner requested that ABC lodge a new ruling application, whereupon the Commissioner would issue a new ruling for the correct future FBT years. ABC would then object against the ruling and the objection would be decided quickly.

In May 2005 ABC lodged the new application for the FBT years 31 March 2006 through to 31 March 2011.

The ATO then rang ABC's advisors to inform it that the ATO policy was only to issue rulings for no more than two future years. This apparent policy would have made any ruling, by the time it went through the courts, unable to protect ABC in any way. ABC referred the ATO to the decision of Hill J in the CBCI case [***Corporate Business Centres International Pty Ltd v C of T*** [2004] FCA 458 (20 April 2004)], where mandamus was ordered against the Commissioner for not making a valid ruling as requested.

Finally, on 30 June 2005 the Commissioner issued ABC a valid private ruling for all years requested. The [negative] ruling confirmed that the Commissioner's position was as set out in TR 1999/5 until a Full Court decided otherwise.

… In July 2005 ABC and the franchisees objected to the ruling. The Commissioner disallowed the objection. [ABC] appealed to the Federal Court under Part IVC of the TAA [and won in both the Federal Court and, on appeal in April 2007, the Full Federal Court].

5.33 Submissions to this review recounted similar Tax Office behaviours to that in the above case study. Inspector-General staff also observed similar behaviours in Tax Office files. They underlie PBR applicants' perceptions that such Tax Office behaviours evidence an undue revenue bias: the Tax Office is reluctant to be bound by its view and is seeking to wear down the applicant by avoiding resolution of the issue.

5.34 The Inspector-General considers that it is generally inappropriate for the Tax Office to ask a taxpayer to withdraw a PBR application regardless of its motivations, especially in the absence of a full explanation of the circumstances. It is also inappropriate to unduly delay issuing a PBR because the Tax Office is awaiting the resolution of informal or formal dialogue with Treasury. Tax Office implementation of the Inspector-General's recommendations for improving transparency and timeliness should result in a discontinuation of these practices and the other inappropriate behaviours illustrated in the case study above.

A lack of clarity surrounding Tax Office-Treasury interactions on technical matters

5.35 The Tax Office is reluctant to be open with applicants about the fact that it is in dialogue with Treasury officials on the implications of technical issues relating to PBR applications. The implications of these technical issues may include such things as impacts on taxpayers, revenue, compliance, Tax Office administration, and questions of interpretation.

5.36 The processes agreed between the Tax Office and Treasury are public knowledge. The Tax Office-Treasury protocol, the Technical Issues Management Sub-committee of the NTLG, the pilot of the new Tax Issues Entry System[26] and the desirability of dialogue between the two agencies are all well known and supported in the large business taxpayer segment. Large business PBR applicants, members of the tax profession and representatives of large business strongly supported Treasury having a role in ensuring that Tax Office views are consistent with policy intent when the Tax Office resolves ambiguities in the tax laws.[27] This is because they consider it would minimise compliance costs and provide greater ongoing certainty. However, they express some concerns about the potential for this dialogue to increase PBR timeframes.

5.37 Treasury considers that it has no role in providing advice on the 'policy intent' of already enacted legislative provisions and strongly discourages the use of the term. Once legislation is enacted, the law, together with permissible extrinsic materials (Explanatory Memoranda for example), evidences the only relevant intention for interpreting the law — Parliament's. Parliament's intention is to be determined according to the accepted principles of statutory interpretation. Treasury officials' views on the 'background' to the legislative provisions or what was intended when the law was drafted are, in Treasury's view, unhelpful and should not be relied upon to settle interpretive matters as the Tax Office must come to its own view of the law. This will not preclude Treasury from discussing with the Tax Office whether the better view has been reached by reference to publicly available extrinsic materials and whether the position is consistent with other views the Tax Office has adopted. Treasury input in these discussions is only one of many; any member of the community is open to engage the Tax Office in these types of discussions. However, Treasury says that the Tax Office should not attempt to prop up the law because it feels frustrated that the law is not getting changed, nor should it delay giving interpretive advice in these circumstances.

5.38 It is interesting to note that in 1996, before the tax law design role was transferred to the Treasury, the Tax Office appeared to have a simpler view of the world:

> Where the policy intent is unclear or gives rise to anomalous or unintended outcomes, these matters are communicated, as matter of practice, to Treasury in order to either obtain

26 Board of Taxation, ***Improving Australia's tax consultation system: A report to the Treasurer***, Canberra, February 2007.

27 See Tables 32 and 33 in the Survey Report in Appendix 2; See also, Drenth F, Executive Director of the Corporate Tax Association, as quoted in the ***Australian Financial Review***, p 1, 6 July 2006.

> clarification of the policy intent or to allow Treasury to advise government. Traditionally, anomalies have arisen in the law where a rule was provided, but the reason for the rule was not expressed in the law or fully articulated by the drafter. In these circumstances the rule may require a result that drafters would have avoided if they had considered it.[28]

5.39 This statement could be characterised as the Tax Office searching for an administrative interpretation and not a search for Government's policy intent before the law was presented to Parliament. However, the Tax Office's loose use of the term 'policy intent' to mean Parliament's underlying purpose for legislative provisions, observed Tax Office-Treasury communications and the views expressed in the Tax Office's final submission in Appendix 6 imply that the Tax Office continues to have these expectations of Treasury.

5.40 The Inspector-General considers that in its role as an impartial rulings administrator the Tax Office must come to its own view of the law according to the accepted principles of statutory interpretation. To minimise adverse perceptions of what may appear to be Treasury's influence on interpretive matters, the Tax Office should come to a view, or possible views, on a case before it approaches Treasury for dialogue on the technical issues in question or the implications arising from the Tax Office's view. The Tax Office should also tell applicants when Tax Office-Treasury processes are active and the reasons why.

5.41 The potential for continuing misunderstandings should also be addressed by clarifying in the interagency protocol the Tax Office's and Treasury's expectations of each other in relation to interpretive matters and also re-enforcing with Tax Office technical decision makers that discussions on the 'policy intent' for enacted law have no relevance in interpretive matters.

5.42 Regardless of these nuances, what remains unchanged at the broader level is that to operate effectively the tax system needs a mechanism for significant implications of Tax Office interpretations to be drawn to the attention of the Treasury and where necessary the Government.

5.43 Without this opportunity in the system, there would be a greater number of situations where Government might respond to implications by changing the law after the Tax Office has ruled — resulting in an uneven playing field or a need to undo administrative actions — especially where it considers the Tax Office's view is not aligned with its policy:

> I have a concern about trying to retain a balance between the independence of the ATO, which is sacrosanct, and the government preserving its prerogative to drive policy … I want to make sure that when we have rulings … that their outcome is not to drive policy away from where the government had it.[29]

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28 Australian Taxation Office, NTLG Minutes of 15 March 1996 National Tax Liaison Group meeting, Item 9.3 'Linkage between objects and letter of law', available from www.ato.gov.au.

29 Dutton P, the then Minister for Revenue and Assistant Treasurer, as quoted in the ***Australian Financial Review***, 6 July 2006, p 1.

5.44 Changing the law after issuing a PBR has the potential to cause significant commercial damage to those rulees. However, this risk could be reduced by increasing transparency surrounding the possibility of law change in each particular case and enacting legislation with transitional provisions providing PBR rulees a reasonable opportunity to reorganise their affairs where the prospective effect of the law change would otherwise be detrimental.

5.45 Notwithstanding these views of the broader system, there are four specific areas for improvement which would better facilitate these processes and reduce perceptions of revenue bias:

- adhering to formal inter-agency processes in dealings with Treasury;
- improving the internal recording of the source of technical decisions;
- improving Tax Office transparency and communication to taxpayers when it is in dialogue with Treasury on implications of its view; and
- improving transparency of the Tax Office's understanding of the purpose underlying legislative provisions.

Adhering to formal inter-agency processes in dealings with Treasury

5.46 In circumstances where the Tax Office foresees implications arising from its interpretations, under the formal inter-agency arrangements, it is required to clearly advise Treasury of its inability to administer the law in a manner that gives effect to the purpose of the legislation, allowing Treasury to consult with the Government on the need for any law change. The Tax Office must also clearly state how it will administer the law if there is no law change and the impacts that this approach will have including revenue and interest groups. The Tax Office is required to give Treasury detailed advice on the impacts of its view.

5.47 Inspector-General staff observed some cases in which the Tax Office fully complied with the spirit of this practice statement — for example, in one case the Tax Office advised Treasury of unintended outcomes of a certain legislative provision. The Tax Office outlined its technical position and the impacts that non-tax policy factors had on the resulting outcomes of applying the legislation to the circumstances in question. It outlined the administrative impacts and the potential industry criticism of such a position if the Government chose not to amend the law to remove the uncertainty. It also estimated the cost to revenue of any potential amendment and recommended certain action to Treasury. The Tax Office clearly set out how it would administer the provisions if the Government chose not to change the law.

5.48 However, Inspector-General staff also observed some cases in which the Tax Office did not fully embrace the spirit of this practice statement. In relation to some of the PBR applications, the Tax Office discussed the relevant technical issues with Treasury officers and merely alerted Treasury to the relevant compliance risks or deficiencies in the legislation in delivering its intended purpose, as understood by the Tax Office. It did not state how it would administer the law if there was no law change,

or the impacts on revenue and interest groups. The Inspector-General made similar observations in his living away from home allowance case study report.[30]

5.49 In the context of the framework in which the two agencies operate, it is inevitable that informal dialogue will exist and often will be desirable, if only as a precursor to formal engagement. However, if the Tax Office is reluctant to act without a Treasury response and those matters are not formally and quickly raised with Treasury in line with the interagency protocol, delays and uncertainty for taxpayers will be compounded. Without anything formally in the system it is likely that nothing will come out, and matters will not progress.

5.50 The Inspector-General considers that the Tax Office should not delay settling its view or issuing PBRs because it is in dialogue with Treasury. Treasury also agrees that delay should not occur because of such dialogue. By its design, the PBR system gives applicants certainty on a timely basis while minimising any risk to the revenue that an incorrect Tax Office view might have by limiting the application of that view to the applicant.

Improving the internal recording of the source of technical decisions

5.51 Inspector-General staff saw a number of cases where inadequate records were kept on its Technical Decision Making System. This is the Tax Office's internal system for keeping records relating to the provision of written binding advice. In some cases, there were missing records of internal discussions on technical issues (by way of email or record of meetings) and letters from taxpayers on significant technical matters. In almost all cases where the Tax Office consulted with Treasury on a technical issue in relation to the PBR, those communications were not sufficiently identified, if at all. This is surprising as these communications went to the core of the policy objective sought to be achieved in the Tax Office's interpretation of law.

Improving Tax Office transparency and communication to taxpayers when it is in dialogue with Treasury on implications of its view

5.52 Taxpayers awaiting a PBR involving matters of technical uncertainty remain variously unaware of whether the Tax Office has a view of the law; if the Tax Office has formally advised Treasury of any implications of its interpretation and is waiting response; or if its interpretation is based on delivering the purpose of the law as it sees it.

5.53 A lack of transparency in disclosing when these processes are active on a particular matter is one of the main underlying causes for taxpayers' perceptions of revenue bias. In these circumstances, taxpayers have nothing to go on but their own interpretation of what may be happening and what Tax Office behaviours mean. The ATAX researchers also commented that from PBR applicants' perspectives, improved communication and visible changes to processes and outcomes are critical to the reduction of perceptions of revenue bias (see page 36 of the survey report).

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30 Inspector-General of Taxation, ***Case study — living away from home allowance***, Sydney 2007, paras 3.87 and 3.105.

Improving transparency of the Tax Office's understanding of the underlying purpose of provisions

5.54 In some cases, the Tax Office has also not clearly explained to taxpayers the reasons for its understanding of the underlying purpose of legislative provisions where it was the settled following input from external bodies.

5.55 In one case, the Tax Office merely advised applicants that it adopted a purposive interpretation which delivered the 'policy intent'. However, no explanation was given for the reasons or source for its view of the 'policy intent'. The Tax Office's view was at odds with the applicant's understanding of the underlying purpose of the provisions, but unknown to the applicant the Tax Office's views relied on what the Tax Office considered was Treasury's advised 'policy intent'. The applicant's understanding of the provisions' legislative purpose was derived from the publicly available extrinsic materials and their consultations with Treasury during the design of that law. Taxpayers were effectively asked to trust the Tax Office that its view of the 'policy intent' was cogent and should be preferred to the purpose indicated by the publicly available extrinsic materials. Taxpayers, however, disputed the Tax Office's view.

5.56 Also disconcerting is that the lack of transparency under present arrangements allows perceptions to flourish that the Tax Office is pushed towards administering the system on an untenable interpretation of the law. Applicants consider that the Tax Office is seeking to resolve deficiencies in the law by achieving policy outcomes through administrative means where the resolution is detrimental to PBR applicants — legislation by administrative fiat.

NEED TO INCREASE TANGIBLE SIGNS OF OBJECTIVITY

5.57 Perceptions of revenue bias could be reduced if there were improvements to:

- current Tax Office approaches that can impede mutual understanding of technical views; and
- the limited routine review mechanisms.

5.58 The reasons why improvements are considered desirable and what they might be are discussed below.

Improvements to Tax Office approaches that can impede mutual understanding of technical views

Demonstrated consideration of taxpayer information

5.59 Almost two-thirds of surveyed PBR applicants felt the Tax Office had not fully considered the material they provided with their application.

5.60 Survey participants commented that although the Tax Office acknowledged their technical arguments, they appeared as a 'cut and paste' in the PBR but with

nothing to show that their view had been balanced against the Tax Office's and nothing to show why the Tax Office preferred its view over the applicant's — a lack of comparative reasoning.

5.61 By not indicating how the Tax Office has considered taxpayers' views or the weight of evidence, taxpayers are left with impressions that Tax Office views are taken to achieve revenue objectives without regard to the cogency of taxpayers' reasoning.

Adequate opportunities to be heard

5.62 Inspector-General staff observed that Tax Office approaches were mixed. In some cases, tax officials clearly provided adequate opportunities for PBR applicants to be heard before potential adverse PBRs were issued. However, in other cases, the Tax Office did not communicate with applicants before adverse rulings were given. In an isolated case, this caused a disjunction between what was asked to be ruled upon and what was actually ruled upon.

5.63 Providing, as a matter of course, early opportunities to be heard before adverse decisions were made would improve taxpayer perceptions of Tax Office objectivity.

5.64 In non-favourable PBRs, transparency, procedural fairness and a greater degree of interim certainty are more likely to be perceived where, at the earliest time possible in determining the PBR, the technical decision maker:

- meets face to face with the applicant;
- provides the basis for the likely Tax Office view;
- explains why the Tax Office's view should be preferred, weighing the applicant's view against the Tax Office's; and
- in finely balanced matters, explains what alternative facts would likely lead to an alternative view and the reasons why.

5.65 Face-to-face consultation also minimises the risk of inadvertent disjunction between what is asked and what ruled upon.

5.66 On a related issue, a common complaint in submissions to this review was that the Tax Office would sometimes rule on the general anti-avoidance provisions when not requested to do so by the applicant. This had prolonged delays and potentially exposed the Tax Office to repeated litigation.[31] However, the ROSA report has since recommended that the Tax Office refrain from ruling on issues not directly raised in PBR applications without the applicant's consent.[32] It has also recommended measures to improve the transparency in the application of Part IVA.[33]

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31 For example, ***Lamont v Commissioner of Taxation*** (2005) 144 FCR 312.
32 Treasury, ***Report on Aspects of Income Tax Self Assessment***, Canberra, August 2004, recommendation 2.16.
33 Id, recommendations 2.10 and 2.12; see also p 75.

Quality of communication

5.67 Inspector-General staff also observed that the higher level of the technical decision maker, the better the quality of communication between the Tax Office and the applicant. In one case one year after the PBR application was lodged, the issue was escalated to a Tax Office senior tax counsel. That official immediately provided the applicant with a copy of an external counsel's opinion on the technical issues. The senior tax counsel then met twice with the applicant and discussed the applicant's options and also gave the applicant an opportunity to comment on the draft PBR before it was issued. The applicant commended the official for their involvement in the matter.

5.68 Perceptions of bias would also be reduced if the Tax Office were to facilitate easy, direct communication with the technical decision maker.

Limited routine review of PBRs

5.69 Large businesses express concern that they perceived inadequate internal checks against the cultural influences of the compliance function influencing its advice function. This is mainly because the same area that is responsible for auditing a large business taxpayer is also the area responsible for providing that taxpayer with a PBR.

5.70 An internal Tax Office report also recognised this implicitly by recommending that tax officials providing advice in the PBR process be separate from the compliance staff.[34] Since these comments were made the Tax Office has sought to keep confine PBR advice work to specialist staff. However, resourcing demands may necessitate these staff becoming involved in audit work from time to time.

5.71 Many submissions argued for increased tangible mechanisms of objectivity in the PBR process. The survey supported stronger assurance mechanisms to address the potential for perceptions of revenue bias arising.

5.72 Some academics argued that a body external to the Tax Office should be tasked with considering and issuing PBRs, such as in the system used in Sweden. As a result of criticisms that the revenue collector was not objective and independent, from 1991 private binding rulings in the Swedish tax system have been issued by a tax law commission (the Council for Advance Tax Rulings) independent of the revenue collection agency (the National Tax Board). The Council acts as a national tax court and is part of the Swedish court system. An application process is adversarial in nature. The Council has an outstanding reputation for the quality of its decisions but has been criticised for the time taken.[35]

5.73 However, no surveyed PBR applicant, tax practitioner or representative organisation commented during this review that such a change was necessary or

34 Australian Taxation Office, 'Complex Binding Rulings Review Blueprint', a report prepared by Amity Management Consulting Group, Version 4.3, October 2004, Amity.

