



Australian Government
Inspector-General of Taxation

Report into the Australian Taxation Office's large business risk review and audit policies, procedures and practices

Report to the Assistant Treasurer

Inspector-General of Taxation

May 2011

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3 May, 2011

The Hon Bill Shorten MP
Assistant Treasurer and Minister for Financial Services & Superannuation
Parliament House
Canberra ACT 2600

Dear Minister

I am pleased to present you with my report of the review into the Australian Taxation Office's (ATO's) large business risk review and audit policies, procedures and practices.

The review received many submissions from large business stakeholders. The main concern for stakeholders was the efficiency and effectiveness of the ATO's management of risk review and audit processes. Significant compliance costs and unnecessary disputes arise where this is not achieved. I have sought to foster greater understanding and cooperation between large business and the ATO in the conduct of this review by convening a consultation forum involving ATO management and external stakeholders.

The recommendations in my report are an integrated package that seek to improve the large business risk review and audit processes through greater transparency, accountability and improved stakeholder understanding.

The report has twenty eight recommendations – the ATO has agreed fully to twenty-two, two in principle, one in part and disagreed with three. If implemented appropriately these are expected to significantly improve tax administration in this market segment.

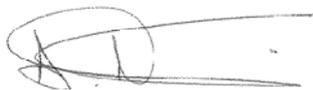
Whilst the ATO has provided reasoning for disagreeing with some of my recommendations, I remain concerned particularly where I have sought to introduce benchmarks and milestones in the audit process to assist the ATO to achieve its goal of completing audits within its set timeframes whilst affording taxpayers due process.

I have also made certain observations about future ATO practice. It may be necessary for the Government to consider legislative action if concerns continue to arise after the agreed recommendations have been implemented and sufficient time has elapsed.

The large market is a very important segment within the tax system providing significant revenue to Government for the benefit of all Australians. The vast majority of tax is collected through voluntary compliance. Large business stakeholders are concerned to ensure that the ATO risk review and audit responses are appropriately measured in delivery and take account of the significant cooperation they provide toward the system, in what is a very complex self-assessment environment.

I offer my thanks for the support and contribution of large business taxpayers, professional bodies, industry associations, taxation advisers and individuals to this review along with the consultative forum. The willingness of many to provide their time in preparing submissions and discussing issues with myself and my staff is greatly appreciated. I also thank the relevant ATO officers for their professional cooperation and assistance in this review.

Yours faithfully

A handwritten signature in black ink, appearing to be 'Ali Noroozi', written over a horizontal line.

Ali Noroozi
Inspector-General of Taxation

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EXECUTIVE SUMMARY

The Inspector-General of Taxation's (IGT's) review into the Australian Taxation Office's (ATO's) large business risk review and audit policies, procedures and practices was prompted by concerns raised by large business taxpayers and their advisers in relation to the ATO's efficiency and effectiveness in managing these risk reviews and audits.

A particular concern raised by large business stakeholders in developing the terms of reference for this review was risk review and audit timeframes. The original ATO policy announcement that it aspired to resolve risk reviews within six months and large business audits within two years was welcomed by many stakeholders including the IGT. The concern was the manner in which the ATO had been managing the fulfilment of this goal.

The IGT received a large number of submissions from stakeholders in the conduct of the review. The key underlying theme was the significant unnecessary compliance costs and disputes as well as the lack of due process arising from the ATO's self-imposed timeframes for completing risk reviews and audits.

To enhance the review process, the IGT convened a consultation forum consisting of large business representatives and ATO management to provide for direct and candid exchange of issues and concerns.

In completing the review, the IGT has formulated a range of recommendations directed at improving the ATO's compliance approaches, risk hypothesis identification, project management and accountability, information gathering approaches, audit and risk review processes, position paper processes and interest and penalties treatments. A separate chapter is devoted to each of these areas with IGT recommendations included. All recommendations also appear in Chapter 3 for ease of reference.

The ATO has undertaken a range of initiatives both during this review and in the adoption of IGT recommendations which seek to address concerns raised by stakeholders. The ATO has launched a number of initiatives in recent years to improve risk review and audit procedures including an updated Large Business and Tax Compliance booklet, an internal LB&I Compliance Manual, Annual Compliance Arrangements, Lead Relationship Managers and Client Feedback Questionnaires.

The IGT is pleased to see that the ATO has acknowledged that there is always room for improvement, in its formal response to this IGT report. The IGT believes that acknowledgement of problems and the need for improvements is an important guard against hubris or group think.

The IGT in setting certain recommendations in this report sought to provide a framework where individual recommendations link or integrate with other related recommendations. The purpose in doing so was to ensure the ATO management process is transparent, accountable, considered and understood by all stakeholders. As the ATO has not agreed to certain recommendations the full benefit of the integrated outcome intended may not be realised.

Whilst the ATO has provided reasoning for disagreeing with some of my recommendations, I remain concerned particularly where I have sought to introduce benchmarks and milestones in the

audit process to assist the ATO in achieving its goal of completing audits within its set timeframes whilst affording taxpayers due process.

The ATO in this review and in other contexts has drawn certain conclusions about the comfort and direction it receives from its Client Feedback Questionnaire (CFQ) responses. As noted in this report, the IGT has not had an opportunity to review this CFQ process. The IGT considers that this is an area that is ripening for review, given the stakeholder feedback that the IGT receives often differs from the CFQ results and the implications that CFQ results have for ATO management direction.

The IGT also made certain observations about the future practice and policy. Where the IGT report recommendations are appropriately adopted by the ATO, the tax administration is expected to be enhanced. Once the ATO has implemented the agreed recommendations and sufficient time has elapsed, if significant concerns continue to arise, it may be necessary to investigate policy and legislative options.

CHAPTER 1: INTRODUCTION

1.1 The Inspector-General of Taxation's (IGT's) review into the Australian Taxation Office's (ATO's) large business audit and risk review policies, procedures and practices ('the Review') was undertaken pursuant to section 8(1) and reported under section 10 of the *Inspector-General of Taxation Act 2003* (IGT Act). In accordance with section 25 of the IGT Act the Commissioner of Taxation was provided with an opportunity to give submissions on any implied or actual criticisms contained in this report.

1.2 The IGT announced the Terms of Reference and Submission Guidelines for the Review on 17 November 2009.

1.3 The Review arose from the concerns raised with IGT when consulting with stakeholders on the IGT's forward work program. Various large business and tax practitioner groups suggested that although audits and risk reviews are generally being finalised within the ATO's specified timeframes, the way they were being handled was not achieving the aim of resolving issues and disputes as early as possible.

1.4 The large business community are particularly concerned about how the ATO interacts and engages with them as taxpayers and believe that the ATO is not resolving audits and risk reviews in the most efficient and effective manner.

1.5 Submissions from stakeholders also raised a broader range of concerns. The 'Report Structure' section that follows provides a list of the main chapters and the issues that were addressed.

1.6 All these aspects have the potential to cause unnecessary disputes and increased compliance costs. The report canvasses issues raised by taxpayers and tax practitioners as well as ATO responses along with IGT observations and recommendations designed to improve the administration of the tax system in this area of review.

1.7 The IGT also established a working group made up of key stakeholder representatives. The group participants were: Gary Christie, Deloitte; John Condon, BP Australia; Frank Drenth, Corporate Tax Association; David Drummond, KPMG; Chris Millett, Commonwealth Bank; Judy Sullivan, Mallesons; Chris Vanderkley, GE; and Glenn Williams, Ernst & Young.

1.8 We greatly appreciate the generosity of the members of this working group in freely giving their time and expertise. Their involvement has greatly enhanced the outcomes of the Review.

1.9 The working group met several times to discuss issues and concerns and to consider potential solutions in the Review. It should be noted, however, that the observations and recommendations expressed by the IGT in this report are not

necessarily those of individual members of the working group. The IGT also worked progressively with ATO senior management to distil the scope for improvement and to agree on specific actions.

1.10 The IGT would like to take this opportunity to thank all the stakeholders for their submissions, insights and support. The Review was one that was characterised by balanced thinking on the issues by all parties and the recommendations made should lead to better outcomes for both the tax administration and taxpayers alike where implemented effectively.

IGT OBSERVATIONS — FUTURE PRACTICE AND POLICY

1.11 The relationship between large business and the ATO has a history that precedes the Review, some aspects of which are outlined in Chapter 2. It has been an evolving and developing relationship.

1.12 The IGT's report identifies certain aspects of the ATO's risk review and audit (or investigation) processes that may be improved. These aspects gave rise to various levels of large business concerns in its dealings or relationship with the ATO. The recommendations in this report if implemented and applied effectively by the ATO should help ameliorate these concerns. A summary of all the IGT recommendations and ATO responses is located in Chapter 3.

1.13 The IGT wishes to make a few observations in relation to future practice. As noted, it is expected that the changes recommended in this report where implemented and applied effectively should address the various concerns raised. There are, however, certain concerns that have been raised in earlier review situations that may require a deeper understanding of the underlying drivers and related behavioural considerations if the nature of the problems identified in this report continue to arise in future practice. Some of the potential issues that may go toward understanding these drivers and behavioural considerations are discussed briefly below.

1.14 It is important to recognise that large business pays a very significant amount of tax voluntarily and that the ATO publicly seeks to facilitate that outcome. A key area in which the ATO and large business taxpayer relationship is often tested is in the area of ATO risk reviews and audits of taxpayer activities.

1.15 The main potential risk to the ATO and large business taxpayer relationship in the conduct of these ATO investigations processes is that a disagreement may arise. These disagreements or disputes are invariably about the respective party's opinion as to how the law should or is expected to operate, but the force underlying the dispute is an economic one — the primary right to money.

1.16 The other area of increasing importance to this relationship is taxpayer compliance costs. The cost of engaging and dealing with broader tax law compliance is a key factor for taxpayers. Increasing tax legislation and related system complexity, along with increasing reporting and analytical requirements from a range of regulators, including the ATO, are primary cost drivers in this context.

1.17 It is important to appreciate that there have been some important changes and improvements that have been effected by both the ATO and taxpayers in this market to improve the relationship. It is also important to appreciate that large business does maintain some concern about certain aspects of the ATO's investigation processes.

1.18 The IGT observed various levels of satisfaction between large business taxpayers and their relationship with the ATO. The spectrum of taxpayer responses had certain extremes, but overall there was a general theme of improvements coming through, particularly in more recent times. During the Review large business expressed a strong desire to focus on the future and improving that relationship and its operation. The ATO also expressed a similar desire.

1.19 As large business is predominately made up of public companies, taxation obligations present a complex range of stakeholder relationship issues for them. Boards and senior management of large market companies must decide what resources are to be directed toward managing the organisation's tax affairs, given the imposition of self-assessment under tax law. This necessarily imposes compliance costs on taxpayers in addition to the tax payments themselves, both of which reduce shareholders' funds that directors and management are expected to maximise.

1.20 At the same time, these companies also need to assess the maintenance of social and political relationships for each given jurisdiction in which business is conducted. Large business companies are typically subject to significant levels of public and regulatory forms of scrutiny and are not in a position to pay out corporation funds without a legal or commercial obligation. Directors also have a range of important legal obligations imposed upon them personally in addition to the companies they represent.

1.21 The process of an ATO risk review or audit is at one level simply a regulatory administrator doing its job and making enquiries in its day-to-day function. However, as noted the nature of interaction that attracts most attention is where a significant investigation or a dispute arises that is not expected or provided for by the company. Typically both large business and the ATO have resources available to deal with investigations or disputes, but the cost of these processes is considerable and ever increasing due to tax law or administrative complexity.

1.22 Some broader considerations may need to be taken into account to better understand the nature of the underlying difficulties that are faced here. It may be necessary to consider the legal system given that it has at its core an adversarial dispute resolution approach. Moreover, given this tension that the company management and stewardship functions are subjected to, it should not be surprising that companies may only seek to pay what tax they believe is reasonably due. Similarly, it should not be considered surprising that companies may challenge the ATO (as administrator) on its interpretation or application of the law. The behaviour that is expected from various parties and what incentives or conflicts exist in realising these outcomes are important issues.

1.23 The above underlying issues are worthy of further consideration. If aspects of the ATO's investigation processes give rise to similar concerns after the recommendations of the Review have been implemented and bedded down effectively,

it may become necessary to review the policy arrangements underpinning the statutory elements applicable to risk review and audit processes.

STATUTORY STRUCTURE — FORMAL PROCESSES

1.24 In the course of the ATO's investigative processes a degree of frustration occurs around the communication and information-gathering requirements. The IGT observed that this was the case for taxpayers and for the ATO itself. As an underlying policy matter, it may be worth considering whether a more formal and detailed statutory codification of these processes should be applied in ATO investigations of taxpayer affairs, should these concerns continue to arise in future practice.