35 Fransberg, E, ***The Swedish advance ruling regime,*** Wintercourse 2002, Stockholm School of Economics, p 23.

desirable for Australia. This option was also considered and rejected in the Ralph report as to likely result in unacceptable delays and increase uncertainty.[36]

5.74 Other submissions argued for internal independent review of PBRs on significant precedential matters. Comparisons were also made to the New Zealand system where the representative tax professional organisation considers that the Inland Revenue rules impartially 'without fear or favour'. This is largely due to the New Zealand system of structural separation of functions within the Inland Revenue and its Rulings and Adjudication area's strong culture of impartiality.

5.75 The Adjudication and Rulings area of the New Zealand Inland Revenue provides private binding rulings. The Inland Revenue maintains a strict structural separation between this area and its Policy Advice Division[37] (New Zealand's equivalent to Australia's Treasury in relation to policy matters) and compliance functions. There is, however, open communication between the three areas. The rulings area will obtain input from the compliance and policy areas. Rulings are also not delayed because of delays in obtaining input from its policy area. When the timeframes for these rulings are compared with the Tax Office's large complex rulings, the timeframes are similar (see Appendix 4).

5.76 Implementing such a system into the Australian system would require a Tax Office restructure to separate technical decision makers and reviewers from the influences of the compliance culture of the organisation. The Tax Office could be expected to regard such proposals as a step backwards to the 1980s and 1990s when it was suffering from major backlogs of requests for review and from internal tensions between compliance and review areas. The Inspector-General considers that in the context of large business PBRs, increased transparency would better address perceptions of bias and Tax Office culture.

5.77 The Tax Office has a technical quality review process which assesses the Tax Office's decision making in individual cases, including in large business PBRs. However, the Inspector-General notes that in relation to PBRs expressing a precedential Tax Office view on a significant matter, the reasoning is not reviewed by subject specialists. The technical views adopted in large, complex PBRs are ultimately settled by senior tax officials as precedential Tax Office views settled under the Tax Office's precedential decision making system.

5.78 The Inspector-General considers that perceptions of objectivity could be increased by providing applicants, before an adverse decision is made, the basis for the likely Tax Office view (including external opinions where relevant), an explanation of why the Tax Office's view is to be preferred over the applicant's, including the weight given to information provided by applicants, and an adequate opportunity to comment. In unfavourable PBRs, the Tax Office should also include a statement of the underlying purpose of the legislative provisions on which the interpretation is based

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36 Commonwealth of Australia 1999, ***Review of Business Taxation: A tax system redesigned***, Canberra, July 1999, p 145.

37 Inland Revenue's Policy Advice Division, works together with The Treasury to advise the New Zealand government on all aspects of tax policy and social policy measures that interact with the tax system, including drafting tax legislation and forecasting tax revenues: Annual Report, 2004, p 20.

and the source for that view — for example, which materials are relied upon to ascertain that purpose.

5.79 The Tax Office says that effective external review of its views in PBRs is provided by the Part IVC process. Applicants may object to a PBR. If unsatisfied with the Tax Office's determination of the objection, applicants may apply to the Administrative Appeals Tribunal or Federal Court for review of the Tax Office's PBR objection decision.

5.80 However, submissions indicated that large business taxpayers are, in part, deterred from seeking PBRs because of the hurdles they face in the event that they need to challenge the Tax Office's position. These hurdles are:

- the prohibitive costs involved which, for significant issues, ultimately may require a Full Federal Court decision to resolve the matter;
- the lengthy timeframes between the implementation of the arrangement and external review in light of the time limits the Tax Office places on the life of the PBR which may effectively preclude an appeal being heard on the objection to the PBR[38];
- that objecting to a PBR will also restrict a taxpayer's right to object an assessment (by virtue of section 14ZVA of the TAA 1953), leaving the better strategic approach to challenging Tax Office views through an objection to an amended assessment;
- the perception that the Tax Office is free to distinguish the decision on the grounds that the PBR was not implemented as stated in the application because all the facts are unable to be set out in the application; and
- the context of many complex rulings being that without Tax Office approval the arrangements are unlikely to go ahead in the forms proposed.

5.81 Until recently, PBR applicants did not have a statutory means to force the Tax Office to issue a PBR where the application was being delayed. Under the new laws (for PBR applications received or rulings made after 1 January 2006), a PBR applicant may, subject to certain timeframes and procedural steps, object to the Tax Office's failure to make a ruling. This process provides a right to avoid Tax Office delay and bring the matter to an external forum for review of the substantive matter.

5.82 However, large businesses say that because of the hurdles above, most are unlikely to challenge the Tax Office's PBRs with the result that these PBRs become 'de facto law'. They argue that the Tax Office is able to interpret the law to its advantage through rulings and is free to ignore case law without consequence to its view,[39] but, the taxpayer is not free to do so. Taxpayers who are unwilling or unable to match the

38 See for example, ***CTC Resources NL v. Commissioner of Taxation*** (1994) 120 ALR 197; also raised in Commonwealth of Australia 1999, ***Review of Business Taxation: A tax system redesigned***, Canberra, July 1999, p 139.

39 For example, the Tax Office's approach to the definition of fringe benefits in five Federal Court cases, resulting in ***Commissioner of Taxation v Indooroopilly Children Services (Qld) Pty Ltd*** [2007] FCAFC 16 (22 February 2007).

Tax Office resources do not challenge these rulings and those that do, do so to their detriment.

5.83 These perceptions have a behavioural effect. Large businesses who perceive a revenue bias do not to apply for PBRs unless the transactions are ongoing or critical to the taxpayer's business. This is supported by the main finding of the survey — those with a reduced level of perception of bias will be more likely to seek a PBR.

5.84 Generally, large businesses consider external counsel advice as a better risk management strategy than a PBR. Ultimately this depends on the nature of the transaction, the strength of external opinion and the business' tolerance for risk. If the issues are disputed by the Tax Office during a later audit the taxpayer will seek to rely on a reasonably arguable position and any tax indemnities.

NEED TO FURTHER REDUCE DELAYS FOR LARGE BUSINESS PBRS

5.85 The average elapsed time for large business PBR applications to be finalised during the 2003-04 and 2004-05 years was around 174 days, almost six months. For PBRs requiring the Tax Office to create a precedential view, this average was around 227 days, over seven months (see Appendix 3).

5.86 Submissions argued that many of these delays evidenced a revenue bias.

5.87 Two-thirds of survey participants said that the Tax Office kept them adequately advised of the progress of their application. However, some qualified their responses in that they felt they had to be 'proactive' in this regard (see Table 14 of the survey).

5.88 Over the last few years, the Tax Office has implemented case management systems which have progressively reduced elapsed timeframes for issuing large business PBRs. It says that it has reduced elapsed timeframes for large business PBRs to an average of 92 days in 2005-06 (just under 65 per cent being completed within 90 days) and 74 days in 2006-07 (just under 70 per cent being completed in 90 days).

5.89 The Tax Office has also introduced the priority PBR process to speed up the resolution of some of the most urgent large business PBR cases.

5.90 Notwithstanding these significant measures to reduce timeframes, there are three main areas for further improvement in reducing PBR timeframes:

- delays where public rulings are contemplated;
- delayed resolution of escalated precedential matters; and
- Tax Office requests for additional information.

5.91 These areas are discussed below.

Delays where public rulings are contemplated

5.92 The Tax Office will delay a PBR while the issue is the subject of a contemplated public ruling or other interpretive advice. Public Rulings may take 18 months or more to issue and PBRs are then delayed pending the outcome of those rulings. For example, in one PBR application case a year and two weeks elapsed waiting for a public ruling to issue.

5.93 In these circumstances, the Tax Office may also ask applicants to withdraw their application or refuse to rule and may direct the applicant to more general non-binding advice.

5.94 Although the outcome sought by the Tax Office in awaiting the outcome of public rulings is to ensure a consistent view applies to all in the industry and therefore maintain a level playing field, the private sector perception is that a delay in providing PBRs evidences an undue revenue bias: the Tax Office is reluctant to be bound by its view and is seeking to wear down the applicant by avoiding resolution of the issue.

5.95 Large, complex PBRs should not be delayed because the technical issue being considered is the subject of a developing public ruling. Where the technical issue being considered is the subject of a developing public ruling, the Tax Office should consider whether the private binding ruling can be issued before those processes are finalised — as is done in the priority PBR process.

5.96 In these circumstances, the Tax Office could better provide tax certainty to commercial transactions by considering whether those interests outweigh the desire to provide a level playing field for business.

5.97 This would provide an alternative to the Tax Office's global approach to providing certainty on issues. Any views subsequently found to be misaligned with the Tax Office's global view would then be quarantined to individual cases and not extend further — consistent with the rationale for the PBR system in limiting the adverse effects to the revenue of any erroneous views. Any such risk could be highlighted to the public by a disclaimer on the sanitised publication of the view, noting that view is the subject of a contemplated public ruling, that the expediting of the ruling required it to be issued before the resolution of the public ruling, and therefore, the view should not be relied upon by other taxpayers to indicate the Tax Office's public position on the matter.

5.98 The Tax Office could also consider receiving the Public Ruling Panel's advice and, where appropriate, seek timely industry consultation.

Delayed resolution of escalated precedential cases

5.99 In cases observed by Inspector-General staff there was an average time lag of over five months in escalating precedential matters to the Tax Counsel Network (TCN). There was also occasionally a delay in approving TCN involvement or allocating TCN officers to matters. Delays were also experienced in some cases due to the Tax Office considering what further information it needed and having its TCN area consider the technical issues relating to tax avoidance (taking between one-quarter and three-quarters of elapsed time, 2.5 to 9.5 months).

5.100 Submissions expressed frustration with the negligible influence case officers had over the process or time periods where issues are referred outside of their area. Inspector-General staff also observed that some CoE and TCN officers were reluctant to communicate with the applicants and, in some cases, reluctant to provide indications of expected timeframes to the case officers either.

5.101 Also, applicants say that 'agreed' or 'negotiated' timeframes between applicants and case officers are generally illusory. Applicants say that these timeframes are changed, in some cases many times, at the sole discretion of the Tax Office backed by the perceived threat of an adverse ruling if the applicant refuses to agree — for example, in one case the case officer 'agreed' with the applicant 15 times to extend the deadline over a nine-month period, notwithstanding the applicant's obvious frustration towards the end of the period in only 'agreeing' to 'one more shift in date' but ending up 'agreeing' to a further four more until eventually having the matter escalated.

5.102 Tax Office aged case management has improved over time. However, further improvement could be made in those matters where precedential issues are considered. In these cases there is a greater risk of delay where technical issues are considered outside the BSL segment area.

5.103 In line with the Tax Office's processes, where a matter is referred to CoE or TCN for resolution of a technical issue, CoE or TCN officers' accountability should include communicating directly with the client over the issue (while keeping the case manager informed of that communication), including the indicated timeframes and reasons for any delays.

5.104 The Tax Office's priority PBR process creates an environment in which tax officials occupying lower level positions and PBR applicants can enter dialogue on the technical issues under consideration with the understanding that such dialogue is conducted with the purpose of quickly narrowing the issues and facts to be considered.

5.105 The principles could be easily applied to applications not falling within the current priority PBR process criteria to assist applicants and Tax Office technical decision makers to quickly narrow the issues in consideration and the facts needed to conclude a view. The Tax Office has previously indicated an intention to consider widening the category of rulings to which priority PBR process approaches apply.

5.106 Prior discussion between applicants and the Tax Office aims to minimise time delays by laying out the whole proposal, providing key information, providing an opportunity for the Tax Office to ask general questions so that decision makers have sound understanding of the proposal and providing an opportunity for the Tax Office to describe information that is likely to be relevant. This process would also address the Tax Office's concerns that delays are sometimes caused by applicants not providing enough information in their application.

Public reporting on elapsed timeframes

5.107 Some submissions strongly argued that information requests were a Tax Office tactic to deliberately delay making a ruling or to improve Tax Office

performance statistics (an information request will 'stop the clock' for the Tax Office's reporting purposes). This perception is supported by the average time lag of about three and a half months in determining the need for and waiting on further rulee information. Extended delays were also caused by taxpayers responding to Tax Office information requests. In one case an applicant took six months to respond to Tax Office information requests.

5.108 More than a third of survey participants felt that the Tax Office requested immaterial information (see Tables 15 and 17 of the survey). Inspector-General staff also observed instances where numerous different information requests were made — for example, in one case the Tax Office asked five times for further information.

5.109 Applicants perceive a need for Tax Office discipline in limiting information requests to those relevant to the technical issues in question in the PBR request. Extending the priority PBR procedure of providing cogent reasons for requesting further information would also improve taxpayer perceptions.

5.110 Implementing ROSA recommendation 2.16 (a recommendation directed to addressing concerns that the Tax Office requests arguably unnecessary additional information to ensure that largely unlikely hypothetical circumstances are dealt with) is aimed at eliminating requests in relation to issues not directly raised in PBR applications. However, for those information requests in relation to issues directly raised in PBR applications, cogent explanations for the reasons such information are needed, including the specific aspect of the technical issue that turns on the facts requested. Once again, this could be achieved by extending the scope of key priority PBR process approaches.

5.111 The Tax Office calculates its PBR timeliness performance standards from the date the Tax Office considers it has received all the relevant information on which to rule. In addition to these timeframes, performance on elapsed timeframes from receiving the application should also be reported as a key performance indicator. This would eliminate perceptions that additional information requests are made to improve Tax Office statistics.

APPENDIX 1 — TERMS OF REFERENCE

A.1.1 In accordance with paragraph 8(3)(a) of the ***Inspector-General of Taxation Act 2003***, the Inspector-General of Taxation conducts the following review at the request of the Minister.

A.1.2 The Inspector-General will review whether there is a Tax Office 'pro-revenue' bias in dealing with large complex private binding rulings (PBRs). It will focus on:

(a) the evidence and extent of any revenue bias in dealing with PBRs;

(b) the basis for any perception of revenue bias in dealing with PBRs; and

(c) the relevant governance measures.

APPENDIX 2 — SURVEY REPORT

Report on the perception of revenue bias in private binding rulings

for

The Inspector-General of Taxation

by

Atax (the Australian Taxation Studies Program)
Faculty of Law
The University of New South Wales

Atax
UNSW
Faculty of Law

23 January 2006

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Executive Summary

This report is based on research conducted by Atax on behalf of the Inspector General of Taxation (IGT) into the perception of revenue bias in private binding rulings on large complex matters. The relevant population for the research was limited to those internal and external advisers who had applied for a private binding ruling (PBR) between 1 July 2003 and 30 June 2005 for a corporate taxpayer with an annual turnover in excess of $100 million. The ATO identified approximately 350 individuals who satisfied these conditions, from which the IGT selected a random sample of 50%. These selected individuals were then contacted by the researchers and invited to participate in a telephone survey.

The adjusted response rate to the survey was higher than expected at 86.4% (Table 1). After excluding responses that did not meet the conditions being studied, 78 full interviews were completed in total by three interviewers. On average, full interviews took 22 minutes to conduct and required three calls each. Interviews were conducted over a three week period beginning 18 November 2005. The interviews were used to collect both quantitative and qualitative data. The high sampling and response rates increase the level of confidence with which generalisations can be made in respect of the total relevant population based on the survey findings.

A large majority of interviewees (72% at Table 35) reported that they themselves believed that the ATO had a revenue bias in resolving the types of PBRs under consideration. This belief was mainly based on personal experience. Further, most interviewees (88% at Table 37) believed that others perceived the ATO as having a revenue bias. Of those interviewees who perceived bias, most (88% at Table 38) felt that it needed to be addressed. Measures suggested as likely to be most effective in reducing bias included a change in culture on the part of the ATO; greater independence in the making of rulings including external input; tangible signs of objectivity; and more dialogue between the applicant and the person deciding on the ruling.

Revenue bias was generally perceived to come into effect at the 'margin'. Where applications related to areas of uncertainty, interviewees felt that they were more likely to be decided in favor of the revenue, and particularly where substantial loss of revenue would result. The perception of bias was not found to be related to the type of adviser, the industry group, the outcome of applications, or the complexity of the issue. A statistically significant relationship (at the 95% confidence level) was found between the perception of bias and the number of applications made. Taking into account responses to other questions and comments, this relationship is interpreted as where the interviewee had a perception of bias, he or she was less likely to apply for a ruling unless certainty was essential.

More generally, interviewees (81% at Table 12) felt that the clarity of the ATO's decision(s) was acceptable, but only half (50% at Table 13) agreed with the decisions that they had received. There are many instances (for example, see Table 28 and Attachment 3) where interviewees questioned the ability of the ATO (its staff and its internal control measures) to ensure that the law is consistently and correctly applied. There was support for the concept of the ATO discussing the interpretation of both policy intent and the law with Treasury. In terms of timeliness in dealing with PBR applications, the experiences of interviewees were evenly divided (Table 10). However the majority (69% at Table 27) agreed that they were

satisfied with the overall standard of service provided by the ATO in dealing with applications for PBRs on large complex matters.

The final part of the report addresses a range of areas of interest specifically identified by the IGT. The strengths and weaknesses of the research are also discussed. We conclude that given the sampling and response rates that occurred, the results contained herein can be generalised, with a high level of confidence, to the total population of applicants to which the research relates.