1.25 The relevant statutory processes might be specified in greater detail to ensure both parties are aware of their respective positions and obligations. Such an approach would have an impact on both parties, as its greater rigidity would necessarily impose higher discipline in application, but it would also provide more certainty to both large business and the ATO as to these processes. It may also be that the approach would need to be differentiated to ensure smaller taxpayers have flexibility of choice.

1.26 Other jurisdictions have made some steps toward such an approach. It may be worth reviewing aspects of these innovations to consider their efficacy and potential application in the Australian context should the need and opportunity arise.

REPORT STRUCTURE

1.27 This report sets out a separate chapter for each major issue arising from both large business stakeholder submissions and the Review's conduct. In taking this approach and to ensure that each chapter may be read on a stand-alone basis, some brief contextual discussion is outlined within certain chapters that are more fully considered in another more specific chapter topic. A reference or link is provided to the more specific chapter topic discussions where this occurs for ease of reference and access.

1.28 The introduction at Chapter 1 provides some commentary about practice and policy and report navigation. Chapter 2 is a background section that provides some historical context. A snapshot of the report's context, findings and recommendations is summarised in Chapter 3. The ATO's compliance approach is described in Chapter 4, to provide an understanding of the administrative approaches expected to be taken organisationally. The risk hypothesis identification and related communication processes are addressed specifically in Chapter 5.

1.29 The issue of ATO project management and accountability is considered in Chapter 6 and information gathering is canvassed in Chapter 7. The audit and risk review as processes in themselves are discussed in Chapter 8. The expectations and issues surrounding the ATO's development, communication and delivery of its position papers is the subject of Chapter 9. Finally Chapter 10 summarises interest and penalties matters.

CHAPTER 2: BACKGROUND

2.1 This chapter sets out a brief description of the ATO's Large Business & International compliance program and results including the number of risk reviews and audits conducted, the total liabilities raised and collected and the tax collected from the large market through cooperative processes such as Annual Compliance Arrangements.

2.2 It also describes the ATO's management of LB&I including the organisational structure, the role and responsibilities of those involved in risk reviews and audits and the various management reports regarding performance of audit and risk reviews¹.

2.3 The chapter then briefly sets out the main sources of guidance to LB&I officers on undertaking risk reviews and audits. It considers the key findings of the Burges Report and the ATO's response including a detailed examination of the 13 specific initiatives announced by the Commissioner at that time.

2.4 The chapter then sets out the community feedback regarding the LB&I approaches, processes and work practices received by the ATO through the Professionalism Survey and Client Feedback Questionnaires.

LB&I COMPLIANCE PROGRAM AND RESULTS

2.5 There are over 1,300 economic groups and entities in the ATO's large market segment, encompassing over 32,000 businesses. Approximately two-thirds of these businesses are public companies and approximately 1,100 of these groups have an annual turnover of greater than \$250 million.²

2.6 Large business represents a significant part of the Australian economy and plays a crucial role in the tax system. In 2008-09 large business represented 63 per cent (\$37.8 billion) of income tax collections from companies and 53 per cent (\$20.2 billion) of total net GST.

2.7 The ATO's historical approach in communicating its large market compliance program is to use various mediums including, speeches, guides, other publications and by engaging directly with specific industry forum groups. This market is a very significant area for revenue collections (across a range of taxes applied directly or by way of withholding) and as a consequence for the ATO's functional delivery to Government. The strategy and approach along with the underlying risks or concerns that the ATO sees are outlined in more detail in the Large Business and Tax Compliance booklet which is discussed in Chapter 4.

1 A new ATO management LB&I organisational structure was established during the course of this review, a copy of which is provided in Appendix 1. References in this section are to the new structure, unless otherwise stated.

2 Large Business and Tax Compliance, p 2.

2.8 The ATO has indicated that it is moving towards a more sophisticated measurement of its compliance performance so as to evaluate whether its compliance activities are having the expected impacts. This involves measuring the efficiency (cycle times and completion targets) and effectiveness of risk reviews and audits. Some measures of effectiveness include direct revenue adjustments, revenue protected, audit strike rates, success of litigation, assessments of changed taxpayer behaviour, conformance with the ATO's Integrated Quality Framework and taxpayer satisfaction with the conduct of the risk or audit. The ATO also issues Client Feedback Questionnaires to gauge or measure taxpayer satisfaction with the conduct of the risk review or audit.

2.9 The IGT has not had the opportunity to consider the use or effectiveness of Client Feedback Questionnaires or other external market surveys. While the IGT supports the ATO's attempt to gain insight around their service delivery performance it may be that certain response collection methods may be more effective than others. It may also be that there is potential bias in survey results from respondents even if arranged through third party agents due to factors that may not be completely appreciated, including underlying concerns about anonymity amongst others.

2.10 The ATO also notes that an increasing proportion of tax is now collected from the large market through cooperative processes, such as Annual Compliance Arrangements and also through less formal real-time work to help taxpayers obtain earlier certainty on their tax risks. As such, traditional measures of audit results such as 'liabilities raised' reflect only one part of the ATO's activities to manage tax risks in the large market.

LB&I active compliance program

2.11 According to the ATO's case management system, the number of LB&I compliance cases conducted between 1 July 2006 and 30 June 2010 was 1,284 (some of which were already in progress at 1 July 2006). Table 2.1 provides a break-up of the different types of compliance activities for this period.

Table 2.1: Number of cases by way of compliance activity type

Compliance activity	Number of cases
Client risk review	505
Specific risk review	387
Transfer pricing review	132
Voluntary disclosure	29
Comprehensive audit	150
Specific issue audit	73
Transfer pricing audit	8
TOTAL	1,284

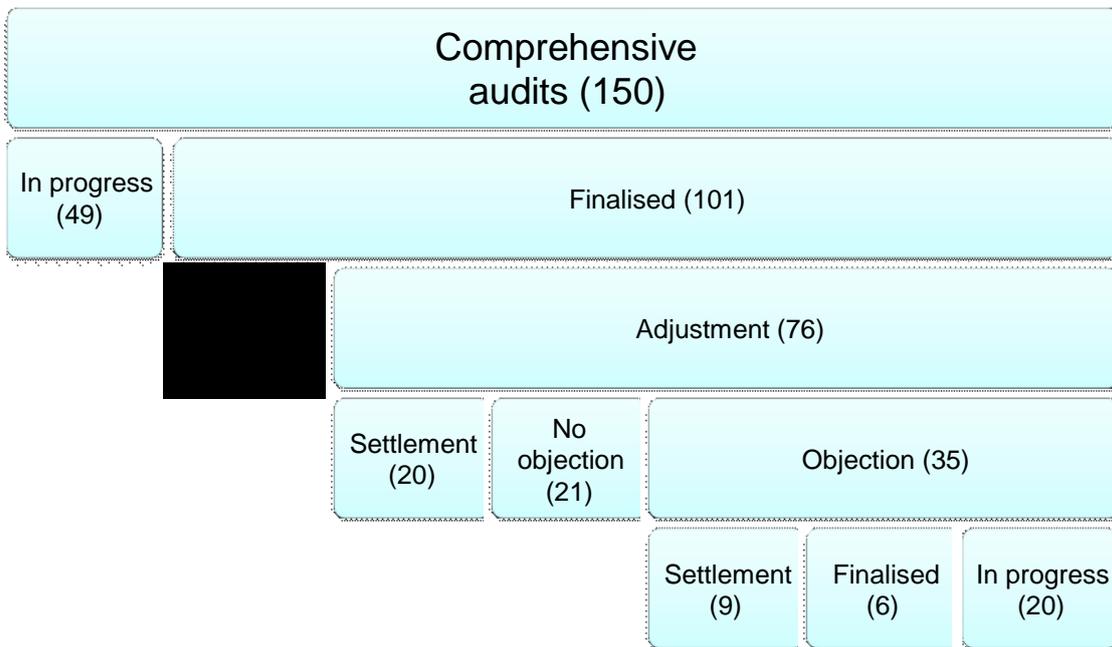
2.12 Of the 505 client risk reviews, 371 did not progress to audit (although in 42 of these risk reviews there was an adjustment without the need to progress to audit). Of the remaining 134 client risk reviews, 39 led to a comprehensive audit and 53 led to a

specific issue audit. As at 30 June 2010 there were 42 client risk reviews still in progress.

2.13 Similarly, of the 387 specific issue reviews, 292 did not progress to audit (although in 44 of these cases there was an adjustment without the need to progress to audit). Of the remaining 95 specific issue reviews, 23 led to an audit with a further 72 reviews still in progress at 30 June 2010.

2.14 Figure 2.1 outlines the work flow of the 150 comprehensive audits that were conducted between 1 July 2006 and 30 June 2010. As at 30 June 2010 there were 49 comprehensive audits still in progress.

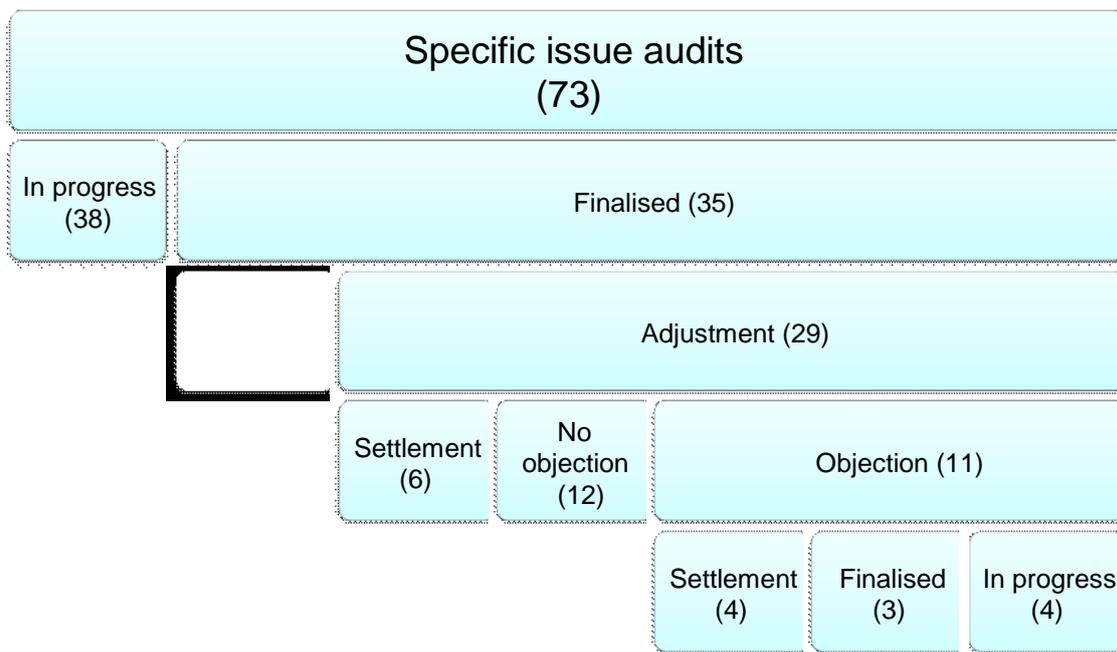
Figure 2.1: Outcomes of comprehensive audits³



2.15 Figure 2.2 outlines the work flow of the 73 specific issue audits that were commenced or recorded on the ATO's case management system during this period. As at 30 June 2010 there were 38 specific issue audits still in progress.

³ This diagram is for general information purposes only. The figures are not precise because a single case can have multiple outcomes in relation to different issues over time.

Figure 2.2: Outcomes of specific issue audits⁴



2.16 Table 2.2 provides a more detailed break-up of the large market revenue adjustments arising from ATO compliance activities together with total collections.

Table 2.2: Large market liabilities raised and collections (\$m)⁵

Tax Type	Total Collections	Active Compliance Liabilities Raised	Active Compliance Collections	Active Compliance Credit Amendments
2006-07				
Income Tax	48,151	2,156	1,526	717
GST	22,064	303	298	0
PAYG With.	39,688	29	31	0
Excise	20,656	62	16	0
Other	634	7	11	0
TOTAL	131,193	2,557	1,882	717
2007-08				
Income Tax	48,776	2,691	1,502	646
GST	19,815	569	548	0
PAYG With.	37,302	24	21	0
Excise	21,431	17	13	0
Other	265	24	19	0
TOTAL	127,589	3,325	2,103	646

4 This diagram is for general information purposes only. The figures are not precise because a single case can have multiple outcomes in relation to different issues over time.