Margaret McKerchar
Helen Hogdson
Kalmen Datt

23 January 2006

1 Introduction

In October 2005 the Inspector General of Taxation (IGT) engaged the Australian Tax Studies Program (Atax) of the University of New South Wales (UNSW) to assist in a review into the potential revenue bias in private binding rulings (PBRs) involving large complex matters. Specifically, Atax was to advise on the most efficient and effective means to survey a certain segment of taxpayers and their advisors on their perceptions on whether the Australian Taxation Office (ATO) has a pro-revenue bias in dealing with PBRs; to conduct the survey; and to report its findings to the IGT by the end of January 2006. That is, Atax's contribution was limited to research on the *perception* of bias, not its existence or incidence - this being part of the broader review being undertaken by the IGT in response to the Review of Aspects of Income Tax Self Assessment (ROSA). Atax researchers Ms Helen Hodgson and Mr Kalmen Datt conducted the research under the leadership of Associate Professor Margaret McKerchar.

The report is presented in five parts. Following on from the introduction, the second part of the report deals with the research design and conduct. The third part presents and analyses the results of the research. The final part presents a review of the key findings of the research given the following areas which were identified at the outset by the IGT as being of particular interest:

- the role of the ATO in relation to PBRs that involve uncertainty in the application of the law or underlying policy intent, including the ATO's interaction with Treasury;
- the potential adverse effects of not following a PBR;
- the perceived cogency of reasons provided for ATO decisions in relation to PBRs;
- the transparency of the PBR process and technical issue resolution;
- the adequacy of ATO assurance measures and controls that are aimed at minimising the potential for revenue bias;
- the timeliness in providing PBRs, in particular the effect that the ATO's Priority Ruling Process (PRP) has had on perceptions;
- the basis for any perceived revenue bias in the ATO's treatment of their particular PBR application; and
- the potential measures that will resolve perceptions of bias.

The final part also includes a review of the strengths and weaknesses of the design and conduct of the research; and comment on the extent to which the findings can be generalised to the relevant population as a whole.

2 Research design and conduct

This part of the report presents an overview of the brief and the various considerations that influenced the design and conduct of the research.

2.1 The brief

The brief was to conduct a survey of taxpayers and tax advisers that had made an application on behalf of a corporate entity, for a PBR on a large complex matter between 1 July 2003 and 30 June 2005. Initial indications from the IGT (based on ATO advice) were that there were some 600 taxpayers and 600 advisers that would satisfy these conditions. Given the tight timeframe within which the research was to be conducted and the anticipated time constraints of the potential interviewees, a telephone survey was recommended as the most appropriate means of conduct. Telephone surveys have been found to have a higher response rate than postal surveys[1] and a high response rate was desirable to maximise the reliability of the results.

Another distinct advantage of telephone surveys (particularly where open-ended questions are included) is that they facilitate the collection of both quantitative and qualitative data. Given the interests of the IGT were both about *what* was perceived (to which quantitative data is relevant) and *why* it was perceived (to which qualitative data is relevant) a telephone survey was recommended as the most appropriate design.

To minimise the potential for bias to be introduced by the interviewers, only the three principal researchers were to conduct the interviews. Together with the condition that all surveys were to be completed within a month, this meant that it would not be possible to survey all applicants and that random samples would need to be drawn. It was originally proposed to sample the two groups separately, drawing a sample of 100 from each group. With an expected response rate of 60 per cent, this would have given at least 60 respondents in each group which would have been sufficient to make statistical generalisations within reasonable confidence ranges (+/- 4 to 10 per cent).

However, it was subsequently found that the total population of PBR applicants that met the conditions of the study (after the removal of duplications) was approximately 350 in total. As a result, the decision was made to draw a random sample of 50 per cent, which is relatively high in terms of desirable confidence levels, from the total relevant population. That is, given the diminished size of the total relevant population, it was unlikely that valid statistical generalisations could be made on the two groups (i.e. taxpayer and tax adviser) independently, although comparative analysis could still be facilitated. The sample size of 50 per cent of the total population would result in each of the three researchers having to conduct up to 60 surveys within the month which was considered achievable.

[1] Based on the literature, the response rate for a telephone survey could be expected to be in the range of 60-65% (see Fowler F, 1993, *Survey Research Methods*, 2nd edn, Sage, Newbury Park CA). In contrast, postal surveys conducted in Australia on tax issues have generated response rates in the range of 26-50% (see for example, McKerchar, M, 2003, *The Impact of Complexity Upon Tax Compliance: A Study of Australian Personal Taxpayers*, Australian Tax Research Foundation Research Study 39, ATRF, Sydney at p 166-167). A more recent electronic survey of Australian tax agents generated a response rate of only 1% see McKerchar, M, 2005, McKerchar, M., 2005, "The impact of income tax complexity upon practitioners in Australia", *Australian Tax Forum*, Vol. 20 No. 4, pp. 529-554.

2.2 The design

The survey instrument was designed in four parts. The first part collected information on the basic characteristics of the respondents which were to verify their inclusion in the population and to provide a basis for comparative analysis to be undertaken. The second part collected information on the respondents' overall experience in dealing with the ATO in respect of PBRs. The third part collected information on the respondents' views of the ATO decision making processes. The fourth part collected information on the respondents' perception of bias and how (if needed) it could be addressed. The final section allowed for respondents to make any further comment. The questions themselves were a mixture of both open-ended and closed. Responses were subsequently coded to facilitate data analysis.

Staff of both Atax and the IGT were consulted in the development of the survey instrument. The survey instrument was then piloted with both taxpayers and tax advisers (six in total) [2] who could reasonably be expected to be representative of the relevant population. Feedback was specifically sought on the appropriateness of the questions to the brief and their interpretation was tested cognitively. As a result, the survey underwent refinements and enhancements over a two week period before being submitted to the relevant bodies for approval. The final survey instrument (Attachment 1) was approved by the Statistical Clearing House (01778-01) and by the UNSW Human Research Ethics Advisory Panel B (05 2 141).

The IGT made the random selection based on information provided by the ATO and provided the contact details for the sample population of 177. The sample was then divided randomly and equally between the three researchers. Prior to making telephone contact, an introductory letter (Attachment 2) on IGT letterhead was mailed to each person in the sample population. This was important in terms of establishing the credibility of the research and in achieving as high a response rate as possible.

2.3 The conduct of the survey

The introductory letters were mailed on 11 November 2005 to the bulk of the sample population. A small number of those included in the sample were subject to higher security provisions and the provision of their contact details by the IGT was temporarily delayed as was the mailing of their introductory letters (which were sent in due course). Once all contact details were made available it became apparent that there were six remaining duplications in the sample population. That is, the corrected sample population was reduced to 171 which still approximated 50 percent of the total population (adjusted to 344).

Telephone interviews began on 18 November 2005 and all successful interviews were conducted before 8 December 2005. No further attempts were made to conduct interviews after 20 December 2005. A breakdown of response types is at Table 1.

[2] None of the six were subsequently selected in the sample population. Undoubtedly the final version of the instrument was much improved as a result of the valuable input of others, which was much appreciated.

Response types	**Frequency**
Completed interviews	108
Declined to be interviewed	5
Contact person has left employment	21
Contact person on leave	5
Contact person unavailable (but contact details correct)	12
Contact person unable to be contacted (contact details incorrect or overseas)	20
Total	**171**

Table 1: Telephone survey responses

After excluding those who had left employment, were on leave or were unable to be contacted, there were 125 potential interviewees remaining in the frame. With 108 completed interviews, a **response rate of 86.4 per cent** was achieved. This response rate was higher than expected. Coupled with the random sample of 50 per cent of the total population, a high level of confidence can be placed in the representativeness of the views of those interviewed in respect of the total relevant population. Non response bias[3] may still exist, though its impact is unlikely to be significant given the sampling and response rates that occurred.

On average, a completed interview took three calls (1 minimum, 8 maximum) and 22 minutes to complete (14 minimum, 42 maximum). This excludes those interviews where the contact person advised (Question 1.1 of the survey refers) that he or she had *not* applied to the ATO for a PBR between 1 July 2003 and 30 June 2005 for a corporate entity taxpayer with an annual turnover exceeding $100 million. Of the 108 interviews completed, 30 did not meet the conditions of Question 1.1, leaving 78 completed interviews to be the basis of the research. Some of those who did not meet the conditions of Question 1.1 failed the turnover test, but had applied for PBRs in respect of research and development expenditure. Some were very keen to still express their views on the subject and these are to be forwarded to the IGT by the researchers under separate cover. Their responses have not been included in any of the analysis in the body of this report.

On average, 6 calls were made to each of the 12 contact persons who were categorised as 'unavailable' in Table 1. Seven of the completed interviews had incorrect contact details but were able to be traced by the interviewers. In the case of 20 contact persons who were categorised as 'unable to be contacted' in Table 1, three calls were made to each of the contact persons where they had an Australian telephone number. There were 5 contact persons located overseas whom the interviewers did not call.[4]

[3] Typically, in a number of the non responses contact was made (usually with the personal assistant of the contact person) but the person had other commitments that precluded an interview being scheduled (or rescheduled) within the timeframe for the research.

[4] The rationale here was that timing differences and potential language barriers would be expected to preclude the satisfactory completion of a telephone interview.

3 Findings

This part of the report presents both the descriptive and analytical findings of the research based on the conduct of the survey. The descriptive findings report the frequency of the various responses to each of the survey questions. The analytical findings include the testing of responses for significant relationships and the drawing of statistical and analytical generalisations.

All findings reported in this part are in respect of the 78 interviewees who confirmed that they had applied to the ATO for a PBR between 1 July 2003 and 30 June 2005 for a corporate entity taxpayer with an annual turnover exceeding $100 million (i.e. a positive response to Question 1.1).

3.1 Descriptive findings

Descriptive findings are presented for each question in the prescribed order. Further comments are made where relevant.

Question 1.2: How many applications were made by you that satisfied the conditions of the study?

Number of PBR applications	Frequency
One only	27
Between 1 and 5	37
Between 6 and 10	8
More than 10	6
Total	78

Table 2: Number of PBR applications

The accuracy of this information was not tested against data provided by the IGT. It was collected simply to facilitate the subsequent testing of whether or not the number of applications was related to the perceptions held by the interviewees.

Question 1.3: Where more than one application was made, were they in relation to the same matter?

Multiple applications relating to the one matter	Frequency
Yes	5
No	46
Total	51

Table 3: Breadth of matters to which applications related

The total of responses to this question is consistent with those that indicated in Question 1.2 that they had made more than one application that satisfied the conditions of the research.

Question 1.4: In what capacity were you acting?

Capacity of contact person in respect of qualifying PBRs	Frequency
Always acting as an employee (internal adviser)	21
Always acting as an external adviser	57
Total	78

Table 4: Capacity of interviewee

No interviewees indicated that they had acted in mixed capacities. The breakdown of internal advisers (27%) and external advisers (73%) interviewed is consistent with data provided by the IGT on the relevant total population. Again, this strengthens confidence in the representativeness of those interviewed. Responses to this question will facilitate the subsequent testing of whether or not perceptions held by interviewees were related to the capacity in which they acted.

Question 1.5: In what industry did the corporate entity operate?

Industry division	Frequency
Mining	4
Electricity, Gas and Water Supply	1
Wholesale Trade	1
Transport and Storage	3
Finance and Insurance	11
Cultural and Recreational Services	1
Total	21

Table 5: Industry division

Industry codes were only collected where the interviewee acted as an internal adviser (i.e. 21 interviewees based on responses to Question 1.4). It was presumed external advisers could have clients across industry groups making this a less relevant factor for subsequent testing. The codes used were based on the current Australian and New Zealand Standard Industrial Classification (ANZSIC) at the divisional level.[5]

[5] Going to lower levels may have allowed individual taxpayers to be identified. Further, given the small numbers in many cases, subsequent testing may best be facilitated by reducing industry groupings to only two types: 'Finance and Insurance', and 'Other'.

Question 1.6: What was the most common area to which the application(s) related?

Main areas to which applications related	**Frequency**	**Percentage**
Capital gains tax (CGT) including rollover relief and event K6	14	18%
Debt, equity and capital restructuring including demergers and share buybacks	12	15%
Consolidations and thin capitalisation	10	13%
International issues including withholding tax, tax treaties, sources and rights	8	10%
Tax losses including loss integrity measures	5	6.5%
Dividend streaming, streaming of franking credits and corporate distributions	5	6.5%
Depreciation, uniform capital allowances including black hole expenditure	5	6%
Goods and services tax (GST)	3	4%
Deductions	2	2.5%
Taxpayer status including the assessability of income	2	2.5%
Interest deductibility including financing arrangements, capital raising and new products	2	2.5%
Remuneration arrangements and employee share plans	2	2.5%
Fringe benefits tax (FBT)	2	2.5%
Part IVA	2	2.5%
Research and development	2	2.5%
Share buybacks and portfolio transfers	1	1.5%
Debt forgiveness	1	1.5%
Totals	78	100%

Table 6: Main areas to which applications related

Question 1.6 was an open-ended question. Many respondents (approx 50%) identified up to three main areas to which their applications related. Table 6 is based on the main area as identified by the interviews based on frequency of applications. Some of these categories may well overlap to some extent (for example, capital raising, capital restructuring and share buybacks) and be further collapsed in subsequent testing. The accuracy of responses to this question was not verified against data provided by the IGT.

Question 1.7: Where the application(s) considered, withdrawn or did the ATO refuse to rule?

Treatment of application(s)	**Frequency**	**Percentage**
Always 'considered'	47	60%
Always 'withdrawn'	2	2.5%
Always 'refuse to rule'	2	2.5%
Mixed treatments (i.e. a combination of above)	27	35%
Total	78	100%

Table 7: Treatment of PBR applications

The accuracy of responses to this question was not verified against data provided by the IGT given that it was the interviewees' *perceptions* that were being studied rather than the accuracy of their responses.

Question 1.8: Where the application was considered, was (were) the outcome(s) favorable or unfavorable?

Outcomes of considered application(s)	**Frequency**	**Percentage**
Always favorable	48	61.5%
Always unfavorable	10	13%
Mixed outcomes (i.e. a combination of above)	14	18%
Awaiting decision or application ruled invalid	6	7.5%
Total	78	100%

Table 8: Outcomes of PBR applications

Again, the accuracy of responses to this question was not verified for the same reason as given at Question 1.7. Applications ruled invalid were regarded by the ATO as being in regard to a question of fact not law.

Question 1.9: Where application(s) was (were) withdrawn, what was (were) the main reason(s)?

Reasons for withdrawal of application	**Frequency**
Probable unfavorable outcome (usually based on discussions with ATO)	9
ATO appeared to be unwilling or unable to rule (sometimes accompanied by unreasonable delays or requests for information that could not reasonably be provided)	10
The question on which the application was based became obsolete (the transaction had changed or already been completed; or the relevant legislation had changed)	5
Total	24

Table 9: Reasons for withdrawal of applications

This was an open-ended question to which 24 of the 78 interviewees responded. That is, over 30% of the interviewees had had withdrawn at least one PBR application.

Question 1.10: Overall, did you experience unreasonable delay on the part of the ATO in dealing with your application(s) for a PBR?

Unreasonable delay experienced on the part of the ATO	**Frequency**	**Percentage**
Yes	33	42%
No	33	42%
Neutral	10	13%
Unsure	2	3%
Total	78	100%

Table 10: Unreasonable delay experienced

No attempt was made to quantify what was meant by an 'unreasonable delay' or to verify the accuracy of the responses. What was relevant here was the opinion of the interviewee. This will subsequently be studied to determine whether or not it is related to perceptions of revenue bias. Notwithstanding, based on their responses to this question, opinions were clearly divided.

Question 1.11: In your opinion, was (were) the application (s) in relation to a complex matter?

Complex matter	Frequency	Percentage
Yes	64	82%
No	5	6%
Neutral	9	12%
Total	78	100%

Table 11: Complexity of issue

Again, no attempt was made to quantify what was meant by 'complex' or to verify the accuracy of the responses. What was relevant here was the opinion of the interviewee. This will subsequently be studied to determine whether or not it is related to perceptions of revenue bias. Notwithstanding, based on their responses to this question, most interviewees (82%) regarded their application(s) to be in relation to a complex matter.

Question 2.1: Overall, were the reasons provided by the ATO for its decision(s) made clear to you?

Clarity of decision(s) made by the ATO	Frequency	Percentage
Clear	63	81%
Unclear	8	10%
Neutral	5	6.5%
Not applicable	2	2.5%
Total	78	100%

Table 12: Clarity of ATO decision(s)

The 'not applicable' responses were by interviewees who had only made application(s) for which a decision had not yet been made, and/or who had withdrawn their application(s) before a decision was made. This comment also applies to Table 13. Some interviewees added that the reasons were clear because they had at times been "cut and paste" from their own applications, or that they had provided the reasons to the ATO in the first instance.

Question 2.2: Overall, did you agree with the reasons provided by the ATO?

Agree with ATO reasoning	Frequency	Percentage
Yes	39	50%
No	23	30%
Neutral	13	17%
Unsure	1	1%
Not applicable	2	2%
Total	78	100%

Table 13: Agreement with ATO reasoning

Based on Tables 12 and 13, although the reasons for the ATO decisions in respect of the PBR applications were generally clear to the interviewees (81%), they did not always agree with them (with 30% being in disagreement). The frequencies of 'neutral' and 'unsure' responses

is expected given that 14 of the interviewees had experienced mixed outcomes (Table 8 refers) where they had made more than one PBR application.

Question 2.3: Overall, did you feel that the ATO kept you adequately advised regarding the progress of your application?

Kept advised by the ATO regarding progress	Frequency	Percentage
Yes	51	66%
No	15	19%
Neutral	12	15%
Total	78	100%

Table 14: Advice regarding progress of application

The majority of interviewees agreed that the ATO had kept them advised regarding the progress of application. Some qualified their responses in that that while they agreed that the ATO had kept them informed, they felt that they (or their client) had to be proactive in this regard.

Question 2.4: Overall, did you feel that the ATO fully considered the material you provided to support your application?

ATO fully considered supporting material	Frequency	Percentage
Yes	29	37%
No	49	63%
Total	78	100%

Table 15: ATO consideration of supporting material

The level of negative response here may be higher than expected and could be a contributing factor to any perception of bias.

Question 2.5: In any case, did you discuss the technical aspects of the matter with the ATO before applying for a PBR?

Technical discussion with ATO before applying for PBR	Frequency	Percentage
Yes	48	62%
No	30	38%
Total	78	100%

Table 16: Technical discussion with ATO beforehand

The percentage of applicants who had prior technical discussions with the ATO was high. This will subsequently be tested against a range of factors (including outcomes, applicant type and number of applications) to determine whether or not statistically significant relationships exist.

Question 2.6: Did you feel that the ATO ever requested further information from you that was immaterial?

Request by ATO for immaterial information	Frequency	Percentage
Yes	29	37%
No	49	63%
Total	78	100%

Table 17: Request by ATO for immaterial information

Question 2.7: How would you describe the timeliness of the ATO's PBR process?

ATO's PBR process is timely	Frequency	Percentage
Yes	38	49%
No	23	29%
Neutral	17	22%
Total	78	100%

Table 18: Timeliness of PBR process

Question 2.8: Are you aware of the ATO's Priority Ruling Process (PRP)?

Aware of Priority Ruling Process (PRP)	Frequency	Percentage
Yes	65	83%
No	13	17%
Total	78	100%

Table 19: Awareness of Priority Ruling Process

Awareness of the priority ruling process was relatively high. Only interviewees who were aware of the PRP were required to answer the next two questions.

Question 2.9: Do you believe that the timeliness in providing PBRs has improved as a result of the PRP?

Improved timeliness as a result of PRP	Frequency	Percentage
Yes	15	23%
No	12	19%
Neutral	8	12%
Unsure	30	46%
Total	65	100%

Table 20: Impact of PRP on timeliness

Many interviewees were unsure of any improved timeliness as a result of PRP as they had not yet used it.

Question 2.10: Would you use the PRP to resolve a large complex matter?

Use the PRP	Frequency	Percentage
Yes	52	80%
No	4	6%
Neutral	4	6%
Unsure	5	8%
Total	65	100%

Table 21: Use of PRP

The percentage of interviewees who would consider using the PRP (of those who were aware of its existence) was relatively high. Some interviewees who expressed dissatisfaction with PRP believed that its requirements (to go via the board of directors) were unwieldy in terms of timeliness.

Question 2.11: If an unfavorable ruling was received, would the potential adverse effects (i.e. penalties) of not following a PBR deter the taxpayer from the planned course of action?

Unfavorable PBR as a deterrent	Frequency	Percentage
Yes	64	82%
No	9	11%
Neutral	2	3%
Unsure	3	4%
Total	78	100%

Table 22: Deterrence effect of an unfavorable PBR

The majority of interviewees agreed that the potential adverse effect of an unfavorable PBR would deter the taxpayer from the planned course of action. Where interviewees disagreed, they generally commented that the taxpayer had already entered into the transaction before the ruling application was decided.

Question 2.12: Are you aware of changes to penalties for not following a PBR that resulted from the Review of Self Assessment (ROSA)?

Aware of changes to penalties	Frequency	Percentage
Yes	57	73%
No	17	22%
Neutral	1	1%
Unsure	3	4%
Total	78	100%

Table 23: Awareness of changes to penalties

Interviewees who were unaware of changes to penalties as a result of ROSA were not required to answer the next question.

Question 2.13: Have these changes influenced your view of the potential adverse effects (i.e. penalties) of not following a PBR?

ROSA changes influenced view	Frequency	Percentage
Yes	12	20%
No	36	59%
Neutral	10	16%
Unsure	3	5%
Total	61	100%

Table 24: Impact of ROSA changes

Question 2.14: Have you had a situation in which you considered applying for a PBR and decided against it?

Deciding not to apply for a PBR	Frequency	Percentage
Yes	64	82%
No	14	18%
Total	78	100%

Table 25: Not applying for a PBR

A high proportion of interviewees agreed that they had had situations where they had considered applying for a PBR but had not proceeded. In the following question they were asked the main reasons for this decision.

Question 2.15: What were the main reasons for not proceeding with a PBR application?

Main reasons for not applying for a PBR	Frequency	Percentage
Timeliness expected to be a problem (in that the issue was complex and it was felt that the ATO would delay its response)	19	30%
There was a risk of getting an unfavorable outcome (including a lack of confidence in the ATO making an unbiased decision)	24	37%
Felt that the ATO would refuse to rule	10	15%
Too costly	5	8%
Client changed instruction	3	5%
Unsure or decided a PBR was unnecessary	3	5%
Total	64	100%

Table 26: Main reasons for not proceeding with a PBR application

This was an open-ended question posed only to those 64 interviewees who had answered Question 2.14 in the affirmative. Their responses are summarised at Table 26. Specifically, comments included "Don't expect to get a balanced view or the correct interpretation – only apply where certainty is needed" and "Unless the matter is clear, there is little assistance from the process. It is tough to get a ruling through where there is some doubt". Many respondents expressed the view that a reasonably arguable position (RAP) was a preferable alternative to a PBR where absolute certainty was not required. In forming a RAP, interviewees indicated that they would at times obtain external advice, for example from senior counsel.

Question 2.16: Overall, were you satisfied with the service provided by the ATO in dealing with your PBR application(s)?

Satisfied overall	Frequency	Percentage
Yes	54	69%
No	19	24%
Neutral	5	7%
Total	78	100%

Table 27: Overall satisfaction

More than two thirds of the interviewees expressed overall satisfaction with the PBR process. Based on earlier questions in this section of the survey, areas where improvements in satisfaction could be made include the full consideration by the ATO of material provided, more proactive advising by the ATO on the progress of applications; and the use of more technical and objective reasoning used in deciding on PBR applications. That is, while the reasons for the decision were generally clear (81% at Table 12), the level of agreement with the reasoning was low (50% at Table 13) when the number of interviewees who had only ever had favorable outcomes (61.5% at Table 8) is considered. Interviewees questioned the technical capacity of ATO staff to correctly interpret the law, and then their objectivity in applying it. Experiences were mixed.

A further area where improvement in satisfaction may be achieved is in respect of timeliness. While 49% (at Table 18) agreed that the process was timely, 42% (at Table 10) felt that they had experienced unreasonable delay.

Question 3.1: By and large do you believe that the ATO makes the correct decisions in respect of PBRs on large complex matters?

Correct decisions overall	**Frequency**	**Percentage**
Strongly agree	5	6%
Agree	28	36%
Neutral	22	28%
Disagree	16	21%
Strongly disagree	4	5%
Unsure	3	4%
Total	78	100%

Table 28: Correct decisions overall by the ATO

The interviewees' responses to this question were mixed with a third remaining either neutral or unsure.

Question 3.2: Do you think that other taxpayers or tax advisors believe that the ATO generally makes the correct decisions in respect of PBRs on large complex matters?

Others believe ATO generally makes correct decisions on PBRs	**Frequency**	**Percentage**
Yes	19	24%
No	40	51%
Neutral	16	21%
Unsure	3	4%
Total	78	100%

Table 29: Others' perceptions of ATO's decisions

Taxpayers and tax advisors appear to believe that their peers are not very confident in the ATO's ability to make the correct decisions in respect of PBRs on large complex matters.

Question 3.3: In practice, in resolving ambiguities do you think the ATO relies more heavily on its understanding of policy intent or on its application of the law?

In resolving ambiguities, the ATO relies on	**Frequency**	**Percentage**
Application of law	19	24%
Understanding of policy intent	36	46%
Neutral	17	22%
Unsure	6	8%
Total	78	100%

Table 30: Resolution of ambiguities

Question 3.4: On which do believe the ATO should place greater reliance?

ATO should place greater reliance on	Frequency	Percentage
Application of law	39	50%
Understanding of policy intent	22	28%
Neutral	17	22%
Total	78	100%

Table 31: Greater reliance on law or policy intent

Interviewees questioned the ATO's interpretation of policy and felt that it did not always accord with their own and that at times it was 'flexible'. Applicants may have greater confidence in the ATO's technical processes and objectivity if PBR decisions on large complex matters relied more heavily on applying the law rather than interpreting policy intent.

Question 3.5: Should the ATO discuss the interpretation of the law with Treasury?

Discuss interpretation of law with Treasury	Frequency	Percentage
Yes	63	81%
No	12	15%
Neutral	2	2.5%
Unsure	1	1.5%
Total	78	100%

Table 32: Discuss law with Treasury

There was strong support for the notion of technical discussion between ATO and Treasury in respect of interpreting the law. Interviewees commented on the complexity of the law and the need to have greater certainty in its application. There were reservations in that some interviewees thought this practice would delay PBR applications.

Question 3.6: Should the ATO discuss the interpretation of policy intent with Treasury?

Discuss policy intent with Treasury	Frequency	Percentage
Yes	64	82%
No	11	14%
Neutral	1	1.5%
Unsure	2	2.5%
Total	78	100%

Table 33: Discuss policy intent with Treasury

There was strong support for the ATO to engage in discussion with Treasury on policy intent.

Question 3.7: Do you believe that discussions between the ATO and Treasury delayed the resolution of your PBR application?

Discussion with Treasury caused delay	Frequency	Percentage
Yes	13	17%
No	55	71%
Neutral	1	1%
Unsure	9	12%
Total	78	100%

Table 34: Delays caused by discussions with Treasury

The majority of interviewees did not believe that discussions with Treasury had delayed their PBR application. However, many interviewees were unaware whether or not such discussions had taken place.

Question 4.2: do you believe that the ATO has a revenue bias in resolving PBRs?

Prior to asking this question it was confirmed that interviewees understood what was meant by revenue bias in the context of this survey. Some of these understandings included "the greater the risk to revenue the less the chance for a favorable ruling"; "where the matter is finely balanced, the ATO tends to rule in favor of the revenue"; "the ATO will go for an interpretation that protects the revenue"; "the ATO is more concerned about the loss of revenue than the correct interpretation of the law" and that "the ATO errs on the side of caution in favor of the revenue when in grey areas".

ATO has a revenue bias	Frequency	Percentage
Yes	56	72%
No	16	21%
Neutral	5	6%
Unsure	1	1%
Total	78	100%

Table 35: Perception of revenue bias

The majority of interviewees did believe that the ATO had a revenue bias in resolving PBRs on large complex matters.

Question 4.3: Why do you believe this to be the case?

Reasons for perception of bias	Frequency	Percentage
Personal experience	58	74%
Expectation	20	26%
Total	78	100%

Table 36: Reasons for perception of bias

Question 4.3 was an open-ended question. The main reason given for their perception of bias (or non bias) generally fell into one of two categories: personal experience and expectation. In terms of personal experience, interviewees' comments were mixed. The focus on the revenue implications of a PBR drew considerable negative comment from interviewees (based on personal experience) as evidence of the existence of bias. For example:

- "*they specifically ask for information to identify amount of tax involved or risk to revenue-help them understand size of transaction";*
- *"part of discussions with ATO showed impact on revenue for our application"*; and
- *"where ATO does not like outcome will rule negatively. If unintended outcome and tax neutral, may convince ATO to rule otherwise will rule negatively because of outcome"*.

There was also comment on the manner and consistency in which the ATO interpreted the law. For example:

- *"in my experience, if the ATO can find an argument to deny, they will do so in finely balanced matters"*;
- *"anti avoidance provisions written wider than specific evil with fear of unknown in mind. Result is when ATO asked to rule, has subjective decisions to make"*;
- *"tax legislation written in vague general terms where Commissioner has a wide discretion"*;
- *"default position on three applications was anti avoidance provisions whilst one other was looked at it impartially. Expect impartial approach. No balance."*;
- *"reasonable attention to law where adverse ruling, ATO probably correct"*;
- *"in some cases adopt restrictive or literal interpretation of the law rather than giving effect to policy"*;
- *"will use policy to overrule the law";*
- *"in my experience in complex and grey areas, the ATO rules in favour of revenue"*;
- *"rather than support policy follow technical approach which supports revenue"*;
- *" ATO not prepared to think laterally"*;
- *"in my experience, if the ATO can find an argument to deny, they will do so in finely balanced matters"*;
- *time taken reflects could not bring themselves to say yes. The nature of the principles they sought to extract from the case were wrong"*; and
- *ATO tries hard to effect policy intent, appears to have a very balanced view".*

With regard to expectation, interviewees commented on the ATO culture of adopting the 'default position' and having an obligation to protect the revenue; many feeling that it was understandable and perhaps inevitable given the conflict of interest (i.e. having to both interpret and apply the law). The culture was seen as an adversarial culture - 'us' and 'them'. For example:

- *"ATO tries to find issues to rule against taxpayer"*;
- *"deal with some dishonest taxpayers and tar all with the same brush"*;
- *"difficult job trying to be objective. Not clear enough what their role is. Managing the Charter is about getting the right outcome. They are not able to deal with their mistakes or cases that have shades of grey or are on the margin"*;
- *"general ATO attitude is that if it's grey they have an obligation to protect the revenue. This influences the outcome"*;
- *"it's their role"*;
- *"there is a lack of leadership. Decision making is a collective (or team) process and taking the softest course (the negative) always wins out rather than taking a stand";*

- *"nature of the organisation - start from a position of assuming bias, may be unconscious"*; and
- *"ATO is a gatekeeper"*.

Question 4.4: Do you have any additional evidence to support your belief?

Again, this was an open-ended question with approximately half of the interviewees having further comments to add. Many drew on their own experience and the anecdotal experiences of others. The responses generally reaffirmed the results from the previous question. For example:

- *"ATO approach is taxpayer trying to get away with something-where only trying to clarify law"*;
- *"probably a cultural issue. ATO staff believe they are policemen of tax rather than umpires"*;
- *"seems where matter is unclear ATO officers default in favour of revenue so as not to be held accountable for a negative revenue outcome"*;
- *"ATO has pursued cases that it had no chance of winning and that were contra to policy"*;
- *"previous correspondence prejudicial"*;
- *"based on experiences during audit no reason to suppose PBR different"*;
- *"experience with smaller clients"*;
- *"case where ruling was eventually reversed by Pt IVA panel"*;
- *"case where favourable ruling given to detriment of revenue"*; and
- *"interpret policy different to announced intent"*.

Question 4.5: Do you think that other taxpayers and tax advisors believe that the ATO has a revenue bias in resolving PBRs?

Others perceive ATO has a revenue bias	**Frequency**	**Percentage**
Yes	69	88%
No	1	1.5%
Neutral	2	2.5%
Unsure	6	8%
Total	78	100%

Table 37: Perception of bias held by others

The responses to Question 4.5 indicate that the interviewees believed that the perception of revenue bias was widely held.

Question 4.6: Do you believe that any perception of revenue bias by the ATO needs to be addressed?

Only respondents who answered in the affirmative to either Questions 4.2 or 4.5 were asked this Question (i.e. n= 73).

Perception of bias needs to be addressed	**Frequency**	**Percentage**
Yes	64	88%
No	8	11%
Neutral	1	1%
Total	73	100%

Table 38: Need to address perception of revenue bias

Although interviewees felt some level of bias was to be almost inevitable given the role of the ATO (Question 4.3), there was strong support for the need to address the perception of revenue bias, which interviewees considered to be quite widely held.

Question 4.7: What measures do you think could be effective in reducing the perception of revenue bias on the part of the ATO?

Only respondents who answered in the affirmative to either Questions 4.2 or 4.5 were asked this question, and some respondents provided multiple suggestions (i.e. n= 73).

Suggested measures	**Frequency**	**Percentage**
Culture change on the part of the ATO (including greater objectivity and understanding of commercial realities faced by business)	16	22%
Greater independence in the making of rulings (including an independent body; an independent panel such as used for Part IVA; and/or a review panel with external representatives)	14	19%
Tangible signs of greater objectivity by the ATO (including more transparency; more technically-based decisions; more marginal decisions in favor of the taxpayer; omission of revenue implications in the PBR application)	11	15%
More dialogue between ATO and stakeholders (including industry groups; educating taxpayers) to build higher levels of mutual trust	10	14%
Unsure of appropriate measures	7	10%
Greater clarity in tax policy	5	7%
Access to the decision maker	3	4%
Separation of the ATO's conflicting roles of interpreting and administering the law	3	4%
More avenues for taxpayers to request internal review (or review by Treasury) of PBR decisions	2	3%
Publication of PBRs	1	1%
Better choice of cases to be litigated by ATO	1	1%
Total	73	100%

Table 39: Measures to reduce the perception of bias

Many of the measures suggested by respondents support the notion of the ATO needing to demonstrate greater objectivity in the resolution of PBRs in respect of large complex matters.

Question 4.8: Do you believe the ATO has adequate assurance measures and controls in place to minimise the potential for revenue bias?

Adequate controls in place	**Frequency**	**Percentage**
Yes	16	21%
No	36	46%
Neutral	7	9%
Unsure	19	24%
Total	78	100%

Table 40: Adequacy of existing ATO controls

The interviewees did not appear to be confident that the ATO has adequate assurance measures and controls in place to minimise the potential for bias. Some respondents indicated that they were not aware of any measures that are in place.