5 Statistics provided by the Australian Taxation Office.

Table 2.2: Large market liabilities raised and collections (\$m)⁶ (continued)

Tax type	Total collections	Active compliance liabilities raised	Active compliance collections	Active compliance credit amendments
2008-09				
Income tax	47,373	1,311	952	222
GST	20,202	745	613	0
PAYG With.	39,669	59	19	0
Excise	21,986	19	20	0
Other	202	3	4	0
TOTAL	129,432	2,137	1,608	222
2009-10				
Income tax	39,807	2,395	1,070	6
GST	22,157	862	675	0
PAYG With.	39,395	74	18	0
Excise	27,356	7	-1	0
Other	237	8	26	0
TOTAL	128,952	3,346	1,788	6

2.17 In the IGT's view 'total liabilities raised' through compliance activities are just one indicator of the ATO's active compliance performance. Solely in hard monetary terms the related and more important measure of collection against such liabilities raised (including both costs of collection and dispute) needs careful consideration. While management across various industries view variance or errors analysis against liabilities raised and collections received as a very useful tool in assessing the effectiveness of outcomes, as noted, the analysis in a tax collection environment should include other measures.

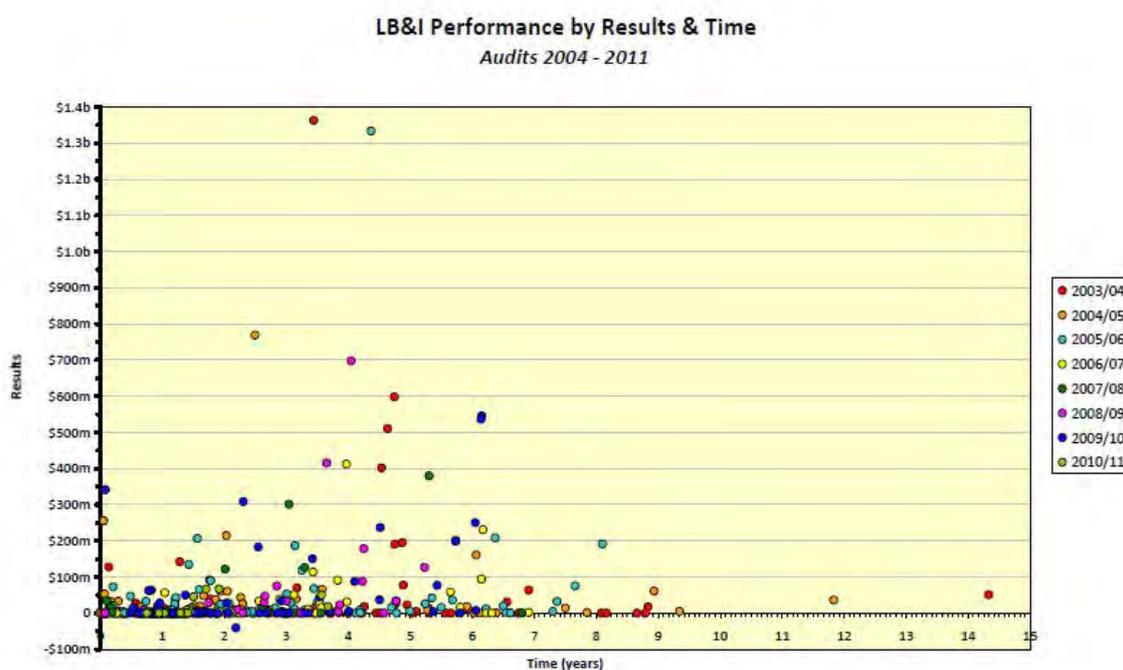
2.18 The ATO's compliance performance like other revenue authorities needs to take into account measures such as the promotion of voluntary compliance, minimisation of taxpayer compliance costs and overall stakeholder satisfaction with the effective running of the system and service level provided.

2.19 The existence of the ATO's active compliance program, depending upon taxpayers' perceptions about the consequences of the ATO's approach or conduct, may have positive or negative behavioural reinforcement effects for voluntary compliance.

2.20 Figure 2.3 displays LB&I audit liabilities raised against the time taken to complete the audit.

6 Statistics provided by the Australian Taxation Office.

Figure 2.3: LB&I audit results by liabilities raised and elapsed time



2.21 The ATO has designed its compliance program around a risk differentiation framework (RDF) approach. This framework directs ATO compliance activity or resources on consequences for, or risk to, expected tax collection revenue. The ATO considers that the significant consequences of potential non-compliance in the largest businesses are such that (even though the likelihood of non-compliance may be lower) it will devote significant resources to monitor, review and (where appropriate) audit them. For more details on the ATO's RDF refer to Chapter 4.

MANAGEMENT OF ATO LB&I BUSINESS LINE

Organisational structure

2.22 During the course of this review, LB&I adopted a new structure, reporting and governance arrangements across the business line. This did not significantly change the day-to-day work of teams working in active compliance but did alter management structure and reporting arrangements above the Team Leader level.

2.23 Prior to the change, LB&I's active compliance teams were organised into broad groups with an industry segment focus and Segment Leaders. Under the new arrangements, a senior tax officer continues to have primary responsibility for managing the ATO's ongoing taxpayer relationship at the strategic level.

2.24 The new arrangements bring ATO active compliance teams together under one Operations group.

2.25 LB&I has a presence across 11 sites in all States and the Australian Capital Territory. The new arrangements place a greater emphasis on site leadership with

Senior Executive and Executive Level officers working together in the active management of compliance and other work for teams under their direction. Committee structures assist these leaders to co-ordinate the entire work program across all sites to improve efficiency and effectiveness (for example, through improved flexibility in work allocation).

2.26 The ATO's interactions with each of the higher consequence taxpayers (that is, higher risk and key taxpayers) is managed by one team that reports to a Senior Executive Service (SES) officer, usually within their own location and working to a strategic plan designed specifically for the circumstances of the taxpayer.

2.27 Other compliance teams work on cases in relation to one taxpayer or a group of taxpayers on a project basis. Project cases may have an industry or tax risk focus. Those teams report to the SES officer who is responsible for managing their site.

2.28 All compliance teams are led by the Team Leader accountable for the ATO's engagement and relationship with the taxpayer in the context of risk reviews, audits or other compliance activities and the day-to-day management and progress of the work program in their team.

2.29 Compliance teams have assistance and support in relation to technical issues and case management from experienced officers within the business line including from LB&I's technical networks.

2.30 Case Leaders also assist and support compliance teams at the request of the relevant SES, or may initiate an intervention by agreement with the SES where assurance processes indicate that this may be required. They can have issues or cases referred to them at any time during the lifecycle of a case.

2.31 The overall business management of the compliance work program is reviewed by the Business Delivery Committee, which consists of SES and Executive Level officers across sites.

2.32 This is complemented by assurance processes led by the Business Management and Governance Team. There are also specific 'intervention points' where the Case Leaders will work with leaders in the sites and the Business Management and Governance team to provide assurance that cases are being appropriately managed as part of the monthly review process and the formal governance call-over process (three times per year).

2.33 LB&I has a monthly reporting cycle and reports are reviewed by the site SES, Business Delivery Committee and the LB&I Executive.

2.34 The Team Leader is responsible for managing their team to ensure the completion of active compliance casework in appropriate timeframes and to a high standard of quality. This responsibility encompasses all aspects of people management, organisation, oversight of work and mandatory sign-off.

2.35 Technical leaders provide leadership to officers within their site in identifying and resolving technical issues within a case.

2.36 Case officers are responsible for the day-to-day active management of a risk review or audit. They do the internal work prior to initial contact with the taxpayer and thereafter in the conduct of the plan.

2.37 Case Leaders (known as Special Advisers under the former LB&I structure) are a small group of senior tax officers who provide specific assistance and technical leadership in selected casework. Case Leaders report to a senior SES Officer who in turn reports to the LB&I Deputy Commissioner. Their interventions in casework may be in relation to a particular issue within a case or it may extend to taking on the role of the SES with ultimate responsibility for the entire case. In such cases, the team leader and case officer remain responsible for the day-to-day running of the case but are subject to the direction of the Case Leader for matters in relation to the case in the same way that they would normally take direction from their site SES.

2.38 The Deputy Commissioner LB&I Case Leadership is a Band 2 SES position reporting to the Second Commissioner, Compliance. This role was established to undertake interventions at a senior level in selected cases with a particular focus on the largest, most complex and sensitive matters.

2.39 LB&I has established technical networks to support the development of capability and sharing of knowledge around key areas of the law (such as Capital Gains Tax, International, Consolidation, and Transfer Pricing). Additional networks also exist around areas of practice, such as the Litigations and Objections network.

2.40 As at 30 July 2010, there were a total of 1,323 ATO personnel (or Full Time Equivalent (FTE)) working as part of LB&I, with a total of 911 FTE involved in active compliance work. Of these, 705 FTE were allocated to undertake risk review and audit work through active compliance teams that were in the previous industry based segments – Energy & Resources (174 FTE in 12 teams), Financial Services Industry Group (210 FTE in 16 teams) and National Client Group (321 FTE in 29 teams).

LB&I management reports — audit and risk review performance

2.41 With the change in the LB&I management structure, it is expected that each area will undertake its own more detailed monitoring and this will involve the production of various reports to track case progress and plans.

2.42 Previously, each segment had a range of localised arrangements for ad hoc and regular reports to assist them in planning and managing their case workload and tailored to the specific needs of these areas. ATO LB&I management has advised the IGT that it is examining these arrangements for extracting performance data and preparing reports at the local and LB&I level to determine the most efficient and effective process.

2.43 The LB&I Compliance Assurance Report is the main report that is prepared for the LB&I Leadership team to monitor the progress of the program of active compliance work.

2.44 The LB&I Executive Report also contains overview format information around performance across all key areas of the work program, including a section about active

compliance work. The information in the active compliance section of this report is largely a high level summary of the content found in the Compliance Assurance Report. Periodically, the LB&I Executive reviews lists of current and planned audits and risk reviews to obtain a more detailed update of the progress of casework and how this is tracking against plans for the year.

2.45 LB&I provides input to corporate reporting (also known as Heartbeat reports) in relation to active compliance. This is a higher level overview of how active compliance is travelling and drawn from the more detailed reports described above.

ATO LB&I GUIDANCE ON COMPLIANCE APPROACHES, PROCESSES AND WORK PRACTICES

ATO Large Business and Tax Compliance booklet

2.46 The ATO Large Business and Tax Compliance (LBTC) booklet (the latest update of which was released in June 2010 during the course of this review) provides a high level explanation of the LB&I end-to-end compliance processes. The ATO developed the booklet through a process of consultation, collaboration and co-design with large business. It is the ATO's intention that the booklet have a broad audience that includes large businesses' internal tax management, chief financial officers (CFO's), chief executive officer's (CEO's) and board members and naturally ATO staff working with the large business sector.

2.47 The statements of mutual expectations in this booklet reflect an approach which promotes frank and open dialogue and outlines the responsibilities of the ATO and expectations of large business in working together.

2.48 The booklet details what taxpayers and their advisers can expect from the ATO including how the ATO manages tax risk, its active compliance approaches and a simplified representation of its processes for carrying out risk reviews and audits. It also sets the principles that the ATO will adopt for gathering information and the points of its interaction with the taxpayer and what they can expect of the ATO.

2.49 The booklet stresses that in conducting a risk review or audit the ATO will have a strong focus on:

- planning to agree on time frames and the scope of active compliance activities;
- open dialogue with taxpayers, including initial discussions on the matter that has attracted the ATO's attention;
- gaining an understanding of the taxpayer's business context and environment;
- gathering relevant information and evidence to get the full facts quickly; and
- making the right tax decisions according to the law.⁷

⁷ Large Business and Tax Compliance, p 27.

2.50 The ATO considers the booklet to be a flagship document – setting out the ATO’s complete engagement model and current service offering for large business. It establishes the platform and reference point for all aspects of its compliance program management. The booklet represents a high-level explanation of its end-to-end process.

2.51 In discussion with the IGT, the ATO acknowledged that it is important that the spirit of the booklet is ‘lived out’ and reflected in the conduct and approaches of the ATO both internally and with its interactions with taxpayers, especially as it moves towards a more differentiated approach. Appropriate guidance to staff and effective assurance processes need to be in place to ensure the consistent and proportional application of the principles and expectations in the booklet through the ATO’s risk review and audit processes in achieving this goal.

2.52 The principles in the booklet also set out ATO expectations of taxpayers who wish to avail themselves of particular engagement or service levels that are provided for in the booklet.