Question 4.9: Are there additional measures and controls that are needed to minimise the potential for revenue bias on the part of the ATO?

Additional measures	**Frequency**	**Percentage**
Unsure/unable to suggest additional measures	32	41%
Greater objectivity of PBR decisions (including external reviews - would need to be cost efficient - and the disassociation of PBR decisions from revenue KPIs)	9	12%
The use of internal ruling teams for more complex matters with a specialist appointed (including greater peer review; the use of a referee; and the use of a 'taxpayer advocate' to ensure the counter arguments are fully considered)	7	9%
A culture change to the mindset of revenue protection	7	9%
Changes to the internal decision making process including addressing the use of delay tactics	7	9%
Improved staff training to enhance technical expertise	4	5%
Wider policy discussion and debate (including with Treasury)	4	5%
Ability for ATO to escalate matter to an independent body	3	4%
Clearer communication and access to decision makers	2	2.5%
Applications not to disclose amount of revenue at issue	2	2.5%
Outcomes need to be made available to public	1	1%
Total	78	100%

Table 41: Additional assurance measures and controls

Interviewees could provide more than one response to this question. Table 41 is based on their primary response.

Question 5.1: Are there any further comments you would like to make?

Many of the interviewees had additional comments to make. They are reproduced at Attachment 3. It is noted that the interviewees reported mixed experiences. A small number were highly complementary of ATO staff particularly in helping applicants meet tight deadlines. However, there were many others who expressed great frustration in their dealings with the ATO on PBRs. Much of the frustration appeared to be related to two areas: firstly, the technical capacity of ATO staff to deal with complex matters; and secondly, the attitude of ATO staff to the applications and applicants. The importance of a good working relationship with the ATO was recognised. Many interviewees acknowledged that there had been improvement over time, but that there was still some way to go in terms of the ATO's technical capacity, timeliness and objectivity.

3.2 Statistical analysis

This section of the report includes a brief explanation of the testing undertaken followed by the presentation and discussion of the hypotheses tested based.

3.2.1 Explanation of analytical techniques

The basis of the quantitative analysis in this section is hypotheses testing: where it is sought to establish claims or conjecture on the basis of strong support from the survey data. Each claim to be established is called the alternate hypothesis or H_1. The opposite statement, one that nullifies the research hypothesis is called the null hypothesis or H_o. The decision to be made, on the basis of data analysis, is whether or not to reject the null hypothesis. The statistical tools considered appropriate to this research are the goodness of fit (chi-square) and the *p*-value measure of significance.

A goodness of fit test attempts to determine if a conspicuous discrepancy exists between the observed frequencies (presented in tabular form) from a random sample and those expected under a null hypothesis. The expected frequencies under the null hypothesis are calculated by specifying the probability of an event and multiplying this by the sample size. The discrepancy in each cell is measured by the squared difference between the observed and expected frequencies divided by the expected frequency. The sum of these discrepancies for all cells is given by the chi-square, or χ^2 statistic.

As a chi-square distribution is not symmetric about zero, the rejection region of the null hypothesis will lie in the upper-tail area. Where the computed χ^2 statistic is less than or equal to the critical value or cut off point, the null hypothesis (H_o) is accepted. Where the computed χ^2 is greater than the critical value, H_o is rejected and the alternative hypothesis H_1 accepted.

The number of degrees of freedom used (calculated as the product of (number of rows less 1) and (number of columns less 1)) will affect the chi-square probability distribution in that the greater the number of degrees of freedom, the greater will become the acceptance region of the null hypothesis.

It is important to recognise that the goodness of fit test is an approximation and that its validity is affected by sample size and distribution across cells (ideally the expected frequency of each needs to be at least 5). As a result, like categories of observations (such as unsure and neutral) have been combined in some of the testing in accordance with normal practices in this type of analysis.

The strength of acceptance is specified by nominating a fixed level of confidence, 0.05 or a 95% confidence level was used in all testing. The strength of rejection is determined by the *p*-value. A small *p*-value (approaching zero) indicates that the null hypothesis should be strongly rejected, or that the result is statistically significant.

3.2.2 Hypotheses testing

In total, 13 hypotheses were tested based on the survey data. The hypotheses were generally directed at establishing whether or not statistically significant relationships existed between the interviewees' personal perception of bias (with neutral and unsure responses combined as one category) and a range of other factors.

3.2.2.1 Was perception of bias related to the number of applications made?

The personal perception of bias held by interviewees was tested against the number of applications made for PBRs using a chi-square test with six degrees of freedom (based on a 3 x 4 table). The acceptance region of the null hypothesis was $\chi^2 \leq 12.59$. Since the computed value of χ^2 was 26.65 and the *p*-value was approaching zero (0.000168), the null hypothesis was strongly rejected. That is, at the 95% confidence level, a statistically significant relationship was evident between the interviewees' perception of bias and the number of applications that they had submitted. Interviewees who had made 5 or more applications reported lower levels of perceived revenue bias than did interviewees who made less than 5 applications. The direction of the relationship is not apparent from this type of testing. It could be that by making more applications that the perception of bias is reduced, or alternatively, it could be that the stronger the perception of revenue bias, the less likely one is to apply for a PBR. However, given the responses made by interviewees to the open-ended questions (such as 5.1 and 2.15) and to Question 2.14, it is concluded that the later explanation is the more likely to be correct. That is, interviewees did not apply for a PBR on large complex matters (unless necessary) *because* they perceived that the ATO had a revenue bias.

3.2.2.2 Was the perception of bias related to the interviewees' capacity?

The personal perception of bias held by interviewees was tested against the capacity in which they operated (internal or external adviser) using a chi-square test with two degrees of freedom (based on a 3 x 2 table). The acceptance region of the null hypothesis was $\chi^2 \leq 5.99$. Since the computed value of χ^2 was 0.382 and the *p*-value was high at 0.82, the null hypothesis was not rejected. That is, at the 95% confidence level, a statistically significant relationship was not evident between the interviewees' perception of bias and the capacity in which they made PBR applications.

3.2.2.3 Was the perception of bias related to industry type?

Industry type was collected only in the case of internal advisers. To improve the reliability of the chi-square test, industry types were broken into 'Finance and Insurance' and 'Non-Finance and Insurance', thus using a 3 x 2 table and 2 degrees of freedom. The acceptance region of the null hypothesis was $\chi^2 \leq 5.99$. Since the computed value of χ^2 was 1.984 and the *p*-value was 0.32, the null hypothesis was not rejected. That is, at the 95% confidence level, a statistically significant relationship was not evident between the perception of bias of the internal advisers interviewed and whether or not they worked in the 'Finance and Insurance' industry.

3.2.2.4 Was the perception of bias related to the treatment of the PBR application(s)?

The personal perception of bias held by interviewees was tested against the treatment of application(s) using a chi-square test with six degrees of freedom (based on a 3 x 4 table) with treatments being either 'always considered'; 'always withdrawn'; 'always refuse to rule'; or 'mixed'. The acceptance region of the null hypothesis was $\chi^2 \leq 12.59$. Since the computed value of χ^2 was 10.425 and the *p*-value was high at 0.99, the null hypothesis was not rejected. That is, at the 95% confidence level, a statistically significant relationship was not evident between the interviewees' perception of bias and the treatment of their PBR applications.

3.2.2.5 Was the perception of bias related to the outcome of the PBR application(s)?

The personal perception of bias held by interviewees was tested against the outcome of application(s) using a chi-square test with six degrees of freedom (based on a 3 x 4 table) with outcomes being either 'always favorable'; 'always unfavorable'; 'mixed'; or 'awaiting a decision or ruled invalid'. The acceptance region of the null hypothesis was $\chi^2 \leq 12.59$. Since the computed value of χ^2 was 1.36 and the *p*-value was high at 0.967, the null hypothesis was not rejected. That is, at the 95% confidence level, a statistically significant relationship was not evident between the interviewees' perception of bias and the outcomes of their PBR applications.

3.2.2.6 Was the perception of bias related to having experienced unreasonable delay?

The personal perception of bias held by interviewees was tested against their experience regarding the experience of unreasonable delay using a chi-square test with six degrees of freedom (based on a 3 x 4 table). The acceptance region of the null hypothesis was $\chi^2 \leq 12.59$. Since the computed value of χ^2 was 7.87 and the *p*-value was 0.303, the null hypothesis was not rejected. That is, at the 95% confidence level, a statistically significant relationship was not evident between the interviewees' perception of bias and their experience regarding unreasonable delays on the part of the ATO in dealing with their PBR applications.

3.2.2.7 Was the perception of revenue bias related to the matter being complex?

The personal perception held by interviewees of revenue bias by the ATO was tested against their opinion on the complexity of the subject matter using a chi-square test with four degrees of freedom (based on a 3 x 3 table). The acceptance region of the null hypothesis was $\chi^2 \leq 9.487$. Since the computed value of χ^2 was 0.23 and the *p*-value was high at 0.993, the null hypothesis was not rejected. That is, at the 95% confidence level, a statistically significant relationship was not evident between the interviewees' perception of bias and their opinion on the complexity of the subject matter.

3.2.2.8 Was the overall level of satisfaction related to the outcome of the PBR applications(s)?

The overall satisfaction (Question 2.16) of interviewees was tested against the outcomes of their PBR application(s)(Question 1.8) using a chi-square test with six degrees of freedom (based on a 3 x 4 table). The acceptance region of the null hypothesis was $\chi^2 \leq 12.59$. Since the computed value of χ^2 was 10.425 and the *p*-value was 0.107, the null hypothesis was not rejected. That is, at the 95% confidence level, a statistically significant relationship was not evident between the interviewees' overall level of satisfaction and the outcome of their PBR applications.

3.2.2.9 Were pre-application technical discussions with ATO related to the perception of bias?

The conduct of a pre-application technical discussion with the ATO (Question 2.5) was tested against the interviewees' personal perception of revenue bias (Question 4.2) using a chi-square test with two degrees of freedom (based on a 3 x 2 table). The acceptance region of the null hypothesis was $\chi^2 \leq 5.99$. Since the computed value of χ^2 was 0.579 and the *p*-value was high at 0.784, the null hypothesis was not rejected. That is, at the 95% confidence level, a statistically significant relationship was not evident between the interviewees' perception of revenue bias and whether or not they had had a technical discussion with the ATO prior to lodging a PBR application.

3.2.2.10 Was overall satisfaction related to perception of revenue bias?

The overall satisfaction (Question 2.16) of interviewees was tested against their perception of revenue bias by the ATO(Question 4.2) using a chi-square test with four degrees of freedom (based on a 3 x 3 table). The acceptance region of the null hypothesis was $\chi^2 \leq 9.487$. Since the computed value of χ^2 was 5.919 and the *p*-value was 0.205, the null hypothesis was not rejected. That is, at the 95% confidence level, a statistically significant relationship was not evident between the interviewees' overall level of satisfaction and their perception of revenue bias by the ATO.

3.2.2.11 Was personal perception of revenue bias related to the perceptions of others?

The personal perceptions regarding revenue bias held by interviewees (Question 4.2) was tested against what they perceived other taxpayers and tax advisors believed (Question 4.5) using a chi-square test with two degrees of freedom (based on a 3 x 2 table). The acceptance region of the null hypothesis was $\chi^2 \leq 5.99$. Since the computed value of χ^2 was 5.577 and the *p*-value was 0.061, the null hypothesis was not rejected. That is, at the 95% confidence level, a statistically significant relationship was not evident between the interviewees' personal perceptions of revenue bias and what they perceived others to believe.

3.2.2.12 Was the personal perception of revenue bias related to the subject matter of PBR applications?

The personal perceptions regarding revenue bias held by interviewees (Question 4.2) was tested against the most common subject matter of their PBR application(s) (Question 1.6) using a chi-square test with six degrees of freedom (based on a 3 x 4 table). Subject matters of applications were categorised as either 'corporate financing and related issues;; CGT; International issues' or 'Other". The acceptance region of the null hypothesis was $\chi^2 \leq 12.59$. Since the computed value of χ^2 was 8.06 and the *p*-value was 0.233, the null hypothesis was not rejected. That is, at the 95% confidence level, a statistically significant relationship was not evident between the interviewees' personal perceptions of revenue bias and the most common subject matter of their PBR applications.

3.2.2.13 Was personal perception of bias related to whether or not the PBR application was regarded by the ATO as precedential?

At the specific request of the IGT, the interviewees' personal perception of revenue bias (Question 4.2) was tested against whether or not there had been a PBR application that was regarded by the ATO as precedential (based on data provided by the ATO to the IGT). This was tested using a chi-square test with two degrees of freedom (based on a 3 x 2 table with precedential status being either 'yes' or 'no'). There were 16 interviewees who were positive in this respect, with the ruling requests of the remaining 62 interviewees being identified as non-precedential. The acceptance region of the null hypothesis was $\chi^2 \leq 5.99$. Since the computed value of χ^2 was 2.74 and the *p*-value was 0.25, the null hypothesis was not rejected. That is, at the 95% confidence level, a statistically significant relationship was not evident between the interviewees' personal perceptions of revenue bias and whether or not their application(s) were regarded by the ATO as precedential.

3.2.3 Discussion

With one exception, there were no statistically significant relationships apparent between the perception of revenue bias on the part of the ATO held by the interviewees, and a range of factors with which a relationship could be expected to exist. These included the capacity in which interviewees operated; the outcome of their applications; the industry in which internal advisers operated; the main subject matter to which applications related; the level of overall satisfaction; their perception of what others believed regarding revenue bias; whether not the resolution of their applications had been unreasonably delayed; or whether or not their applications were in relation to a complex matter.

The one exception to this general finding was that a statistically significant relationship was found to exist between the number of applications made and the interviewee's perception of bias. It is felt that the nature of this relationship is such that the perception of revenue bias acts as a general deterrent to the lodgement of applications for PBRs on large complex matters in the case of corporate taxpayers with an annual turnover in excess of $100 million. This conclusion is further supported by the general comments made by respondents, and by the finding that pre-technical discussions were not related to the perception of revenue bias. That is, it does not appear that increased contact with the ATO on these matters dispels the perception of revenue bias.

Further, the lack of statistically significant relationships is not unexpected given the high percentage of interviewees who themselves felt that revenue bias did exist and that the view was widely held.

It is noted that there are variations on what interviewees understood to be meant by 'revenue bias' based on their responses to Question 4.1 – that is, whether it occurs 'across the board' or at the 'edge'. The most common meaning interviewees gave was that the bias came into play at the 'edge'. That is, applications for PBRs that fell into grey or uncertain areas were more likely to be decided in favor of the revenue, and particularly where substantial loss of revenue would result. This interpretation is further supported by the responses to Question 5.1.

4 Conclusions

In this part of the report specific comment is made, based on the survey results, on each of the areas of interest identified by the IGT in part 1 of this report. The report then concludes with consideration of the strengths and weaknesses of the research and the ability to draw general conclusions from its findings.

4.1 Areas of specific interest as identified by the IGT

The role of the ATO in relation to PBRs involving uncertainty in the application of the law or underlying policy intent, including the ATO's interaction with Treasury

Almost half (46% at Table 30) of the interviewees felt that in resolving ambiguities, the ATO relied more heavily on its interpretation of policy intent than on applying the law. Half (50% at Table 31) of the interviewees felt that the ATO should place greater reliance on interpreting the law rather than policy intent. In both instances, 22% of interviewees were neutral in their opinion. There was strong support for the ATO to discuss both the interpretation of law (81% at Table 32) and policy intent (82% at Table 33) with Treasury. Some cautionary comments were made about the impact of such interaction on the timeliness of rulings.

The potential adverse effects of not following a PBR

The awareness of the potential adverse effects of not following a ruling was high (82% at Table 22) and the majority of interviewees (73% at Table 23) were aware of the changes to penalties as a result of ROSA. However, the ROSA changes had had limited effect as a deterrent with 59% of interviewees reporting that their opinion on the potential adverse effects of not following a PBR had not changed as a result (Table 24). It would appear that rather than having to address the potential adverse effects of not following a PBR, it was preferable to withdraw the request altogether (hence changes to the penalty regime were of no real consequence). Where interviewees reported that the potential adverse effects of an unfavorable PBR were not a deterrent, they typically qualified their response by stating that the transaction had already been undertaken – that is, the decision was driven by timing and commercial issues, rather than by penalty considerations.

The perceived cogency of reasons provided for ATO decisions in relation to PBRs

While interviewees generally agreed that the reasons given by the ATO for its decisions on PBR applications were clear (81% at Table 12), only 50% (at Table 13) agreed with the reasoning provided by the ATO. A statistically significant relationship was found between agreement with ATO reasoning and the outcome of the applications – that is, where a favorable outcome had resulted, interviewees generally agreed with the ATO reasoning. Conversely, interviewees generally disagreed with the ATO's reasoning where the outcome was unfavorable. Almost two thirds of interviewees (63% at Table 15) felt that the ATO had not fully considered the material that they had provided with their application and 37% (at Table 17) felt that they had had requests for immaterial information.

The transparency of the PBR process and technical issue resolution

Overall, 42% (Table 28) of interviewees felt that the ATO made the correct decisions in respect of PBRs on large complex matters. However, the majority (51% at Table 29) felt that others did not think that these decisions were correct. In terms of technical resolution the level of confidence expressed by interviewees could be described as marginal. Many interviewees commented (Questions 4.7, 4.9 and 5.1) that increased dialogue between applicants and ATO staff would be appreciated. In turn, this may result in increased transparency and greater confidence by interviewees in the objectivity and ability of ATO staff to apply the law. Another aspect of technical resolution that drew considerable comment in these same questions was the need to further develop the expertise of ATO staff and their understanding of commerce.