ATO LB&I Compliance Manual

2.53 The ATO LB&I Compliance Manual is an internal document that seeks to provide a bridge between the high level steps in the Large Business Tax Compliance (LBTC) booklet and the ATO’s end-to-end skilling materials and Siebel case management system procedures. It is intended to provide a one-stop shop for all instructional material available to LB&I staff conducting risk reviews and audits.

2.54 The LB&I Compliance Manual sets out guidance on the expected thinking, logic, judgement and reasoning behind the LB&I risk review and audit processes. It covers a range of different aspects of the risk review and audit process including:

- the risk hypothesis, planning a risk review, identifying and reviewing tax risks and conducting internal workshops;
- assessing the risk, developing recommendations and communicating the outcomes to taxpayers; and
- commencing and planning the audit, information-gathering, refining the risk hypothesis and determining the ATO position.

2.55 The manual is an important management and operational document. It is vital that the manual interface and link effectively with the ATO’s Risk Differentiation Framework and the LBTC booklet in a manner that provides instruction to staff, and ensures consistency in application.

2.56 Complementing the LBTC booklet and LB&I Compliance Manual are detailed procedures, support tools and instructions provided on the work processes intranet site and Siebel case management system. In announcing the release of the LBTC booklet the Commissioner in his speech⁸ noted that it was to be completed by a

8 Colours to the Mast, Commissioner’s speech to the CTA Convention, June 2010.

comprehensive skilling program for staff, being an 11 day training course directed at end-to-end compliance management.

BURGES REPORT — KEY FINDINGS AND ATO INITIATIVES

2.57 The IGT in conducting background research into the area of large business ATO audit and risk reviews looked to consider matters that were raised in any previous reviews undertaken, particularly in the Australian context.

2.58 In September 2004 the then Commissioner of Taxation (Michael Carmody) announced that he had appointed Mr Kevin Burges to conduct one-on-one interviews with representatives of large corporate taxpayers to get a picture of their experiences and concerns about ATO audits.

2.59 A report was issued in April 2005, entitled 'Report on the concerns of a number of the largest companies in the Large Business Segment with ATO audit, investigation, and advice procedures' (the Burges Report).⁹

2.60 The Burges review was part of a larger initiative to improve the quality and timeliness of ATO audit processes in the large corporate sector. The review was undertaken on the basis that it was not to test the veracity or reasonableness of the statements made by large business, although the report noted that:

... if the Cooperative Compliance Model is to achieve the full benefits sought by both the ATO and by taxpayers, it is important that the perception of less than desirable professionalism and level of service felt by these companies, be addressed by the ATO, just as it is equally important that taxpayers maintain appropriate standards of honesty, frankness and courtesy in their dealings with the ATO.

2.61 In relation to audits, the Burges Report noted three main areas of concern raised by large business:

- delays, often long after all information requested had been provided, leading to last minute position papers and inadequately considered assessments;
- difficulties in arranging meaningful discussion of issues during the progress of the audit; and
- some instances of perceived aggressive or oppressive conduct in relation to settlement negotiations.

2.62 The Burges Report also noted some concerns in regard to the risk assessment process including the procedures involved in making the assessment and the consequence of the risk assessment.

⁹ This section of the IGT report quotes extensively from the Burges Report, but it should be noted that the discussion is historical and relates to the time covered by the report unless the context indicates otherwise.

2.63 On 13 October 2005 the then Commissioner of Taxation, Michael Carmody, released the Burges Report together with details of his strategy for improving the audit experience for large business, including a series of 13 specific initiatives¹⁰.

Initiative 1 — Early engagement of technical experts in audits

2.64 The Commissioner indicated that this initiative would ensure that senior technical experts, including those from the ATO's Tax Counsel Network and Centres of Expertise, are brought into the process early to assist with focusing the information-gathering and contributing to the formation of the ATO view on the facts. It was also envisaged that taxpayers would have the opportunity to respond and discuss the issues with the ATO technical experts as the ATO view is being formed.

2.65 This initiative was aimed at ensuring that all technical issues and information needs are identified as early as possible in the audit process, providing greater clarity for the taxpayer and minimising the need for protracted information gathering processes.

Initiative 2 — Twice yearly meetings with top 100 taxpayers

2.66 This initiative was aimed at helping to build an ongoing professional relationship with the largest corporate groups. It involved corporate group executives being invited to meet with senior tax officers (Senior Executive Service officers for the top 30 taxpayers and Executive Level officers for the balance of the top 100) on a half-yearly basis to discuss the progress of any compliance activity and significant events in the company's business or revenue performance.

Initiative 3 — Engagement of external experts to improve the ATO's understanding of business

2.67 To strengthen the ATO's understanding of business imperatives and commercial practices, the ATO announced it would put into place arrangements with a range of external topic and industry experts who will be available on an advisory basis for major reviews or audits. The experts were to provide the ATO's key technical staff with greater insights into the business environment and help the ATO to quickly identify the issues and information needs.

2.68 In an update to the ATO's key consultation group, the National Tax Liaison Group (NTLG), the ATO advised that the use of external experts has already occurred in a number of cases and LB&I officers have been notified to use external consultants when appropriate. For example, experts have been engaged in market valuations work, transfer pricing cases and corporate financing issues.¹¹

2.69 The ATO also indicated that this initiative was being supplemented by internal workshops and technical forums across the ATO to share knowledge and

10 Commissioner's speech to the International CFO Forum, Sydney, Australia, 13 October 2005.

11 ATO update on large market initiatives to the NTLG (21 June 2006).

understandings about industry sectors, business processes and lessons from the use of consultants in active compliance work.

Initiative 4 — Workshopping technical issues arising in risk reviews

2.70 Corporate representatives had indicated that some audits may have become unnecessary if the ATO had undertaken more complete internal workshopping of the commercial and technical issues before the risk review was completed.

2.71 The initiative requires case officers to workshop the risks arising from all risk reviews that are likely to lead to an audit. ATO technical leaders and experts must participate in these workshops and they must be held prior to the finalisation of the risk review.

2.72 The aim of these workshops is to ensure that all relevant tax officers (Case Officers, Team Leaders, technical specialists and experts) have a greater understanding of the issues to clearly explain the significant tax risks to taxpayers and their internal risk management committees.

2.73 The benefits for the ATO would be improved decision-making and better quantification of the risk through a greater ability to explain the tax risks, their scope and legal basis and the allocation of resources to higher tax risks. For taxpayers, the intended benefits included the clearer articulation of the risks, scope and legal considerations in the event that risk review proceeds to audit and the assurance that the issues have been discussed with the relevant experts.

2.74 The involvement of appropriate technical leaders and experts at these workshops would be reflected in the ATO's corporate assurance results and taxpayer feedback such as the Client Feedback Questionnaire and Professionalism Survey.

Initiative 5 — Provision of draft report to taxpayer for comment

2.75 Corporate representatives had indicated that some risk reviews escalate to audits without adequate consultation and that the final letter does not provide guidance on the next course of action. The Commissioner stated that there was a need to provide further opportunities for taxpayers to interact in the risk review and audit decision-making processes.

2.76 This initiative requires that the ATO issue a draft risk findings letter and then having a discussion with corporate executives prior to finalising its position. At those discussions the implications of the ATO's conclusions should be raised. This letter must be issued before the finalisation of all risk reviews except where the risks are rated low or trivial in which case the ATO will issue a finalisation letter stating that no further action will be taken at this time.

2.77 The benefits for the ATO would include improved dialogue and openness with the taxpayer and greater opportunity to build a better understanding of the taxpayer's perspective of the risks and technical interpretation. Taxpayers would also benefit through an improved awareness of the outcomes of the risk review and have the opportunity to correct any errors of fact.

Initiative 6 — Senior ATO staff to discuss outcomes with taxpayers

2.78 The Commissioner stated that where the risk review process proceeds to an audit the ATO would take further steps involving discussions at more senior levels to ensure that the corporate executives understand clearly what is likely to take place.

2.79 This initiative requires senior ATO officers to meet with taxpayers at the conclusion of a risk review to discuss the risk findings and their implications. This applies to all risk reviews except for those cases involving a taxpayer outside the Top 30 and where the risks are low or trivial.

2.80 The senior ATO officer must lead the discussion about the technical issues leading to the identified risks, the reasons why the ATO believes they are risks, the implications for the taxpayer, the timing of any audit activity and what a taxpayer can do to mitigate the risks.

2.81 The ATO considers that this initiative provides greater certainty to taxpayers about future ATO action and allows taxpayers to make any voluntary disclosures before the commencement of any audit. This should be reflected through improved feedback that taxpayers have a better understanding of the identified tax risks, the ATO's view on these risks and the likely next course of action.

Initiative 7 — Discussion of audit plan with taxpayers

2.82 The aim of this ATO initiative is to provide taxpayers with a clear understanding of the scope of the audit, the tax risk being audited, the audit process and the proposed audit project plan timelines. The ATO notes that this is a critical step in the management of the audit and requires much more openness with taxpayers than has been the case in the past to ensure that the discussions are more than just identifying milestones. This initiative is intended to complement the requirement for Team Leaders to maintain regular discussions with taxpayers throughout the course of an audit.

2.83 The initiative requires that at the commencement of an audit, a senior ATO officer must meet with the taxpayer to discuss the audit project plan. At this meeting, the ATO will clearly explain the stages and scope of the audit, what the ATO will do if it finds new issues or decides it will not pursue a certain issue and the protocols for information gathering. These discussions should also cover the taxpayer's other commitments and when they might occur during the audit, such as year-end accounts, preparation and lodgement of returns and the availability of advisers and key personnel.

2.84 At subsequent meetings, the ATO will provide updates on the process of the audit and indicate any further information required and the reasons for seeking that information.

2.85 The benefits for taxpayers through this improved dialogue and openness is that they should be in a better position to respond to information requests and allow them to plan their workloads to allow for the timely progression of the audit.

2.86 The ATO states that the success of this initiative should be reflected through improved taxpayer feedback in Client Feedback Questionnaires which shows that taxpayers have a clear understanding of the scope of the audit and the audit process. The ATO's assurance processes also examine whether audit plans and minutes of the initial audit discussions are on the audit file and whether senior ATO officers have undertaken a review of the audit plan prior to discussing with the taxpayer.

Initiative 8.1 — Case call-overs

2.87 This initiative requires that case call-overs of significant audits are conducted on a six-monthly basis by senior tax officers. Subsequent reviews occur every six months from the initial call-over until the completion of the audit.

2.88 The purpose of this initiative is to assist teams working on significant audits, to identify issues that are causing delays and to progress those issues to a solution. The ATO envisages a number of benefits from the case call-over process, including:

- cases are actively managed leading to a reduction in the number of aged cases and minimising taxpayer's compliance costs;
- intelligence gathered from the audits is fed back into the risk assessment process in a timely manner;
- expertise can be brought into the audit process early leading to the arrangement of workshops with other technical officers and experts to work through difficult audit or technical issues or to more quickly refine the scope of the audit where the risk does not exist or is immaterial;
- audit teams obtaining assistance to resolve problems in obtaining relevant information to progress an audit; and
- improved quality results, productivity, audit coverage and strike rates.

Initiative 8.2 — Monthly reviews

2.89 This initiative requires team leaders to conduct a monthly review of audit and risk review cases to ensure they are progressing in an appropriate manner and without unnecessary delays. All cases must be reviewed on a monthly basis until the risk review or audit has been finalised.

2.90 As part of a monthly review, team leaders are required to:

- ensure that the case plan is still relevant and the milestones are still achievable;
- ensure that the risk review or audit is progressing in accordance with the agreed case plan;
- identify and address emerging issues and risks which are delaying the progress of the case;

- ensure that any internal or external blockers to the progress of a case are identified and appropriate strategies are implemented to mitigate their impact; and
- identify additional support that may be required by the audit team.

2.91 Team Leaders are required to sign-off on the monthly reviews while Segment Directors have responsibility for ensuring that monthly reviews are being undertaken.

Initiative 9 — Remission of the SIC and GIC for the period audits go beyond two years

2.92 The Commissioner noted that delays in completing an audit can add a substantial interest charge and that the assignment of the cause of the delay is at times difficult and contentious. It was also observed that the previous process suffered from the lack of benchmarks for reasonable timeframes for particular activities undertaken in the course of an audit.

2.93 In response to these observations, the Commissioner announced the introduction of a new ground for remission of Shortfall Interest Charge (SIC) and General Interest Charge (GIC) based on an expectation that it is reasonable for a large corporate audit to be concluded within two years of the notification of its commencement. Only in exceptional cases involving blatant obstruction would this remission not apply. Such cases would need to be agreed by the Deputy Commissioner following discussion with executives of the relevant large business taxpayer. The Commissioner noted that implicit in the two year benchmark is a purposeful approach to the management of large cases that, in appropriate circumstances, will involve the use of the ATO's formal powers where it considers that there is a genuine lack of co-operation. The intention of this initiative was to apportion no blame to either party for delays in completing audits and to make it clear that a large taxpayer audit should not take more than two years to complete with a purposeful approach to case management.

2.94 The benefit of this initiative would be that large audit cases would be better managed so as reduce the need to remit the interest charge for audits that have taken more than two years.

2.95 Practice Statement PS LA 2006/8 sets out the ATO's policy on the remission of SIC and GIC and incorporates the Commissioner's initiative by remitting interest to the base rate for large business audits exceeding two years. The Practice Statement also provides additional grounds for remission, including:

- delay in commencing audit;
- expected audit completion date exceeded or unreasonable delay;
- delay in obtaining information from a third party; and
- longer resolution times due to complexity of issues.

Initiative 10 — New edition of the Large Business and Tax Compliance booklet

2.96 The Commissioner announced the publication of the LBTC booklet to provide large businesses (and their advisers) with detailed information on the ATO's approach to tax risk management and compliance. The first booklet was developed in consultation with key stakeholders and launched at the Large Business and Tax Administration Symposium on 30 August 2006.

2.97 For completeness it should be noted that this was the second LBTC booklet. The first LBTC booklet of this kind issued in 2003. The most recent version was launched by the Commissioner of Taxation (Michael D'Ascenzo) on 15 June 2010.

Initiative 11 — Development and implementation of Forward Compliance Arrangements

2.98 In October 2005 the ATO announced a range of initiatives to improve its processes, enhance its understanding of business operations and strengthen its relationship with large business. One of the initiatives sought to develop and implement a Forward Compliance Arrangements (FCA) model.

2.99 Since 2005 the ATO has sought to develop a more 'real-time' relationship with large taxpayers. This has been through both formal and informal processes such as FCAs, Annual Compliance Arrangements (ACAs), building and maintaining cooperative relationships that encourage taxpayer disclosures of potential risks and a proposal to require large business taxpayers that the ATO regards as higher risk to make disclosure about their uncertain tax positions.

2.100 The FCA was an incentive-based approach to managing compliance for all tax obligations, and provides an alternative to traditional compliance approaches. It is a voluntary arrangement between a large business and the ATO which sets up an agreed way of working together in the future.

2.101 In particular, the FCA is a commitment in writing by large business and the ATO to make a joint effort to focus on complying with current tax requirements and anticipate future tax needs, especially when major transactions affecting tax are likely.

2.102 The ATO expects that a commitment to the principles of an FCA, such as transparency and real time collaboration, will lead to:

- an environment less likely to produce surprises;
- a reduced likelihood of audit;
- concessions in relation to administrative penalties and interest that apply in the event of tax shortfalls; and
- more certainty, trust and ultimately less compliance cost.

2.103 In addition, the ATO requires a high standard of corporate governance (and a corresponding 'low' tax risk profile) as a prerequisite for entry into the FCA program. A demonstrated commitment to continuous disclosure is also a requirement.

2.104 In May 2008, the Commissioner announced a package of initiatives that aimed to add certainty and improve the relationship between large business taxpayers and the ATO.

2.105 These initiatives include ACAs which are designed to provide practical certainty by jointly assessing tax risks in real-time or at the time that the tax return is lodged. The ACA process is intended to build on its learnings and experience from the FCAs that the ATO has in place with some large businesses.

2.106 ACAs are built around two concepts: the company having sound tax risk management processes and a commitment from the company to full and true disclosure of all relevant and material facts. The key features of the ACA are:

- confirmation, from the Chief Financial Officer or Chief Executive Officer on behalf of the board, that the company meets the key corporate governance guidelines set out in the ATO's LBTC booklet and has a genuine commitment to 'putting all cards on the table';
- workshopping with the ATO during the course of the year major transactions or tax positions which have a level of uncertainty so that the ATO and taxpayer can jointly assess the tax risks; and
- once the tax return is lodged, undertaking jointly with the ATO a review of the tax return and other information, including the statutory accounts, and book to tax adjustments.

2.107 The ATO states that the main difference between the ACA and audits and risk reviews is that the ATO asks companies to put their tax risks on the table and to discuss how risks have been mitigated, giving early practical certainty and support to resolve any apparent differences. This requires a sound approach to tax governance and a clear view of the kinds of things that the ATO would see as a risk.

2.108 In return, taxpayers will get a significant level of practical certainty. With both the taxpayer and the ATO having looked at tax risks broadly, the ATO would not as a general rule allocate resources to low risk matters.

2.109 The ATO advises that taxpayers that choose to use an ACA are able to manage their planning and compliance from a position of greater certainty, with 'no surprises' if material risks have been disclosed, and with little or no exposure to penalties and interest.

2.110 An alternative to the FCA and ACA process, and one that is being adopted by a number of taxpayers, is the disclosure of potential tax risks at or around the time of lodgement of a tax return. This assists taxpayers to manage their planning and compliance from a position of greater certainty without having to enter into a formal FCA or ACA. From an ATO perspective, it assists in building a more cooperative relationship and narrows the potential risks that may require further examination.

2.111 The ATO has also raised the possibility of requiring certain large business taxpayers to make disclosures about their uncertain tax positions (UTP). At that time

the ATO suggested it may as a starting point look at having large business taxpayers it regards as 'higher risk' making such disclosures.

2.112 More recently the ATO has advised the IGT that it is developing an information disclosure package designed to provide assurance regarding large businesses' most contentious and material risks, and to better understand tax risk across the market. The approaches being developed by the ATO will support the differentiated approach based on the ATO's Risk Differentiation Framework. Further, some concepts and approaches are being trialled in a limited pilot project and were the subject of initial consultation during 2010.

2.113 The IGT recognises that this is an area of potential concern for all. Whatever approach is ultimately taken by the ATO, it is important that potentially affected taxpayers and tax practitioners are engaged and consulted directly to ensure the risk assessment process is effective for both the taxpayers and the ATO.

Initiative 12 — Review of key client manager roles

2.114 Following positive feedback about the effectiveness of the ATO's key client manager concept (KCM), the ATO was to examine building on that success by creating a new role that had direct authority to resolve administrative and transactional issues.

2.115 The outcome of this examination was realised on June 2009 when the Commissioner announced the new role of Lead Relationship Manager for the largest business taxpayers, particularly those considered to have shown a genuine desire to work collaboratively with the ATO. Further information on the Lead Relationship Manager role is contained in Chapter 6 of this report.

Initiative 13 — Large Business and Tax Administration Symposium

2.116 The Commissioner committed to convene a large market symposium to foster strong co-operative relationships between the Tax Office and our largest corporations.

2.117 The inaugural Large Business and Tax Administration Symposium was held on 30 August 2006 and was attended by 84 of Australia's top 100 corporate taxpayers, together with representatives from the major accounting and law firms, other regulatory authorities, the Treasury, the Office of Parliamentary Counsel and the Board of Taxation.

2.118 There were a number of action items arising from the symposium:

- examining the cost of compliance with a focus on tax returns, schedules and corporate reporting;
- developing a suite of key performance indicators to measure the ATO's performance against the commitments made in the LBTC booklet, based on a mix of quantitative measures (such as volumes and cycle times) and qualitative measures (feedback from the case call-over process);
- co-designing the Client Feedback Questionnaire to ensure the process encourages honest taxpayer feedback;

- clarifying the ATO escalation and contact points for large business taxpayers; and
- exploring how the ATO can provide greater clarity and closure at the end of a risk review. The ATO established a Segment Leaders Forum that meets on a quarterly basis to focus on the outcomes of risk reviews and determine what further action might be appropriate. Under the new LB&I management structure announced during the course of this review this forum was replaced.

2.119 As well as launching the new version of the LBTC booklet, the symposium also covered topics such as Tax Office directions and performance, commercial and business directions, developments in tax law, compliance processes and services, key risks and common adjustment areas.

Professionalism Survey

2.120 The ATO engages DBM Consultants Pty Ltd to conduct a biannual Professionalism Survey across different areas within the organisation, encompassing a broad range of taxpayer groups.

2.121 Its main objective is to evaluate ATO employees' level of 'overall professionalism' as perceived by taxpayers who have had an interaction with the ATO in the previous six months.

2.122 This is completed by the evaluation of client satisfaction in two general areas:

- Professionalism displayed by ATO staff, specifically how satisfied was the taxpayer with the professionalism of the ATO staff they recently had contact with?
- Client understanding of the issue recently discussed with ATO staff, specifically how satisfied is the taxpayer that it now has a better understanding of the issue that it recently discussed with the ATO?

2.123 The level of professionalism (known as the 'overall professionalism' score) is derived from the average of the two questions listed above.

2.124 ATO staff professionalism is further evaluated by an assessment of the behaviour and ability of ATO staff across six key elements of professionalism; empathy, fair and just outcomes, accountability, communication, behaviour and ability. These six elements are measured by nine predefined characteristics. The table below shows how these nine Characteristics of Professionalism are measured in this and previous waves of the survey.

Table 2.2: ATO Characteristics of Professionalism

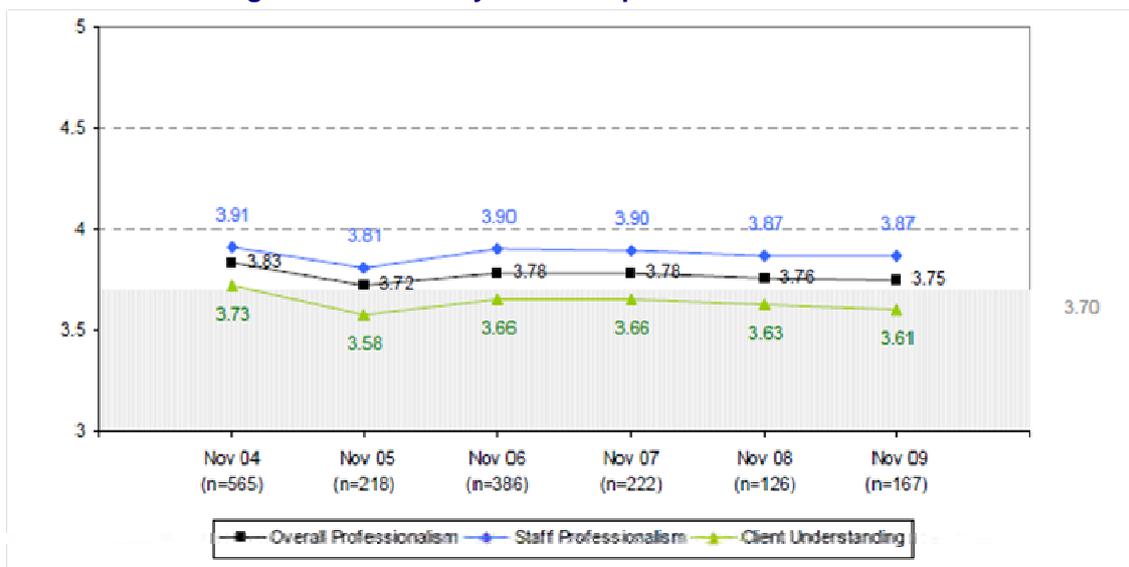
Element of Professionalism Model	Characteristic of Professionalism	Label used in Charts	Question from Survey
Empathy	Respect for taxpayers	Respectful and courteous	Staff were respectful and courteous towards taxpayer
	Explain and respect taxpayer's rights	Willingness to explain rights	Staff were willing to explain taxpayer's rights, obligations and entitlements
Fair and Just outcomes	Procedural fairness	Assisted to best of ability and within law	Staff assisted taxpayer to the best of their ability and within the law
	Distributive justice	Result fair and reasonable	The result was fair and reasonable
Communication	ATO's communication	Communicated clearly	Staff communicated clearly in ways taxpayer could understand
Accountability	Accountable for actions	Willingness to follow matter through to conclusion	Staff were willing to ensure that the matter was followed through to a conclusion
	Understand taxpayer's needs	Understood needs	Staff understood taxpayer's needs and assisted taxpayer in meeting them
Behaviour	ATO's behaviours	Staff are fair, reasonable and unbiased	Staff were fair, reasonable and unbiased
Ability	ATO's ability	Sufficient understanding of issue	Staff had sufficient understanding of the issue being discussed to be able to help taxpayer

2.125 Results from the Professionalism Survey are used to report to internal and external stakeholders as follows:

- to report ATO performance in the annual report and as one of the agency agreement corporate outcome measures;
- to measure taxpayer perceptions of staff professionalism and service to feed into the ATO's Outcome and Outputs Framework with a view to helping to maintain community confidence in the administration of the tax system;
- to collect data that is used to evaluate compliance with the requirements of the Taxpayers' Charter; and
- to identify areas within the ATO for improvement – including training and support required for ATO staff overall and specific business areas, as well as systems and process improvements.