The adequacy of ATO assurance measures and controls that are aimed at minimising the potential for revenue bias

Based on their responses to Question 4.8, interviewees were generally not confident in the adequacy of the ATO's assurance measures and controls that are aimed at minimising the potential for bias. At Table 40 it can be seen that 46% of interviewees believed the assurance measures and controls to be inadequate with a further 33% being either 'neutral' or 'unsure' in their response to this question.

The timeliness in providing PBRs, in particular the effect that the ATO's Priority Ruling Process (PRP) has had on perceptions

Based on responses to Question 1.10 (Table 10), 42% of interviewees felt that their applications had experienced unreasonable delay. Responses to Question 1.10 were evenly balanced, as they were to Question 2.7 where interviewees were asked whether, overall, the timeliness of PBRs was acceptable (49% in agreement at Table 18).

Most (83% at Table 19) interviewees were aware of the PRP and of these, 23% (at Table 20) felt that it had improved the timeliness of rulings processing and 80% (at Table 21) indicated that they would use PRP. However, in Question 5.1 there were comments made about the resourcing impact of PRP on the timeliness of the resolution of other applications.

The basis for any perceived revenue bias in the ATO's treatment of their particular PBR application

The dominant factor on which interviewees based their perception of revenue bias was their personal experience (74% at Table 37), followed by an expectation (26%) of revenue bias by the ATO given its responsibility for revenue collection. These prior personal experiences included the unfavorable outcomes of applications made and the circumstances leading to the withdrawal of other applications. Further supporting evidence cited was the anecdotal experience of others. The interviewees widely (88% at Table 37) held the view that others perceived the ATO to have a revenue bias. There was also strong support (88% at Table 38 of those who perceived that bias existed) for the need to address the perception of revenue bias. This need is further evidenced in the responses to Question 5.1.

The potential measures that will resolve perceptions of bias

The potential measures suggested by the interviewees to resolve the perception of bias are at Table 39. They include:

- Culture change on the part of the ATO (including greater objectivity and understanding of commercial realities faced by business);
- Greater independence in the making of rulings (including an independent body; an independent panel such as used for Part IVA; and/or a review panel with external representatives);
- Tangible signs of greater objectivity by the ATO (including more transparency; more technically-based decisions; more marginal decisions in favor of the taxpayer; disclosure of revenue implications not being required in the PBR application)
- More dialogue between ATO and stakeholders (including industry groups; educating taxpayers) to build higher levels of mutual trust
- Greater clarity in tax policy
- Access to the decision maker
- Separation of the ATO's conflicting roles of interpreting and administering the law
- More avenues for taxpayers to request internal review (or review by Treasury) of PBR decisions
- Publication of PBRs
- Better choice of cases to be litigated by ATO

These measures are in order of frequency, not necessarily importance. Read in conjunction with the responses to Question 5.1, it appears that addressing the issue of improved communication between applicants and the ATO will be critical to the reduction in the perception of revenue bias. Interviewees need to be convinced that an acceptable level of objectivity exists on the part of the ATO – improved communication can assist to some extent, but visible changes to processes and outcomes are likely to be more influential.

4.2 Strengths and weaknesses

As is the case in all research, there are strengths and weaknesses in design, conduct and analysis that add to or detract from the overall confidence in the findings and need to be acknowledged. In this case, the strengths in design include the telephone survey to facilitate the collection of both quantitative and qualitative data; and the provision of a random sample of the relevant database by the IGT. Weaknesses in design included the short time frame for data collection; and the availability of limited resources at short notice which meant only a sample of the relevant population could be surveyed; and that the interpretation of questions may vary between parties (piloting of the survey can address this to some extent).

The strengths in conduct were that the survey was conducted in a short time frame and that a very high response rate resulted. The willingness of the interviewees to give up their time and to discuss their concerns was far greater than expected. Weaknesses in conduct include non response bias (though this is likely to be minimal given a response rate of 86.4%), and potential bias caused by having three interviewers. This was considered using a Kruskal Wallis Rank Test. At the 95% level of confidence, no significant differences (χ^2=2.874 with 2 degrees of freedom, p=0.238) were evident between the three groups thus if interviewer bias did exist, it was not significant. Unfortunately a number of those selected for interview had since left employment and could not be contacted. Similarly, it was unfortunate that resources precluded the follow up of those individuals whose contact details were overseas.

The strength in analysis is that both quantitative and qualitative data was available on which to base interpretations. The main weaknesses in analysis is that at times the chi-square tests are less reliable given the small number of observations in given cells. This was addressed as far as possible by combining responses as indicated to strengthen the reliability of the comparisons.

4.3 Generalising from the findings

Short of surveying the total population (which is rarely cost effective), a simple random sample is the preferred means of population sampling. All applicants had an equal and high chance (50%) of being selected which effectively halves the sampling error for the given sample size i.e. to between $\pm$ 2% to $\pm$5%. Given the sampling rate and the response rate, the statistical findings of this research can be generalised with a high degree of confidence to the total population of those who applied between 1 July 2003 and 30 June 2005 for a PBR on a large complex matter for a corporate taxpayer with an annual turnover in excess of $100 million. Similarly, given the patterns that emerged in the open-ended questions, it can be assumed with reasonable confidence that analytical generalisations made herein apply to the total relevant population.

Attachment 1: Survey instrument

Respondent code	
Interviewer code	
Date of interview	
Contact details correct?	Yes / No
Number of calls	
Time taken to conduct interview	Mins

REVIEW INTO POTENTIONAL REVENUE BIAS IN PRIVATE BINDING RULINGS (PBRs)

INSTRUCTIONS TO INTERVIEWER

IN CONDUCTING THE INTERVIEW:

1. Confirm that the person you are speaking to is the person as listed by the IGT.
2. Explain who you are and identify yourself as a staff member of Atax, UNSW. (Introduce other Atax staff if present and explain their role.)
3. Explain that on behalf of the IGT, you are conducting a survey of taxpayers and their tax advisors into the perception of revenue bias in private binding rulings involving large complex matters.
4. Confirm that the interviewee has received an explanatory letter from the IGT which includes contact details for the IGT, Atax and HE UNSW should there be any concerns about the survey. (If not received, take details and resend).
5. The interview is expected to take up to 30 minutes – confirm that the present time is suitable, or arrange a time more convenient to the interviewee.
6. Explain that participation is voluntary, confidential and that the interviewee can choose to terminate the interview at any time.
7. Confirm that responses by individuals will not be identifiable in any reporting to the IGT.
8. Briefly explain the structure of the survey to the interviewee.

IN COMPLETING THE FORM:

9. Record responses in the 'response' column.
10. The respondent code number (each page) must match database code.
11. Include all attempts to contact the respondent in the number of calls (page 1).

Part 1: Respondent's characteristics

Question		Response	
1.1	Did you apply to the ATO for a PBR between 1 July 2003 and 30 June 2005 for a corporate entity taxpayer with an annual turnover of > $100 million?	1. Yes 2. No (discontinue)	
1.2	How many applications were made by you that satisfied these conditions?	1. One only (go to 1.4) 2. > 1 but ≤ 5 3. > 5 but ≤ 10 4. > 10	
1.3	Were the applications in relation to the one matter?	1. Yes 2. No	
1.4	In what capacity were you acting?	1. Always as employee (incl. director) 2. Always as external advisor (go to 1.6) 3. Various	
1.5	In what industry did the corporate entity operate?		
1.6	Broadly speaking, what was (were) the main area(s) to which the application(s) related? (in order of decreasing frequency)	1. ……..…… 2. ……..……. 3. ……..……	
1.7	Was (were) the application(s) considered, withdrawn or did the ATO refuse to rule?	Result Considered Withdrawn Refuse to rule	Frequency
1.8	If considered, was (were) the decision(s) favorable or unfavorable?	Result Favorable Unfavorable	Frequency
1.9	If withdrawn, what was (were) the main reason(s)? (in order of decreasing importance)	1. ..... 2. ……..… 3. ..……	
1.10	Overall, did you experience unreasonable delay on the part of the ATO in dealing with your application(s) for a PBR?	1. Yes 2. No 3. Neutral 4. Unsure	

1.11	In your opinion, was (were) the application(s) in relation to a complex matter?	1. Yes 2. No 3. Neutral 4. Unsure

Part 2: Overall experience in dealing with the ATO regarding PBRs

Question		Response
2.1	Overall, were the reasons provided by the ATO for its decision(s) made clear to you?	1. Yes 2. No 3. Neutral 4. Unsure 5. Not applicable (go to 2.3)
2.2	Overall, did you agree with the reasons provided?	1. Yes 2. No 3. Neutral 4. Unsure
2.3	Overall, did you feel the ATO kept you adequately advised regarding the progress of your application(s)?	1. Yes 2. No 3. Neutral 4. Unsure
2.4	Overall, did you feel that the ATO fully considered the material you provided to support your application(s)?	1. Yes 2. No 3. Neutral 4. Unsure
2.5	In any case, did you discuss the technical aspects of the matter with the ATO before applying for a PBR?	1. Yes 2. No
2.6	Did you feel that the ATO ever requested further information from you that was immaterial to the application under consideration?	1. Yes 2. No
2.7	How would you describe the timeliness of the ATO's PBR process?	1. Acceptable 2. Unacceptable 3. Neutral 4. Unsure
2.8	Are you aware of the ATO's "Priority Ruling Process"?	1. Yes 2. No (go to 2.11)

2.9	Do you believe that the timeliness in providing PBRs has improved as a result of the ATO's "Priority Ruling Process"?	1. Yes 2. No 3. Neutral 4. Unsure
2.10	Would you use the Priority Ruling Process to resolve a large complex matter?	1. Yes 2. No 3. Neutral 4. Unsure

Question		Response
2.11	If an unfavorable ruling was received, would the potential adverse effects (i.e. penalties) of not following a PBR deter the taxpayer from the planned course of action?	1. Yes 2. No 3. Neutral 4. Unsure
2.12	Are you aware of the changes to penalties for not following a PBR that resulted from the Review of Self Assessment (ROSA)?	1. Yes 2. No (go to 2.14) 3. Neutral 4. Unsure
2.13	Have these changes influenced your view of the potential adverse effects (i.e. penalties) of not following a PBR?	1. Yes 2. No 3. Neutral 4. Unsure
2.14	Have you had a situation in which you considered applying for a PBR and decided against it?	1. Yes 2. No (go to 2.16)
2.15	What were the main reasons for this decision?	1. ……. 2. ……..……
2.16	Overall, were you satisfied with the service provided by the ATO in dealing with your PBR application(s)?	1. Yes 2. No 3. Neutral 4. Unsure

Part 3: Decision making by the ATO

Question		Response
3.1	By and large do you believe that the ATO makes the correct decisions in respect of PBRs on large complex matters?	1. Strongly agree 2. Agree 3. Neutral 4. Disagree 5. Strongly disagree 6. Unsure
3.2	Do you think that other taxpayers or tax advisors believe that the ATO generally makes the correct decisions in respect of PBRs on large complex matters?	1. Yes 2. No 3. Neutral 4. Unsure
3.3	In practice, in resolving ambiguities do you think the ATO relies more heavily on its understanding of policy intent or on the application of the law?	1. Application of law 2. Understanding of policy intent 3. Neutral 4. Unsure
3.4	On which do you believe the ATO should place greater reliance?	1. Application of law 2. Understanding of policy intent 3. Neutral 4. Unsure
3.5	Should the ATO discuss interpretation of the law with Treasury?	1. Yes 2. No 3. Neutral 4. Unsure
3.6	Should the ATO discuss the underlying policy intent with Treasury?	1. Yes 2. No 3. Neutral 4. Unsure
3.7	Do you believe that discussions between the ATO and Treasury delayed the resolution of your PBR application?	1. Yes 2. No 3. Neutral 4. Unsure

Part 4: Opinions on perception of revenue bias by the ATO

Question		Response
4.1	In relation to PBRs, what do you understand to be meant by the term "revenue bias"?	…… …….... ……
4.2	Do you believe that the ATO has a revenue bias in resolving PBRs?	1. Yes 2. No 3. Neutral 4. Unsure
4.3	Why do you believe this to be the case?	1. …….. 2. …….. 3. …….
4.4	Do you have any (additional) evidence to support your belief?	1. ……..…… 2. …….. 3. ……..
4.5	Do you think that other taxpayers and tax advisors believe that the ATO has a revenue bias in resolving PBRs?	1. Yes 2. No 3. Neutral 4. Unsure
4.6	(ONLY if answered "yes" to EITHER 4.2 OR 4.5) Do you believe that any perception of revenue bias by the ATO *needs* be addressed?	1. Yes 2. No 3. Neutral 4. Unsure
4.7	(ONLY if answered "yes" to EITHER 4.2 OR 4.5) What measures do you think could be effective in reducing the perception of revenue bias on the part of the ATO?	1. ……. 2. ……..…… 3. .……
4.8	Do you believe the ATO has adequate assurance measures and controls in place to minimise the potential for revenue bias?	1. Yes 2. No 3. Neutral 4. Unsure
4.9	Are there additional measures and controls that are needed to minimise the potential for revenue bias on the part of the ATO?	1. …….. 2. …..…….. 3. ……

Part 5: Other comments

5.1	Any other comments?	…… …… …… …… …… …… …… …… …… …… …… …… ……

THANK THE INTERVIEWEE FOR PARTICIPATING IN THE SURVEY

Attachment 2: Introductory letter

Australian Government
Inspector-General of Taxation

Telephone: (02) 8239 2111
Facsimile: (02) 8239 2100

Level 19, 50 Bridge Street
Sydney NSW 2000
GPO Box 551
Sydney NSW 2001

File: 2005/0055
[Date]

[representative of PBR applicant]
[mailing address]

Dear [identified individual]

Research into the perception of revenue bias in private binding rulings

The Minister for Revenue and Assistant Treasurer has asked me to review and report on whether there is a pro-revenue bias in Private Binding Rulings (PBR) issued by the Commissioner of Taxation. Based on consultations with private sector stakeholders, I have decided to broaden the scope of the review to include PBR applications which taxpayers withdrew and PBR applications on which the Tax Office refused to rule. This will enable me to review the potential for pro-revenue bias in the Tax Office's dealings with PBRs and to review the basis for perceptions of revenue bias in the PBR system.

To assist me to review any perception of revenue bias I have engaged a team of researchers at the Australian Tax Studies Program (Atax) at the University of New South Wales to report on the perceptions of taxpayers and tax advisors in respect of the processing of private binding rulings in large complex matters. The research is being conducted by Associate Professor Margaret McKerchar, Ms Helen Hodgson and Mr Kalmen Datt.

The research will be conducted across a random selection of taxpayers and tax advisors from the large business sector. You have been selected as a potential participant and you can expect to be contacted shortly by telephone by one of the researchers. I am hoping that you agree to participate in this research as the success of any review in improving the tax administration system depends directly upon the open, frank and representative views of affected taxpayers.
I understand that some involved in the large corporate sector would prefer to maintain confidentiality of their views from the Tax Office. With a view to hopefully understanding, and thus helping to overcome, the apparent difficulties which are

concerning some I want to give you my personal assurance that I will not, nor will any of my staff, disclose to the Commissioner or his officers any information which may be conveyed to me in the course of this research which may be specific to, or tend to identify, any company or tax official involved.

This confidentiality involves:

- As regards to information provided to the researchers, as part of the researcher's consultancy contract with me to undertake this research, the researchers are bound by the secrecy provisions of section 37 of the *Inspector-General of Taxation Act 2003* in the same way as the staff of my office.

- As regards to information provided to myself or my staff, the very purpose of this research is to receive information independently of and confidentially from the Tax Office.

Findings will be presented only in aggregate form and no individual responses will be identified or identifiable.

Participation is entirely voluntary. If you do participate, you will be asked a series of questions the duration of which should not take longer than 30 minutes. You can withdraw at any time and you may also decline to answer any one or more of the questions. However, you are strongly encouraged to take part. Your open and frank views are important to the findings of this research and the quality of recommendations directed towards beneficially changing the tax administration system.
Should you have any concerns about this research you can contact me direct. Please also note that the Statistical Clearing House has approved the survey (approval number 01778-01).

Yours sincerely

David Vos AM
Inspector-General of Taxation

Attachment 3: Transcript of responses to Question 5.1

Note: Responses herein are numbered for the purposes of discussion and are not presented in any particular order. The numbers do not refer to any codes used to identify the interviewees by the researchers.

1. The survey is a positive process and to be encouraged.
2. In my experience I do not feel staff in charge of rulings are adequately trained resulting in them referring to Centres of Excellence which cause long delays. Cases should be allocated to personnel that have experience in area. Officers require training and need allocation of matters to knowledgeable staff.
3. Hope priority system will be good-concern that it does not degenerate into extended periods. Few technical decision makers in rulings group-they try but are overwhelmed. Priority ruling does not resolve the need for more resources of senior staff. Seems always same people making the technical call. Bad experiences 5-10 years ago scarred regime. Staff require constant training - they have limited expertise in various fields.
4. Made PBRs less flexible and more costly and rigid. Tax office reluctant to put anything in PBR that is against legislation even though they accept it should not work on facts given.
5. Survey is positive step. ATO staff need training in objective decision making. Writing of rulings done at a relatively low level in ATO. Require external advisors in training programs. Bias experienced more in audit. Bias is not limited to PBRs. Collection of debt may also show signs of bias. Perception of bias can be removed by dealing objectively with issues.
6. Examples in public rulings should identify nuances and not just give clear examples.
7. For the most part the process is of a high quality. Decentralisation is a problem - different issues being reviewed by different officials causes delay and loss of perspective of whole matter. Bias occurs in minority of cases.
8. Trend in right direction.
9. Bias determined by individual corporate experience. Tend to hear the negative rather than positive.