2.126 The November 2009 survey found that satisfaction with 'overall professionalism' and its two components (staff professionalism and client understanding) has remained quite consistent among large market taxpayers over the last six surveys, with the 'overall professionalism' mean score of 3.75, which is above the benchmark score of 3.7.

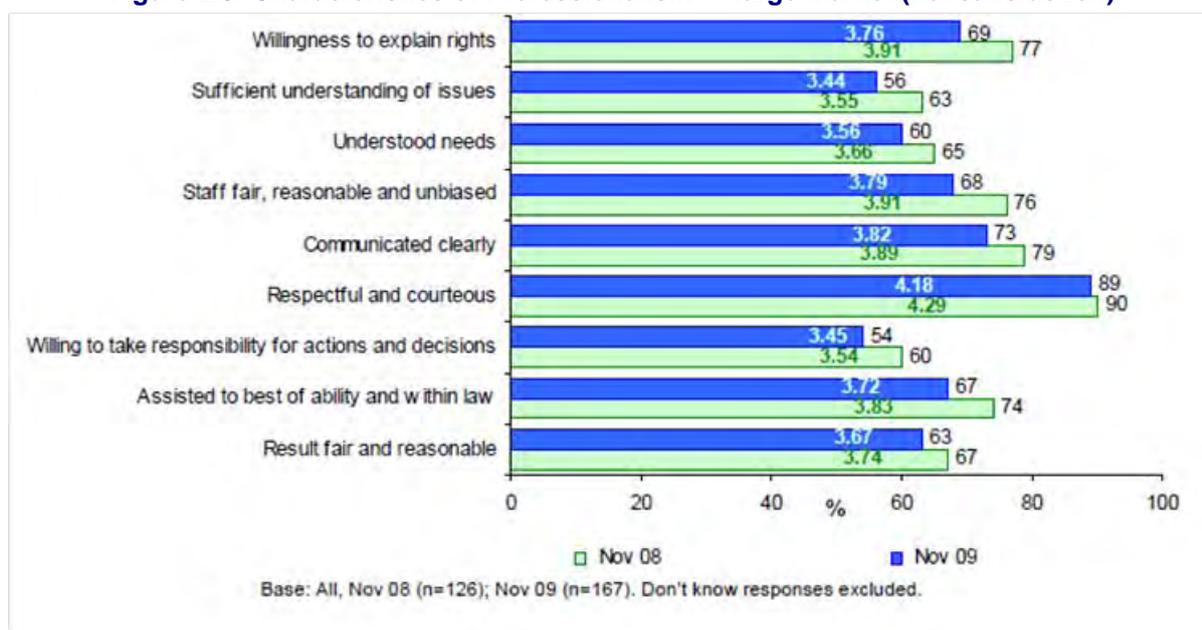
Figure 2.4: Summary of overall professionalism scores



2.127 The proportion of large market taxpayers who were either ‘very satisfied’ or ‘satisfied’ with ‘client understanding’ has remained consistent since November 2007 at 63 per cent. However, in November 2009 the proportion of ‘very satisfied’ taxpayers increased six percentage points (to 17 per cent), while the proportion of ‘satisfied’ taxpayers decreased six percentage points to 46 per cent.

2.128 The proportion of net satisfaction and mean score satisfaction for all Characteristics of Professionalism remained relatively consistent this survey with no statistically significant changes recorded.

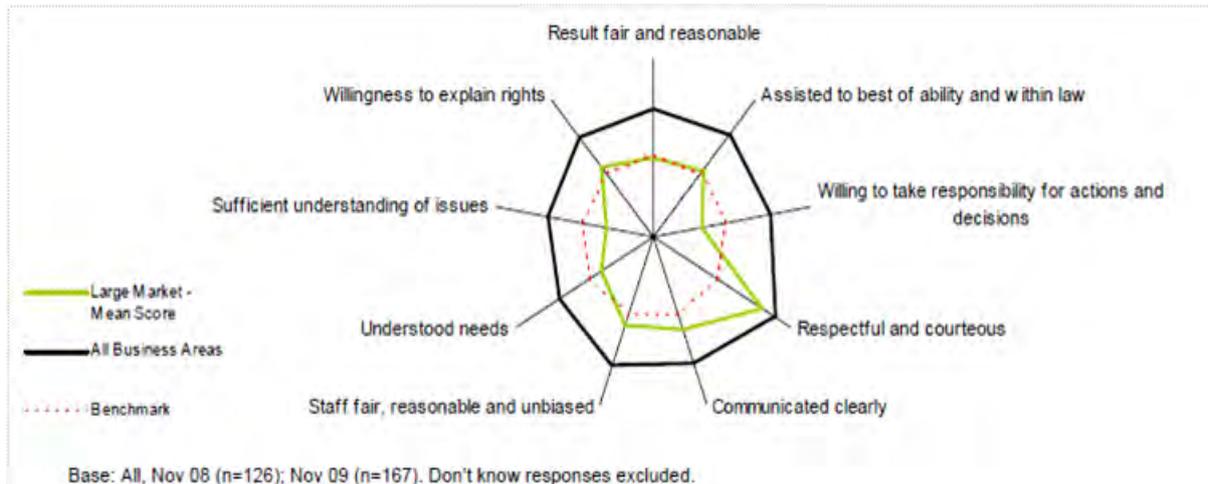
Figure 2.5: Characteristics of Professionalism — large market (net satisfaction)



2.129 The IGT notes that the highest performing characteristic was ‘respectful and courteous’ and ‘communicated clearly’ while the lowest were ‘willingness to take responsibility for actions and decisions’ and ‘sufficient understanding of issues’.

2.130 Satisfaction among large market taxpayers was lower than the other business areas for all Characteristics of Professionalism, with satisfaction for some characteristics falling below the ATO benchmark. The largest performance gaps were for 'sufficient understanding of issues', 'willing to take responsibility for actions and decisions' and 'understood needs' all of which were also below the ATO benchmark.

Figure 2.6: Characteristics of Professionalism — comparison between large market and all other business areas



Client Feedback Questionnaires

2.131 As part of each risk review and audit the ATO has advised the IGT that it gives taxpayers an opportunity to provide feedback through its Client Feedback Questionnaires (CFQ). CFQ results are made available to LB&I leadership group and compliance teams to help them understand what they are doing well and to identify potential areas for improvement.

2.132 By way of comparison, the 2005-06 results (prior to the LBTC booklet) indicated an overall client satisfaction of 73 per cent, with specific product scores being:

- written binding advice products achieving the highest satisfaction level of 79 per cent, with a further 14 per cent rating the experience as neither high nor low;
- risk review and audit products achieving a 73 per cent level of satisfaction, with a further 21 per cent rating the experience as neither high nor low; and
- audits-in-progress receiving the lowest satisfaction rating of 51 per cent, with a further 31 per cent rating the experience as neither high nor low.¹²

2.133 The main issues raised by taxpayers were the need for ongoing communication about the progress of compliance products and the ATO not providing adequate closure upon the finalisation of risk reviews and audits.

¹² Speech by Jim Killaly (Deputy Commissioner LB&I) to the Australian Taxation Summit, Sydney, 5-7 February 2007.

2.134 Table 2.3 sets out a break-up of the CFQ results in relation to the highest and lowest rated questions for 2005-06.

Table 2.3: CFQ results for 2005-06

CFQ type	Audit or risk review	Written binding advice	Audit-in-progress
Highest rated questions	<ul style="list-style-type: none"> Explanation of the reason for the risk review or audit Providing taxpayer with enough time to prepare Negotiation of a suitable timeframe Helping taxpayer to understand the risk review or audit process Taking a cooperative and collaborative approach 	<ul style="list-style-type: none"> Application of tax law knowledge to the issues taxpayer identified Ability to listen to taxpayer Communication about the progress of taxpayer's advice Focus on reaching a decision 	<ul style="list-style-type: none"> Explanation of the reason for the audit Providing the taxpayer with enough time to prepare Explanation of why information was requested Taking a cooperative and collaborative approach
Lowest rated questions	<ul style="list-style-type: none"> Understanding of taxpayer's industry Understanding of taxpayer's business Willingness to negotiate about how these outcomes would be achieved Timeliness in finalising the risk review or audit 	<ul style="list-style-type: none"> Understanding of taxpayer's industry Understanding of taxpayer's business Flexibility in negotiation Timeliness in finalising the advice 	<ul style="list-style-type: none"> Consideration of taxpayer's point of view Taking a fair and reasonable approach Communication about the progress of the audit Willingness to negotiate about any points of disagreement

2.135 The IGT considers that ATO compliance performance measurement is a very important area for both the ATO, taxpayers and the community more broadly. It may also be that for the community broader measures of compliance performance management of the tax system itself may need to be considered. The developments in this area need to be monitored closely.

CHAPTER 3: CONTEXT, FINDINGS AND RECOMMENDATIONS

3.1 The ATO identified 'large business' market segment represents a significant part of the Australian economy and plays a crucial role in the tax system. In 2008-09 large business represented 63 per cent (\$37.8 billion) of income tax collections from companies and 53 per cent (\$20.2 billion) of total net GST.¹

3.2 Large business taxpayers operate under the self-assessment regime, which means that taxpayers have a responsibility to correctly determine their tax obligations, in the same manner as other taxpayers. This requires taxpayers to take their own action in meeting these obligations, including:

- forming a view on the correct legal treatment of matters required for their tax return;
- lodging a tax return on the basis that they believe it correctly reflects the law as it applies to the relevant facts and assessing the appropriate amount of taxable income and tax payable;
- seeking advice where appropriate; and
- making full and true disclosures of all material facts when subject to ATO risk review or audit.

3.3 The ATO's role in the tax system, under the leadership and authority of an independent Commissioner, is to administer the tax laws as enacted by Parliament and as interpreted by the courts and tribunal without fear or favour.

3.4 The ATO has accepted the responsibility of providing taxpayers with guidance, advice and other support in assisting them to meet their tax obligations. The ATO is also responsible for the integrity of the tax system, not only in the sense of its wholeness and soundness, but also its fairness and honesty. This is re-affirmed in the ATO's Compliance Program with its two stated compliance roles:

- to maximise the number of taxpayers who choose to voluntarily comply by making it as easy as possible for them to understand and meet their obligations; and
- to have strategies to deter, detect and address non-compliance.

3.5 This requires the ATO to ensure that taxpayers are voluntarily complying with their tax obligations and paying or remitting to the ATO what is required under the law. As part of this role the ATO undertakes a variety of compliance activities, ranging from telephone calls and, questionnaires to risk reviews and audits.

1 Large Business and Tax Compliance, p 7.

3.6 There is general acknowledgement that there has been a significant improvement in ATO interactions with taxpayers and a higher degree of diligence and professionalism in the large market segment.

3.7 However, the management and handling of risk reviews and audits, including their efficient and effective progression and the accountability of decisions and actions, are areas that have an important bearing on the broader relationship between the ATO and taxpayers.

3.8 In response to the 2005 Burges Report, the ATO announced 13 initiatives to improve its risk review and audit processes and strengthen its relationships and understanding of large business. For details on this report and the ATO initiatives refer to Chapter 2.

3.9 The ATO noted that the key themes behind the process improvements was the need to actively engage with taxpayers, keep them informed of the progress of a risk review or audit and ensure that taxpayers understood the technical basis for the ATO's concerns about transactions and risks. This was to be a move away from a more closed approach to dealing with large market taxpayers of previous years to a more cooperative and transparent relationship. The ATO indicated that these principles and guidelines would be followed by case officers and the implementation of the initiatives would be embedded into its quality assurance processes and performance agreements.

3.10 The IGT found that the ATO's large business risk review and audit policies, procedures and practices have undergone major changes over the last five years and a number of the initiatives have had a positive impact on the finalisation of the majority of risk reviews and audits within the specified timeframes.

3.11 For example, the IGT found that audit teams convene internal workshops throughout a risk review and audit as a way to bring together subject experts and technical specialists. This has allowed for the more timely identification of potential issues and information needs. Also, the ATO now places greater emphasis on case management of risk reviews and audits to ensure cases progress in a timely manner, (primarily through the use of risk review and audit plans, monthly call-overs, audit call-overs and workshops).