10. Believe ruling process is good.
11. ATO is making efforts to deal with PBRs in a timely fashion. Greater transparency is needed for reasoning ATO adopts and openness of dialogue between ATO and Treasury.
12. Generally dealings are amicable. ATO has lack of understanding of fine principles of law. Lack of knowledge of large issues other than tax.
13. Progress being made. Majority of ATO officers doing right thing. About 25% of officers are letting everyone down.
14. This is an opportunity to try and realign relationship between ATO and taxpayers- to reduce compliance costs and to add certainty to process. Above adds certainty to overall tax system. With complex rulings ATO is structured into Centres of Excellence - unable to resolve matters easily.
15. Have refused to rule on prior applications -use delaying tactics. ATO perception was not to accept commercial reasons-believed it was tax based - could not give any explanation for this approach.
16. Rulings administered to facilitate policy making on the run. Current senior tax counsel good.
17. About to lose a lot of good people and newcomers not experienced. Individuals in ATO rule on basis of personal bias - no access to seniors to result in review.
18. Certain draft rulings or interpretative documents by ATO have a revenue bias.
19. Did not appoint specialists early enough in process.
20. ATO trying to bring resources to bear on rulings. Too much specialisation - Centres of Excellence deal with all issues. Centres have authority but no responsibility - there is a disconnect. In creating specialisation ATO has disempowered business lines. Some people as part of ruling process refuse to speak to taxpayers or their advisors - no chance for a dialogue. Dialogue essential. ATO bogged down in process rather than resolution of matter. Petroulias affair exacerbated issue.
21. ATO current proceedings bogged down in process-should be quick and easy and now long and involved. This is needed to prevent abuses in past. Rulings take too long. Bias exacerbated by slowness in process. Perception of bias merely a symptom of undue length of process.
22. Act more expeditiously.

23. Approach by ATO is mostly reasonable and getting better. There appear to be some resourcing issues, but ATO were upfront about timeframe. Think there may be more evidence of bias in product based rulings or class rulings than in PBRs.
24. ATO tends to start from a negative position. Staff appeared inexperienced and checklist focused, rather than giving the issue the technical analysis that was required.
25. Difficult to get to the right contact person in relation to specific issues, though do have good contacts in general. The ATO staff are good. Process works well, but could be quicker. Takes 6-8 weeks to get back to client, this is too long.
26. Bias created by showing details including name of applicant and revenue involved.
27. Concerned that ATO skill levels are generally not high. They build up one side of the argument, concentrating on arguments against the taxpayer and flippantly dismiss counter arguments. They become entrenched in their argument and can't break through. They disregard precedents (e.g. relying on an AAT finding and ignoring a High Court decision) and at times the PBR is in conflict with public rulings. The underlying thought processes need to be checked by an independent party and at a reasonable cost - rather than going to court. Objections and appeals are a joke - not an independent hearing. There is a bias towards the big end of town - the higher up the taxpayer the more likely they are to be heard by the ATO. The small end of town has no forum to get an 'unofficial' view of their issue - they have to commit it to paper.
28. Overall, a very positive experience with the ATO. The staff are professional and service orientated and have really improved their game. They have worked together with us when we've had very tight timeframes. But some decisions are too hard. The ATO needs to be more proactive in taking unintended consequences back to Treasury.
29. The law is complex and often not workable, but it is put into place anyway. There needs to be more effort made into creating certainty at the outset, not by a series of public rulings afterwards. They should take the time to get it right and give greater attention to the practical implications. More use could be made of industry bodies. Information needs to be circulated to the public more quickly. The problems get bigger as time goes on. They could shortlist some key areas that need immediate attention such as K6 and Div 149.

30. Experience has been very different for different applications. In one case (where there was no revenue differential) we were offered real assistance (such as which cases to rely on). In the other cases where there was revenue involved, there was immediate disbelief on the part of the ATO. Their approach was inconsistent.
31. PBR system is at risk when ruling on existing law. The ATO has a fairly rigid approach which they use to their own advantage. For example, not wanting to rule on existing law when they know it is about to change. This is churlish. The client needs to build a relationship with the ATO, understand their approach to tax risk profiling and corporate governance. Great variations in dealing with the TCN - some have a very strong revenue bias and others are excellent.
32. The writers of rulings have a vested interest to protect the revenue; therefore there is a conflict of interest. There needs to be an area of technical excellence. Have mixed feelings about the TCN, one or two are very good and are prepared to work within the ATO to convince their colleagues to give you an objective hearing. Having a case officer is helpful in other respects, but they are not able to help on complex technical matters.
33. Assisting taxpayers doesn't appear to be part of the brief. Skills need to be improved. They need more appropriate training to manage difficult issues. It is a tough culture and they have to wear bad decisions. 'Retail products' appears to be the area where the revenue bias lies. The role of the OPC is unclear.
34. Corporates need a level of confidence. In terms of governance, they try to do the right thing, but need more assistance. Sometimes you just need clarity and signoff, but the ATO opt out by refusing to rule on a question of fact.
35. ATO encourages taxpayers to apply for PBRs for resolving grey areas, but they are costly (external advice needed) and commercially not always possible.
36. The process is too long. This deters investment by sovereign entities. ATO efficient in some areas but not in others. There needs to be better communication by the ATO to taxpayers/advisors.
37. On large and complex matters, the ATO takes a position without any legal base. There is no justification other than to protect the revenue.
38. There is the perception - often unwarranted - that the ATO is very quick to take a revenue stance. We are asking for a more balanced approach in areas of greyness.

39. ATO staff have a poor understanding of the business environment and this is frustrating. Some questions asked are irrelevant. Taxpayers expect a higher level of professionalism. Face to face contact may be more helpful than phone or letters. There are cost benefit issues to consider in applying for a ruling.
40. Current system is not about certainty, which is a shame. There are risks in requesting a ruling. Taxpayers see cynicism and skepticism on the part of the ATO. They'd rather back themselves than request a ruling. Only ask for a ruling where there is a lot of money at stake and the taxpayer has options and will only proceed with certainty. ATO is too pedantic about the information it requests. Taxpayers are viewed with suspicion. The ATO tends not to be very practical, but very technical and focused on revenue collection.
41. Different levels of competencies within the ATO. Senior people won't step in and direct staff unless there is a crisis. It is a bureaucracy and it is easier to take the safest course. Unreasonable delays in getting an outcome are ridiculous, unbelievable and unprofessional. For the foreign client, it is a real deterrent to investment. Our system of government is a danger to the rule of law. It attacks certainty. Dealing with unintended consequences is a real problem.
42. Agent has to be proactive in getting advice from ATO. On finely balanced matters the concern is that the ATO will be biased so will take a RAP. Where absolute certainty is required on big dollar matters will get QC advice. ATO staff have a lack of commercial experience. There needs to be more objectivity on important matters.
43. Timeliness is a real issue. Requests are not finalised in 28 days, never less than 6 months and the measurement is manipulated for internal stats. There is a fundamental conflict of interest. There is information overload. The taxpayer requested a ruling on specific questions and issues, but the ATO cam back with more questions on unrelated issues. It was too broad and over the top, and trying to cover all cases. The focus needed to be on the issue itself and not all its permutations.
44. ATO has difficulty in interpreting policy. Governments need to keep it simple. The priority ruling process was a very positive experience in terms of the level of the people working on them and its co-ordination. But you shouldn't have to go to the priority level to get this level of service. There needs to be an independent board.
45. ATO needs to understand the concept of business and where they're coming from. The key client system works well and can help avoid applying for rulings. There needs to be more of them. Our ruling request was rushed by the ATO and it took the easy way out.

46. Outcome of ruling request was surprising, we knew others had had favorable outcomes. The advice from the ATO was to alter the question posed and relodge the application. This was disappointing and not constructive. There were also other implications including the cost of external advisors and the delay. We had already gone ahead with the transaction and are left with the lingering doubt.
47. It may be helpful if advisors could be included in the process of discussions between ATO and Treasury or if draft requests could be lodged. Dealing directly with the Centre of Excellence would also be helpful. Foreign investors are mesmerised by the process, the length of time, the evidence of bias, the delay for the sake of it, and the unfairness. It is a real deterrent. You expect some bias, but the extent of it and the other practices such as not ruling, not ruling in time, the inertia, are unacceptable to the extent that you just don't go for a ruling. Where there is a sizeable group involved, you are compelled to go for a class ruling, but the bias doesn't appear to be as great in these cases.
48. The practice is don't apply unless you are sure of the outcome. There are different schools of thought within the ATO on Part IVA and this makes it difficult to be consistent and to provide certainty for taxpayers.
49. On debt equity issues, reluctant to apply for a PBR especially if cross hybrid as the ATO refuse to rule or else delay. The Priority Ruling Process is too restrictive in terms of having to already consider the matter at board level - this takes time. Have used it for more bureaucratic issues.
50. Need to be proactive to get advice from ATO on progress of application. Don't apply for a ruling unless there is a third party and certainty is needed. There is always the possibility that the ATO will have a different view. Approach is to get it right, then go to the ATO to just get it finalised. The ATO is not impartial, it takes an advocacy position in its interpretation of the law. Where the law needs to be changed it needs to be done by the proper process, rather than by flexible interpretation. It is difficult to get to the person who makes the decision to engage in discussion and debate. Their own internal checks and balances stop this. A more direct and accessible relationship would be helpful.
51. Have noticed improvement over the last couple of years, but there does still need to be more collaborative relationships. The ATO and taxpayer don't meet in the middle, the ATO needs to be more willing to discuss and debate. Their technical expertise needs to be improved. The TCN is good, but below this there is a gap.
52. Client had to chase the ATO to get advice on progress. It's expected and acceptable for there to be bias at the edges, but the ATO needs to be fair.

53. Lack of training in the ATO and law is too complex.
54. Some good experiences & ATO commercial understanding improving; process is unwieldy & time consuming for both parties; concern regarding timeliness; some individuals in the ATO make it difficult.
55. The profession is the captive of the legislation and the ATO; there is an 'us and them' mentality; applications only lodged where favorable outcome expected - 90% applications are not lodged for this reason.
56. Helpful that enquiry underway; process needs to be fixed; need certainty for commercial reasons; recently PBRs from 10 years ago were overturned - negative experience.
57. Two approaches - be upfront and seek rulings or play hide and seek - tax risk management decision - can put off other party. Frustrating where settlement based on information at time later reviewed. ATO lacks capacity to work in real time; lacks authority, expertise, capacity; delay can result in commercial consequences. Have developed relationships & processes, will proceed on RAP if unfavorable ruling expected.
58. More open discussions with ATO; inexperienced front line officers dealing with enquiries; 28 days unrealistic; ATO only gave taxpayer 21 days.
59. PBRs overused by practitioners using ATO as research tool and stretching resources as a result.
60. Higher the level in the ATO the more policy bias exists; concern about middle management gap in ATO - brain drain leading to lack of commercial and technical knowledge.
61. Has had bad experience with an individual in ATO; levels of competence and commercial understanding vary; suspicious when they don't understand transaction.
62. Fear of decision making by individuals in ATO; Client sees timeliness issue as commercial impediment; advisors also biased where ambiguous; sometimes ATO clearly don't understand transaction - ask for details; PRP diverts resources from other rulings.
63. Priority rulings process should also apply to class rulings as they are significant market transactions & rely on tight commercial timelines.

64. 28 day deadline not realistic leads to request for information; relationship with Treasury & profession needs to improve; inherent tension between profession & ATO; ATO has improved - trying to meet commercial deadlines.
65. Most advisors have anti-revenue bias - is a balancing act; concern arises if don't engage in dialogue or explanations.
66. Specialist cells very helpful - should be more accessible prior to and during process.
67. Tends to be a troubleshooter in the firm - goes to the top in the ATO - handful of senior technical people who will cut through the issues. Three key issues - timeliness, seek irrelevant information, junior staff won't risk a decision. International clients can't believe the process.
68. ATO didn't understand the question asked. Applied precedent although case distinguishable on the facts. Didn't engage with applicant.

APPENDIX 3 — TAX OFFICE REPORTING, PERFORMANCE STANDARDS AND QUALITY ASSURANCE

A.3.1 The Tax Office sets itself performance standards for the delivery of PBRs. It assesses timeliness and quality. It also measures taxpayers' satisfaction with 'professionalism attributes'.

A.3.2 The timeliness performance standards reported in the Commissioner of Taxation's annual reports concern all applications for 'private written binding advice' made to the Tax Office. This includes applications from individuals and small businesses and other classes of binding advice that are not considered PBRs for the purposes of the ***Taxation Administration Act 1953***.

A.3.3 These reported timeframes are calculated from the time at which the Tax Office considers it has received all the necessary information. The benchmark is set for either a 28-day period or an extended period where negotiated with the PBR applicant. It is likely that in most large business PBR applications, if not almost all, the Tax Office would have negotiated longer timeframes. This is because the issues considered in these PBR applications would likely be more complex, requiring more time and resources in which to consider and resolve the issues. The figures in the annual reports aggregate all private binding advice requests, not just those from large businesses. Large business requests comprise an extremely small percentage of all private binding ruling requests.

A.3.4 The Tax Office's internal reporting further breaks up the performance of private written binding advice applications into three categories: 'routine', having a 28-day period; 'complex', having a negotiated completion date; and those having been finalised within 90 days of receiving all information.

A.3.5 The figures provided in the raw data columns (in the table on the following page) are calculated on the basis of elapsed time from the date the Tax Office received the application until the date it was finalised. The figures may include periods in which the Tax Office was waiting on further material from the applicant. These figures only relate to PBRs and do not include other classes of private written binding advice.

Table 2: Performance of Tax Office's timeliness in delivering private written binding advice during the 2003-04 and 2004-05 income years

			Income year	
			2003-04	2004-05
Annual report — all private written binding advice (a)	Finalised within 28 days or as otherwise agreed (as a %)	Benchmark	**80**	**83**
		Performance	**88**	**88.5**
Large business — internal report on private written binding advice (b)	Routine cases (finalised within 28 days) (as a %)	Benchmark		**83**
		Performance		**89.2**
	Complex cases (finalised as agreed) (as a %)	Benchmark		**83**
		Performance		**92.6**
	Finalised within 90 days (as a %)	Benchmark		**100**
		Performance		**56.9**
Large business — raw data on PBRs(c)	Finalised within time period (as a %)	28 days	**14.2**	**21.1**
		90 days	**49.4**	**58.1**
		9 months	**80.6**	**84.1**

(a) The Commissioner of Taxation Annual Reports 2003-04 and 2004-05, Table 1.1
(b) Tax Office, LB&I Provision of Advice internal reports, Section 2.1, June 05 YTD.
(c) Spreadsheet provided by the Tax Office to the Inspector-General listing all large business PBR applications received or considered during 2003-04 and 2004-05.

A.3.6 The following two tables are sourced from the raw data provided by the Tax Office. They break up the numbers of, and average periods for finalising, large business PBR applications received and considered during the 2003-04 and 2004-05 years by outcome and whether the Tax Office needed to create a precedential view.

Table 3: Number of large business PBR applications received or considered during 2003-04 and 2004-05 by outcome and type of Tax Office view needed

PBR outcome	Type of Tax Office view needed		Total
	non-precedential	precedential	
Refusal to rule	**52**	**4**	**56**
Invalid request	**17**	**0**	**17**
Favourable to applicant	**192**	**60**	**252**
Partially favourable	**21**	**8**	**29**
Unfavourable to applicant	**28**	**20**	**48**
Withdrawn	**87**	**20**	**107**
In progress	**49**	**11**	**60**
Total	**446**	**123**	**569**

Source: Tax Office

Table 4: Average period (in days) for finalising large business PBR applications received or considered during 2003-04 and 2004-05 by outcome and type of Tax Office view needed

PBR outcome	Type of Tax Office view needed		Total average (in days)
	non-precedential	precedential	
Refusal to rule	**221**	**180**	**218**
Invalid request	**140**		**140**
Favourable	**111**	**211**	**135**
Partially favourable	**283**	**184**	**256**
Unfavourable	**140**	**259**	**190**
Withdrawn	**207**	**282**	**221**
In progress	**116**	**204**	**185**
Total average (in days)	**158**	**227**	**174**

Source: Tax Office

A.3.7 The Tax Office assesses the quality of its PBRs against performance standards through its technical quality review (TQR) process. Business lines within the Tax Office randomly select finalised cases involving decisions of a technical nature (interpretive decisions) to be reviewed under this process. Cases may include PBRs, other classes of administratively binding advice, audit decisions, penalty decisions and settlement cases. The TQR process is conducted on a regular basis by a panel of tax officials (senior officers experienced in technical decision making) and a 'community representative' (generally a person with experience in tax matters at a large-firm partner level or a person occupying a senior position in an academic institution and specialising in tax administration) who review the files relating to the decisions. They assess those decisions in accordance with the Tax Office's 'judgment model' and assess the compliance with the relevant Tax Office practice statements. Cases are graded in accordance with the quality of the decisions.

A.3.8 The TQR panel reviewed a range of LB&I written interpretive decisions that were finalised during 2003-04 and 2004-05. The benchmark was 85 per cent receiving an 'A' grading and 95 per cent receiving a 'Pass' grading.