3.12 The IGT believes that many ATO risk review and audit policies and principles put in place over the last several years (and as encapsulated in the Large Business Tax Compliance booklet) are appropriate and aimed at making the review and audit processes more efficient, cooperative and less intrusive. There has also been a corresponding improvement in ATO attitude expressed by taxpayers, especially at the senior management level.

3.13 However, a number of the concerns raised in the 2005 Burges Report continue to surface within the range of submissions and consultations received by the IGT in this review, especially relating to issues of communication, engagement and transparency in the risk review and audit processes.

3.14 In addition, the substantial number of submissions received by the IGT during this review suggests that there is a genuine opportunity to improve the relationship between the ATO and large business. A range of taxpayers and their advisers observed

a misapplication of (or lack of adherence to) ATO policies and procedures, leading to undue delays, unnecessary cost and resource demands and a heightened level of frustration on the part of corporate taxpayers and their advisers.

3.15 These concerns were raised by taxpayers from a cross-section of the key large business taxpayer segment and not just in the case of more complex or controversial issues or ATO taxpayer profiles that may have suggested taxpayers were higher risk.

3.16 The difficulty and uncertainty that this may create is an unwelcome feature of an already complex tax system that undermines taxpayer and ultimately community confidence in the ATO's administration of the tax system where it occurs.

3.17 Importantly, the inefficient or uncertain application of risk review and audit processes gives rise to significant unnecessary direct and indirect compliance costs for both taxpayers and the ATO. Such costs are a dead weight on the Australian economy.

3.18 The ATO also canvassed with the IGT some challenges presented by the modern large business environment. Briefly, the main challenges relate to globalisation and the increasing importance of a smaller number of much larger taxpayers (or a concentration risk). These taxpayer groups tend to also have increasing international or global offshore business activities in an increasingly complex environment. The ATO also cited complexity of transaction arrangements and dealings as a challenge in this environment. The result is a concentration of tax revenue supply consequences for the ATO as administrator and the Government more broadly.

3.19 The IGT appreciates the significance of this development for the ATO. There is an important tension in ensuring that the law is applied appropriately in the collection of tax revenue and the expectation that business, while needing to comply with their obligations, are able to function without undue compliance cost or interference. Such an approach is critical in fostering and maintaining a taxpayer culture of voluntary compliance and also a positive business environment.

3.20 It is important that principles set out in the Large Business and Tax Compliance (LBTC) booklet and Large Business and International (LB&I) Compliance Manual are adhered to in improving the relationship between the ATO and large businesses so as to reduce the occurrence of negative perceptions around the ATO's risk review and audit approaches, particularly in the more complex or difficult audit cases. This is also relevant in an environment where the ATO is looking to place far greater emphasis on its Risk Differentiation Framework (RDF) by treating large business taxpayers differently according to their risk profile.

3.21 The IGT notes that there are also external factors that may influence the behaviour of the ATO and taxpayers. For example, both large business and the ATO have indicated that the Federal Court Practice Note TAX 1, which sets out revised arrangements for the management of tax cases that go on to litigation in the Federal Court, has had a considerable impact on the conduct of large business risk reviews and audits.

3.22 Given the requirement to narrow the issues at the early stages of litigation and the limitations on both the ATO and taxpayers obtaining further information or documentation, the ATO now seeks to ensure that it is 'litigation-ready' at the audit

stage. The ATO states that to resolve issues, it needs to be in the same factual position as a taxpayer's decision-makers, which requires the ATO to get to the 'full facts quickly', along with the relevant supporting evidence.

3.23 A range of taxpayers suggested that the ATO's attempts to be in the same factual position as the taxpayer's decision-makers has led to blanket requests for information even where it is irrelevant or immaterial to the issues subject to audit.

3.24 The ATO management have suggested that their intention for a given matter is to ensure they have full facts quickly and that 'blanket requests' are not supported under instructions to staff².

3.25 The issue of information gathering and related requests is an extremely important one for taxpayers, their advisers and the ATO. It is addressed further in Chapter 7.

ATO EXPECTATIONS OF LARGE BUSINESS TAXPAYERS AND TAX PRACTITIONERS

3.26 The ATO's new strategic statement sets out its aspiration to actively engender willing participation in the tax system through a range of strategies. These include collaboration to generate greater community involvement (for example, the Large Business Advisory Group and other industry forums and working groups across the Large Market); supporting voluntary compliance through public rulings, private rulings and education products; and protecting the integrity of the systems through targeted and appropriate compliance work and differentiated approaches recognising that non-compliance can have a range of causes.

3.27 The ATO has taken an approach of directly engaging with senior management (CEO and CFO) and board members of large market companies to ensure that a sound framework is in place to manage tax risks and comply with tax obligations. This includes ensuring there is:

- a well-resourced in-house tax governance capability to manage and mitigate tax risk and a capacity to regularly audit tax governance systems;
- appropriate review and sign-off procedures for material transactions and reporting requirements which ensure that significant tax risks are elevated to the board;
- a system to identify, assess, monitor and approve material tax issues; and
- an understanding of the ATO's risk rating assessment of their business (more recently).

3.28 The ATO wants an enhanced relationship with large business taxpayers characterised by high levels of mutual transparency and trust. This means that even if at times the law appears indeterminate and the ATO and taxpayer hold different views

2 Large Business and Tax Compliance, p 27.

then both parties will seek to have the matter clarified upfront or resolved as quickly as possible.

3.29 The ATO wants taxpayers to share potential tax risks in a real-time environment and where a matter proceeds to a risk review or audit to then get the full facts quickly, along with the relevant supporting evidence. It wants taxpayers to assist the ATO in ensuring that the ATO meets its planned timeframes by providing information in a timely way and ensuring that appropriate staff are available for interview.

3.30 The ATO acknowledges that this requires a general sense of trust, but its role as an administrator means that it will still need to verify some matters to provide system assurance and integrity.

3.31 The ATO acknowledges that building an environment of mutual trust is not easy and involves a degree of cultural change by all parties.

LARGE BUSINESS TAXPAYER EXPECTATIONS OF THE ATO

3.32 Large business taxpayers provided the IGT with clear expectations that they had of the ATO and the tax system. They indicated that high on the list was a relationship based on mutual trust with an appreciation of the practical and commercial realities of transactions, the current complex environment in corporate tax and the resources taxpayers are expending to comply in a self-assessment tax system.

3.33 Taxpayers note that the compliance expectations gap between the ATO and large business taxpayers has narrowed considerably, as evidenced by the increase in voluntary disclosures, but consider that the ATO has not provided sufficient recognition, accommodation or acknowledgement of large business in this regard. There is a general sense amongst large business that the closing of this gap can be largely attributed to the efforts of taxpayers.

3.34 Taxpayers made strong representation to the IGT that over the last 10 years large businesses have made significant improvements to their tax risk management practices. They also indicated that tax is rarely the driver of large businesses' commercial decisions. Large business taxpayers believe that company boards and management now play a far more active role in managing tax risk and expect the ATO's risk review and audit approaches to evolve to acknowledge this and support tax managers and advisers.

3.35 For example, taxpayers that exhibit a highly cooperative approach, with a demonstrated commitment to tax compliance and sound governance systems wanted a more cooperative, transparent and understanding relationship. In particular these taxpayers felt that notwithstanding that the ATO's current RDF places them in a higher risk quadrant due to their size and potential consequence on revenue collection, the compliance focus should be more appropriately measured and directed given the cost and effort they made toward such cooperative compliance.

3.36 Taxpayers also made strong representation to the IGT that they wanted greater recognition that they operate in a self-assessment tax system environment – another concern high on their list. It was acknowledged by taxpayers that there will be some tension in such an environment and that this may even be a positive providing it does not lead to unnecessary uncertainty and increased compliance costs.

3.37 In this context, reference was made by taxpayers to the historical full assessment system that existed prior to the introduction of self-assessment. They felt this process was clear in its approach and final in outcome. A number of taxpayers and advisers familiar with this system indicated that they believe the current approach to the self-assessment system is now a hybrid with the worst of both worlds for taxpayers, where all the primary cost of process, interpretive decision making and liability is placed upon them until amendment periods expire.

3.38 Taxpayers also no longer have the option of obtaining final closure by requesting that the Commissioner provide a ‘full’ assessment. Private rulings were introduced with self-assessment as an attempt to bridge this taxpayer assurance gap to some extent. However, taxpayers expressed the view that lingering uncertainty always remains, as it is simply not possible to obtain private rulings on every issue or to appreciate every legal interpretation that the ATO may wish to review or challenge, given the very complex legal system and administrative requirements placed upon them.

3.39 A significant number of taxpayers also suggested that whether they regularly interact with the ATO (such as seeking private rulings in particular) should not of itself be a factor in determining a taxpayer’s risk rating (please refer to Chapter 4 for further discussion of this risk rating context).

3.40 A range of taxpayers suggested that while some in the ATO have been actively seeking to build a real-time relationship through more cooperative arrangements, there still remain a number of blockers. A not uncommon problem cited by taxpayers was the inability to resolve so called ‘legacy’ or ‘special’ issues and the overriding impact that these have on relationships. Taxpayers more universally felt that there were certain strong dysfunctional influences or cultural issues which also arose from time-to-time that made for unnecessarily strained relationships.

3.41 Large businesses want risk reviews and audits that are well planned and delivered by appropriately trained and adequately supported staff in a manner that is consistent with the spirit of the principles in the LBTC booklet with particular emphasis on engagement, dialogue, timeliness, transparency and a real appreciation of compliance cost minimisation.

POTENTIAL IMPROVEMENTS IN THE ATO'S LARGE BUSINESS AUDIT AND RISK REVIEW POLICIES, PROCEDURES AND PRACTICES

3.42 In light of the above discussion, the IGT has identified three broad areas for improvement:

- greater certainty and transparency in the risk review and audit processes and procedures;
- more consistent and proportionate application of the risk review and audit principles and practices as set out in the LBTC booklet and the LB&I Compliance Manual; and
- greater engagement and dialogue and aspiring to a greater level of trust between taxpayers and the ATO so as to minimise compliance costs.

3.43 The IGT's recommendations seek to improve key aspects of the ATO's large business risk review and audit policies, procedures and practices as set out in Appendix 2.

3.44 It is critical to the ATO large business taxpayer relationship that the principles and guidelines set out in the LBTC booklet and the ATO's Compliance Manual are consistently followed and that this requirement is embedded into the LB&I quality assurance processes and performance management.

3.45 The ATO has made significant efforts to introduce a number of quality assurance processes such as the Integrated Quality Framework, monthly case reviews, workshops and the case call-over process during audits.

3.46 The IGT acknowledges the importance of the revised LBTC booklet that was released during the course of this review. The large market IGT consultations generally supported and agreed with most of the principles embodied in the booklet.

3.47 A key issue was the living out of the principles and their application in the details. ATO management also see this as an important challenge both for themselves and taxpayers. In this regard a number of the IGT recommendations could be grouped under a single heading of improved assurance; that is, to ensure that the ATO's processes are strengthened and improved to provide greater certainty that staff not only operate in accordance with the processes outlined in the LBTC booklet but do so in a way that 'lives out' the LBTC booklet's underlying values and principles.

3.48 The IGT believes that the level of user familiarity with and acceptance of the Siebel case management system (in its current form) impacts on ATO Case Officers, Team Leaders and Technical Leaders in performing their work efficiently and effectively. The IGT observed that some teams were more skilled than others in using Siebel to support ATO processes. Nevertheless, the ATO advises that it has provided LB&I staff with training on the use of Siebel, and also a dedicated support team to assist staff in using the system effectively.

3.49 The ATO acknowledged that Siebel is not always easy to use due to the size and complexity of some large cases and the associated evidentiary and documentation requirements, so it has initiated action during the course of this review to address the problem. In particular, the ATO has undertaken an improvement project that should enhance search functionality and other features. LB&I management also took action to roll out a document management system (Ringtail) that compliments the Siebel case management system. This is initially for use by complex audit teams, but will

eventually be provided to all staff to improve information-gathering, access and management.

LIST OF RECOMMENDATIONS

Outlined in this section is a complete list of the IGT recommendations from the other chapters of the report for summary reference.