Table 5: Technical quality review panel's assessment of LB&I's written interpretive decisions finalised during 2003-04 and 2004-05 (in percentage)

Period in which decision made	Quality of decision (%)				Compliance with practice statements (%)
	'Pass'	'A'	'B', 'C', 'D' and 'E'	'Fail'	
Mar – Aug 2003	**98**	**81**	**19**	**0**	**100**
Sept 2003 – Feb 2004	**98**	**91**	**8**	**0**	**100**
Mar – Aug 2004	**95**	**85**	**10**	**5**	**96**
Sept 2004 – Jan 2005	**100**	**96**	**4**	**0**	**100**

Source: Tax Office

A.3.9 As a result of this process the TQR panel highlighted to the LB&I area as areas for improvement; file management and communication with taxpayers.

A.3.10 The Tax Office has also recently sought feedback from PBR rulees through its Client Feedback Questionnaires (CFQs). During 2006–07, it received 42 responses (131 CFQs were issued) relating to written binding advice averaging a 'satisfaction rating' of 80 per cent (an overall average of answers to questions rating the Tax Office as 'very high' or 'high' with respect to proposed professionalism attributes). Certain PBR applicants were not asked to complete a questionnaire. These included those that withdrew their application, where the Tax Office refused to rule or invalidated the request and where team leaders or quality assurance officers excluded particular cases. The report for these results noted areas that attracted positive and negative comments and commented that:

> The satisfaction rating for written binding advice products for 2006/07 was 80 per cent which is a slight increase compared to the 2005/06 result of 79 per cent. Seventy nine percent of advice cases achieved a satisfaction rating of 70 per cent or higher which is above the benchmark standard and within these results sixteen cases achieved a 100 per cent satisfaction rating. Overall, questions rated quite high, with the question relating to timeliness in finalising the advice showing an improvement compared to the previous year results.

CFQ results for advice products related to thirty six cases where the outcome was favourable and six cases related to an unfavourable or only partially favourable outcome. In relation to the unfavourable outcomes, it is important to note that three of these cases achieved the benchmark standard, with one achieving a satisfaction rating of one hundred percent.

On the whole, regular and open communication was a significant factor in achieving superior CFQ results and maintaining positive client relationships. The majority of client comments for advice products were very positive, particularly in relation to the accessibility and responsiveness of officers and the excellent service delivery. Specifically, the priority ruling system was highlighted as a very positive experience and the efficiency, professionalism and expertise of the teams was commended. The benefits of utilising Centres of Expertise was also noted, however there were comments made by both clients and case officers regarding internal process delays in this area.

APPENDIX 4 — PRIVATE RULINGS IN OTHER COUNTRIES

Private rulings in other countries

A.4.1 Many other countries' tax administrations offer private rulings to taxpayers. Of 46 tax administrations surveyed by the OECD, 36 provide binding private rulings to taxpayers. Submissions to this review highlighted two jurisdictions of note.

New Zealand

A.4.2 Taxpayers may apply to the Inland Revenue for a private binding ruling on proposed, current, and completed arrangements. The Inland Revenue must follow a binding ruling when assessing a taxpayer's tax liability where a binding ruling applies to a particular taxpayer.

A.4.3 A draft ruling must be included in the ruling application. The ruling applicant must set out fully any propositions of law that relate to the issues raised in the application, including the legal reasoning and appropriate case law (including possible contrary arguments) that support the interpretation of the legislative provisions adopted in the draft ruling. An application may be withdrawn in writing at any time, for any reason, before a ruling is issued.

A.4.4 Before the Inland Revenue issues a private ruling, it consults with the applicants. If it is in general agreement with the application, it will send the applicant a draft ruling for comment. If it does not agree, it will send the applicant a letter setting out its initial views and its reasoning and offering the opportunity for further arguments or submissions to be made. The Inland Revenue charges an hourly rate on a cost-recovery basis when considering an application.

A.4.5 Binding rulings are not disputable decisions that can be challenged through the dispute resolution process. This is because a taxpayer who disagrees with a ruling is not obliged to apply it.

A.4.6 The Adjudication and Rulings area of the Inland Revenue gives private binding rulings. The Inland Revenue maintains a strict structural separation between this area and its Policy Advice Division[40] (New Zealand's equivalent to Australia's Treasury in relation to tax policy matters) and compliance functions. There is, however, open communication between the three areas. The rulings area will obtain input from the compliance and policy areas. Rulings are also not delayed because of resolution of discussions with the policy advice area. When the timeframes for these rulings are compared with those for the Tax Office's large complex rulings, they are similar.

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40 Inland Revenue's Policy Advice Division works together with the Treasury to advise the New Zealand Government on all aspects of tax policy and social policy measures that interact with the tax system: Annual Report, 2004, p 20.

Table 6: Comparison between Tax Office and Inland Revenue of time taken to complete interpretive advice in the 2004 income year

	New Zealand	Australia (b)	
	Technical issues contained in applications for private and product binding rulings, accrual determinations and taxpayer-specific depreciation determinations and technical correspondence	All PBRs	PBRs requiring precedential Tax Office view
Total number of cases	**659**	**253**	**59**
% finalised within 30 days	**63 (a)**	**15**	**8**
% finalised within 60 days	**75 (a)**	**32**	**25**
% finalised within 90 days	**90 (a)**	**49**	**39**

(a) Note: Time taken to deliver draft private and product binding rulings and draft taxpayer-specific statutory determinations from the receipt of any additional information necessary and the applicant accepting the cost estimate: Annual Report 2004, pp. 98-99.
(b) Note: Times calculated from date of applications. 255 PBRs in total (ave time 204 days), 59 precedential (ave = 243 days), 3 mth = 128 cases (50 per cent), precedential 24 cases (40 per cent), 6mth = 180 cases (70 per cent), precedential 37 cases (62 per cent), 9 mth = 207 cases (81%), precedential 44 cases (75 per cent).

Table 7: Comparison between Tax Office and Inland Revenue of time taken to complete interpretive advice in the 2005 income year

	New Zealand (a)	Australia (b) (c)	
	Technical issues contained in applications for private and product binding rulings, accrual determinations and taxpayer-specific depreciation determinations and technical correspondence	All PBRs	PBRs requiring precedential Tax Office view
Total number of cases	**491**	**270**	**64**
% finalised within 30 days	**61 (a)**	**23**	**5**
% finalised within 60 days	**84 (a)**	**43**	**19**
% finalised within 90 days	**100 (a)**	**58**	**38**

(a) Note: Time taken to deliver draft private and product binding rulings and draft taxpayer-specific statutory determinations from the receipt of any additional information necessary and the applicant accepting the cost estimate: Annual Report 2005, p 74.
(b) Note: Times calculated from date of receiving applications until date of finalisation.
(c) Note: Figures do not include 36 cases outstanding as at 30 June 2005 (average = 112 days; 2 cases over a year old), including 9 cases requiring a precedential Tax Office view (average = 233 days, 2 cases over a year old).

A.4.7 The New Zealand system of tax policy development involves an open consultative process on legislative change. The policy advice to the New Zealand Government on proposed tax laws is publicly available. This is undertaken under the Generic Tax Policy Process.

> The Generic Tax Policy Process is a significant improvement in the process of policy development and tax reform. Major tax initiatives are now subject to much greater public scrutiny at all stages of their development. As a result, we now have the opportunity to develop more practical options for reform by drawing on information provided by the private sector and the people who will be affected. The process also gives us greater opportunity to explain to interested parties the rationale underlying proposed reforms, thus improving their long-term sustainability.[41]

A.4.8 Tax bills may be scrutinised by New Zealand's Parliamentary Committees. The Inland Revenue will respond to all submissions made to Parliamentary

41 Inland Revenue, 'The policy development process', available at www.taxpolicy.ird.govt.nz; see also, Inland Revenue, Briefing for the Incoming Minister of Revenue — 2005, pp 13-14.

Committees' inquiries of tax bills through an 'official's report'. That report will disclose the policy advice given to Government on issues raised in submissions. It also provides greater clarity around the Government's reasons for specific proposed legislative provisions.[42]

A.4.9 The Inland Revenue also advises the Government of the potential revenue implications separately from the rulings process.

A.4.10 According to the peak tax professional organisation in New Zealand, the Inland Revenue provides fair and impartial rulings 'without fear or favour'.

Sweden

A.4.11 In Sweden private binding rulings are given by a tax law commission (the Council for Advance Tax Rulings) independent of the revenue collection agency (the National Tax Board). As a result of criticisms that the revenue collector was not objective and independent, from 1991 rulings have been issued by the Council. The Council acts as a national tax court and is part of the Swedish court system. It comprises around 25 members and deputies who are all Government appointees.

A.4.12 Taxpayers and the National Tax Board can request an advance tax ruling. Rulings can be generally sought on almost all tax matters, but only on questions of law. The Council does not rule on questions of fact or provide tax planning advice. The National Tax Board can use the advance rulings system to develop legal precedents on tax matters.

A.4.13 The applicant must pay the fees for the ruling. Costs, however, can be reduced if the ruling involves questions of great public importance. There are no costs for rulings on indirect taxation.

A.4.14 The application process is adversarial in nature. The National Tax Board and taxpayers act as counterparties. Proceedings are normally conducted in writing, but there is provision for oral evidence. Comments on each party's statements are obtained. The average ruling takes 6 to 8 months.

A.4.15 Rulings may be appealed to the Supreme Administrative Court (the highest Court with jurisdiction to hear tax cases). However, there is no right of appeal if the application is dismissed. There is no formal publication of rulings.

A.4.16 The Council's rulings are binding only when the taxpayer chooses to apply the ruling.

A.4.17 The Council has an outstanding reputation for the quality of its decisions.[43] However, it has been criticised for the time taken.

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42 See for example, 'Officials' Report to the Finance and Expenditure Committee on Submissions on the Taxation (Annual Rates, Savings Investment, and Miscellaneous Provisions) Bill', available at www.taxpolicy.ird.govt.nz.

43 Fransberg, E, ***The Swedish advance ruling regime,*** Wintercourse 2002, Stockholm School of Economics, p 23.

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APPENDIX 6 — TAX OFFICE FINAL SUBMISSION

Australian Government
Australian Taxation Office

SECOND COMMISSIONER OF TAXATION

Mr Rick Matthews
Acting Inspector-General of Taxation
Level 19, 50 Bridge Street
Sydney NSW 2001

Dear Rick

I refer to the Inspector-General's letter of 25 October 2007, your final draft report and subsequent discussions on the potential revenue bias in private binding rulings (PBRs) involving large complex matters.

We welcome your finding that there was no evidence of actual revenue bias in PBRs. We acknowledge your finding that there are perceptions of revenue bias and appreciate your comments and recommendations to help us address these perceptions.

However, I would like to make some comments about some other aspects of the report.

Revenue bias findings

While we welcome the core finding that there is no evidence of 'undue' revenue bias in PBRs and accept that our dual role as collector and administrator can lead to perceptions of revenue bias, we do not agree that there is an inherent bias in the PBR system.

Strained interpretation and overly legalistic approach

We welcome the Inspector-General's comments that 'the Tax Office genuinely strives to provide an interpretation which supports the 'policy intent' of the law, as it understands it'. And that '(T)his approach is consistent with the purposive approach to statutory interpretation and is not, of itself, a revenue bias'.

However, we note that some taxpayers have said that they thought that the Tax Office sometimes adopted an 'overly legalistic' or strained interpretation of the law and that the motivation for such an approach was perceived to be a pro-revenue bias. We accept that these perceptions exist and that we have to improve transparency to remove these perceptions. We have agreed to the Inspector-General's recommendation No. 3 as a step towards making those improvements.

Withdrawing applications, refusals to rule and delays

We also note that at various points the report states that tax officers ask applicants to withdraw PBR applications.

There may be a variety of reasons where it may be appropriate for an applicant to withdraw an application. Where, for example the issue to be decided is the subject of a pending court

decision in respect of another taxpayer it can save the taxpayer the costs of an objection or an appeal if the taxpayer withdraws the application and waits the court decision. We agree that we should not ask taxpayers to withdraw applications, but we do need to ensure that they are aware of the options that are available in certain circumstances and the consequences that flow from each of those options.

At paragraph 5.32 the ***Indooroopilly*** matter is used as an example that shows how the Tax Office might adjust 'ruling dates' to negate objection rights. We strongly reject this assertion. There is no evidence which suggests that we have done this in ***Indooroopilly***, let alone as a matter of practice.

Need for greater understanding and transparency

Since 2003-04 and 2004-05 (the focus years of the Report), the Tax Office has continued to work on our capacity to respond to PBR requests quickly, including looking at ways to work with large market taxpayers and their advisers to improve timeframes further. Your report acknowledges that we have already made substantial improvements to increase transparency and reduce timeframes for PBRs involving large complex matters, including the introduction of the priority PBR process.

These improvements include increased transparency in the way we communicate progress of PBR applications with taxpayers. Other improvements include better monitoring of aged cases and consequently a better understanding of why cases are delayed. We do accept, however, that there is still room for improvement.

However, there will be circumstances where we are unable to be completely transparent. We agreed in part to recommendations 1 and 2, not because we disagree with the principles on which they are based, but because there will be circumstances in which we are unable to inform taxpayers of the nature or outcomes of discussions with Treasury. Our view is that dialogue with Treasury is confidential and cannot be disclosed to a PBR applicant. We will continue to explore with Treasury if there is any scope for movement on our position in the context of revising the protocol between the two agencies.

The revised Tax Office / Treasury protocol will also clarify the separate roles of each agency on matters of interpretation described in paragraphs 2.16 to 2.23. The revised protocol will be published when it is completed.

The report notes some cases where advice given to Treasury by the Tax Office did not fully comply with our own standards for such advice (see paragraph 5.48). We believe these cases occurred before a recent revision of our practice statement on procedures for giving formal advice to Treasury and the development of a standard template which ensures relevant issues are dealt with in the advice. The revised practice statement was issued in July this year and must be followed by all Tax Office staff.

Recommendations

The Tax Office responses to the Report's specific recommendations are at Attachment 1.

Thank you for the opportunity to provide this response to your report.

Yours sincerely

Bruce Quigley
Second Commissioner Law
1 February 2008

Attachment 1

TAX OFFICE'S RESPONSE TO RECOMMENDATIONS

IGT recommendation	ATO Response
1. *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.*	Agree in part. 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.
2. *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.*	Agree in part. 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.
3. *Where an understanding of purpose is a factor in the decision in large business unfavourable PBRs, including a statement of the underlying purpose of the legislative provisions on which the interpretation is based and the source for that purpose (for example, how the legally permissible extrinsic materials have been relied upon to ascertain that purpose and in concluding its view).*	Agree.
4 *More widely adopting the key principles of the Priority PBR process in relation to large business PBRs:* • *Centralised point of reference (process owner) responsible for marshalling resources and taking remedial action to ensure cases are not delayed* • *Alignment of taxpayer and Tax Office priorities* • *Front end engagement of all expertise to avoid sequential processing* • *Taxpayers and Tax Office working together to clarify the ruling.*	Agree.

IGT recommendation	ATO Response
5. *Increasing transparency, improving communication and more clearly demonstrating objectivity in relation to PBR technical decision making by:* • *before an adverse decision is made, communicating to the applicant the basis for the likely Tax Office view (including external opinions where relevant), an explanation of why the Tax Office's view is to be preferred over the applicant's, indicating the relevance of information provided by the applicant and providing the applicant an adequate opportunity to comment;* • *vetting requests for additional information and (if requested) providing reasons why the information is relevant and identifying the specific aspect of the technical issue that turns on the requested information;* • *if requested by the applicant, providing applicants with written reasons for delay if the PBR has not issued after 3 months, including contact details for the relevant LB&I segment leader, CoE Manager and Deputy Chief Tax Counsel;* • *where necessary, engaging recognised independent external subject specialists to supplement Tax Office capability to respond to large, complex PBRs; and* • *where requested by the PBR applicant, ensuring that the Case Manager provides the applicant with a free and quick flow of direct contact with those technical decision makers (whether in TCN, CoE or LB&I) that determined, or are determining, the technical issues relating to the application.*	Agree. However there may be circumstances where it may not be appropriate to provide applicants with copies of external opinions (e.g. where the Tax Office is claiming Legal Professional Privilege).
6. *Ensuring that tax officials involved in interpretive matters are aware of the accepted principles of the purposive approach to statutory interpretation (including the accepted materials to ascertain that purpose) and that they should not rely on advice of what policy developers or legislative drafters intended.*	Agree.
7. *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:* • *that PBRs should not be delayed because the technical issues relating to those PBRs are the subject of discussions with Treasury;* • *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.*	Agree in part. 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. 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.

IGT recommendation	ATO 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, that was reviewed and reissued in 2007. We will ensure conformance with this process.
9. *Issuing PBRs irrespective of whether the matter involves consideration of a technical issue that is the subject of a developing or contemplated public ruling.*	Agree.
10. *Reporting achievements against performance standards and elapsed time frames of PBRs in Tax Office annual reports.*	Agree in part. While we do report achievements against performance standards, the question of elapsed time is not so clear. A Private Binding Ruling requires a joint effort by the Tax Office and the taxpayer. Accordingly, the elapsed time from the date of application to the date of issue of the ruling is not a good measure of the Tax Office's performance as some delays can be caused by the taxpayer. Where we adopt the principles of the Priority PBR process we engage with the taxpayer when the arrangement is being developed. Much of the work in these cases is done before the ruling is lodged and the time elapsed from the date of lodgement is largely an irrelevant measure.