RECOMMENDATION 4.1

Given the importance of the relationship between the ATO's risk classification of a taxpayer and its consequence, the ATO should continue to develop a more well-defined, transparent and consistent process in discussing and determining a taxpayer's ATO income tax risk rating at a given point in time under the ATO's RDF. This should include the ATO:

- making a risk classification for taxpayers in specific risk quadrants (at a minimum key and higher risk quadrant taxpayers but may be expanded depending upon taxpayer experience and needs);
- communicating the risk classification to the taxpayer disclosing all the relevant facts, metrics, weightings and reasoning underpinning this determination in writing;
- providing these taxpayers with an opportunity to meet face-to-face to discuss the determination;
- providing these taxpayers with a direct opportunity to reply in writing to this risk classification;
- appropriately reviewing and considering this taxpayer response; and
- allowing the taxpayer to escalate the matter to the Deputy Commissioner LB&I, if they are still dissatisfied with the rating.

RECOMMENDATION 4.2

To promote greater consistency and proportionate ATO delivery of a risk review and audit in accordance with the principles set out in the latest LBTC booklet, the LB&I Compliance Manual and supporting LB&I work practices should be revised to reflect more clearly the different risk profiles of taxpayers and support the more differentiated approach. This should include details on the expected process, level and type of engagement and mutual transparency as it relates to higher, key, medium and lower risk taxpayers.

The ATO should enhance its quality assurance processes (including monthly reviews) to include specific criteria or questions that test whether the principles and processes set out in the LBTC booklet (as revised) and LB&I Compliance Manual are fairly, consistently and professionally followed in a manner that is proportionate to the taxpayer's risk profile.

RECOMMENDATION 4.3

To improve transparency and promote greater understanding, the ATO should publicly release the LB&I Compliance Manual so as to provide better guidance and detail to taxpayers and advisers on the risk review and audit processes. This would include more detailed ATO guidance on the:

- scope and purpose of risk reviews and audits;
- thinking, reasoning and judgements behind important aspects of the risk review and audit processes;
- inputs to the risk review and audit processes such as the nature and detail of documentation to be requested at each stage;
- details on the roles, responsibilities and expectations of the various tax officers that may be involved in a risk review or audit;
- ATO and taxpayer expectations regarding the conduct of a risk review and audit; and
- type and level of expected engagement.

RECOMMENDATION 4.4

The ATO should streamline its various post-lodgement risk review and audit products into three specific processes:

- Preliminary risk review – this stage would involve no contact with the taxpayer and be primarily focused on the identification of potential compliance risks through internal ATO risk profiling and ratio analysis, media profiling, tax profiling history and examination of ownership structures.
- Risk review – involves a specific or a broad investigation of various risk areas identified in the preliminary risk review. As more information is obtained and should new risks be identified, the scope of a client risk review may be broadened, although this would be accompanied by updating and communicating of the ATO's revised risk hypothesis to the taxpayer.
- Audit – involves the detailed testing and refining of each specific risk hypothesis arising from the risk review or in the course of the audit.

RECOMMENDATION 5.1

The ATO should supplement its commitment to open dialogue in the LBTC booklet by providing additional guidance to LB&I staff and taxpayers on how it will develop, refine and communicate the risk hypothesis during a risk review and audit.

This should include a commitment to share the risk hypothesis with taxpayers in writing and discuss the risk hypothesis at certain stages in the course of a risk review and audit.

The implementation of this recommendation should consider whether the taxpayer should be notified and or consulted:

- where a risk hypothesis has been materially refined or changed (or a new risk hypothesis is identified) at appropriate management action points (e.g. after an ATO internal workshop);
- where a taxpayer provides additional or new information that results in a change in the ATO's risk hypothesis (either due to the risk hypothesis being refined or a new risk being identified);
- at the preliminary audit interview; and
- prior to issuing draft finalisation letters.

RECOMMENDATION 5.2

The ATO should enhance its assurance processes (including the Integrated Quality Framework) to ensure audit teams develop, refine and communicate a risk hypothesis in accordance with the expectations and requirements of the LBTC booklet and Compliance Manual.

This should include Team Leaders (and where appropriate Technical and Case Leaders):

- ensuring that the risk hypothesis has been correctly understood, tested and refined throughout the risk review or audit;
- examining and refining the risk hypothesis as part of the LB&I monthly review process;
- attending initial workshops to ensure that the risk hypothesis is expressed as a clear statement to be tested, and that it is understood by the audit team; and
- signing off that the risk hypothesis meets the requirements of the LBTC booklet and Compliance Manual, at key stages of the risk review or audit.

RECOMMENDATION 6.1

To provide greater leadership, transparency and accountability involving higher consequence taxpayers, the ATO should allocate a tax officer of executive level or higher as Team Leader with sufficient authority, technical expertise and leadership qualities to ensure there is a strong project management focus and that due process is followed in the conduct of any risk review and audit.

The Team Leader role should have the following responsibilities and expectations:

- end-to-end accountability for a risk review and audit including ensuring that key stages of a risk review or audit (such as technical decision-making and information gathering) are well-coordinated, timely and effective. This will necessarily involve being responsible for the technical components of the audit to ensure that critical technical decisions and the resolution of escalated issues, blockers and irritants are managed effectively;
- effective oversight of Case Officers and active management of other ATO officers involved in the process, to ensure the consistent and proportionate delivery of a risk review and audit in keeping with the ATO LBTC booklet requirements and the ATO's RDF; and

RECOMMENDATION 6.1 (CONTINUED)

- ensuring that there is proper dialogue and engagement with the taxpayer by actively participating in key workshops and meetings.

The Team Leader should also work closely with their Senior Executive Officer to ensure the latter is regularly appraised of case progress and emerging risks for the case plan, so they can develop and implement strategies to mitigate those risks.

The Senior Executive Officer will also:

- act as the key escalation point for taxpayer concerns with the conduct, progress or direction of a risk review or audit; and

consider and decide whether alternative dispute resolution is appropriate and ensure that genuine steps are taken to resolve potential disputes.

RECOMMENDATION 6.2

The ATO should provide greater guidance on the Team Leader's role and its responsibilities and expectations in the conduct of a risk review or audit, to better support consistent and proportionate delivery of the processes in conformity with the requirements of the LBTC booklet.

RECOMMENDATION 6.3

The ATO should revise its monthly case management review practices to capture a more diverse range of activities so as to ensure that all aspects of a case are adhering to established work practices and the expectations set out in the LBTC booklet. This should include revising the case review template to develop more targeted questions addressing audit teams regarding:

- frequency, mode and content of communication with the taxpayer during the month;
- risk hypothesis discussions with the taxpayer, including communication of material changes to the existing hypothesis or any new risk hypothesis raised during that month; and
- extent of engagement with the taxpayer to:
 - i) explain information requirements;
 - ii) identify relevant information; and
 - iii) develop a plan for information delivery to the ATO.

RECOMMENDATION 7.1

The ATO should provide further details on its informal and formal information gathering processes, including its guidance on the Section 264 notice issuance and legal professional privilege and accountants' concession claims, by publishing the ATO's 'Information Gathering in the Large Market' document on its website.

RECOMMENDATION 7.2

The ATO should incorporate appropriate checks and tests into existing assurance processes for informal information requests.

The ATO should:

- provide the taxpayer with an information request;
- give the taxpayer the opportunity to discuss the information request's scope, appropriateness and relevance with the ATO;
- work with the taxpayer to identify acceptable substitute documents, where the documents requested are not readily available; and
- make known to the taxpayer the reason for making the request, including a reference to the relevant risk hypothesis where appropriate (this may not be appropriate for certain third party information requests).

RECOMMENDATION 7.3

To improve taxpayers' understanding and to provide transparency in the evidence-gathering process, the ATO should provide more guidance on this process in the LB&I Compliance Manual.

RECOMMENDATION 7.4

Where the ATO adopts a formal information-gathering approach, the assurance processes need to ensure expectations set out in the LBTC booklet and Compliance Manual are properly met.

RECOMMENDATION 7.5

The ATO improve legal support to audit teams in preparing information requests and providing advice on the evidentiary needs of an audit.

RECOMMENDATION 7.6

The ATO should in consultation with the Large Business Market consider whether an ATO publication be developed, that is more expansive than the LBTC booklet and yet narrower and more targeted in focus than the ATO's Compliance Manual, and is directed at 'Audit and Risk Review' issues with a taxpayer-specific audience.

RECOMMENDATION 8.1

To improve taxpayer certainty, after completion of the risk review the ATO should make the decision as to whether it will proceed to audit promptly. If the decision is made to proceed to audit, then the audit should be commenced as soon as possible. The ATO should also nominate an appropriate contact officer who will maintain regular contact with the taxpayer, to keep them informed of the progress of their case.

RECOMMENDATION 8.2

Agreeing facts assists in maximising understanding of issues and minimising dispute-related costs and better directs evidentiary needs, therefore, the ATO should implement a process that is designed to:

- establish the facts and issues at the early stages of the audit process, by providing taxpayers with a draft Statement of Facts before conducting significant detailed technical legal analysis;
- provide the taxpayer with an opportunity to clarify and correct the draft Statement of Facts by way of explanation or provision of additional information;
- revise this statement as is considered appropriate; and
- communicate the Statement of Facts (as revised) to the taxpayer, noting particularly where there may be a disagreement as to facts or findings of fact.

RECOMMENDATION 8.3

To improve audit case management the ATO should set clearer benchmarks for key events within the two year audit timeframe.

These benchmarks should include the following:

- the ATO provide the taxpayer with a draft Statement of Facts (within 9 months from audit commencement date);
- the ATO to provide an opportunity for an ATO-taxpayer workshop to discuss the draft Statement of Facts and taxpayer response, that is also attended by relevant technical specialists and key decision-makers (within 3 months after the step above);
- the taxpayer to respond and clearly set out the material facts agreed, material facts in dispute along with appropriate supporting evidence (within 3 months after the step above);
- the ATO to issue a draft position paper (within 3 months after the step above); and
- the ATO to provide an opportunity for an ATO-taxpayer workshop to discuss the draft position paper, which should be attended by technical specialists and key decision-makers (within 2 months after the step above).

RECOMMENDATION 8.4

The ATO should review the escalation processes embodied in publicly available guidance (including the LBTC booklet) through a process of consultation with the Large Market, to specifically consider improvements that may be made in enhancing stakeholder understanding and access for addressing concerns in audit and risk reviews.

RECOMMENDATION 8.5

If the ATO wishes to expand the scope of an audit, to encompass issues that were not listed in the original audit notification letter, then it should only do so after subjecting the issues to an appropriate approval process such as business case approval or risk review. This is designed to ensure that the audit is warranted and that overall compliance costs are minimised.

RECOMMENDATION 8.6

An ATO framework should be developed that provides a formal process for determining whether an ATO extension of time request made upon a taxpayer is appropriate in their particular circumstances. Such a framework should ensure that a request is not made where the need for the extension has arisen from undue delay on the ATO's part.

RECOMMENDATION 8.7

The ATO should develop an 'Aged Case Report' showing all audits that have not been finalised within two years and providing reasons, and supply this report to the Deputy Commissioner LB&I on at least a monthly basis. The Deputy Commissioner LB&I should review this report and determine any action required to expedite these audits.

RECOMMENDATION 8.8

The ATO should enhance the IQF process to ensure that the Facts and Evidence Worksheets are completed effectively and progressively throughout the audit process, in accordance with policy and to provide a continuous and accurate repository of operational work activities.

RECOMMENDATION 9.1

The ATO should develop and publish enhanced written guidance on the purpose, content and drafting of position papers in an appropriate publicly available publication.

RECOMMENDATION 9.2

The ATO should enhance its quality assurance processes to ensure position papers issued by the ATO clearly set out and address the following:

- issues subject to audit;
- material facts relevant to each issue that are agreed (including appropriate references to supporting evidence);
- material facts upon which the taxpayer or the ATO rely that are in contention (or expected to be in contention);
- the legal position or view the ATO has adopted and the reasons why (including appropriate legal and factual analysis); and
- the taxpayer's legal position or views and their contentions as to the ATO's legal position.

RECOMMENDATION 9.3

Where a taxpayer does not agree with the content of the ATO position paper (whether on fact or law) a senior technical specialist should review the taxpayer's response, form a view and sign-off on the final position paper. The senior technical specialist should have sufficient technical expertise and should not have been directly involved in the audit.

RECOMMENDATION 10.1

To improve transparency and taxpayer understanding of the ATO's interest and penalty consideration and determination processes, the ATO should improve the quality and timeliness of its communication and engagement with taxpayers.

RECOMMENDATION 10.2

The ATO should enhance the voluntary disclosure process by ensuring that it clearly communicates to the taxpayer, at the time of the disclosure in question or promptly afterwards, whether it accepts that the disclosure is voluntary.

CHAPTER 4: LB&I COMPLIANCE FRAMEWORK

4.1. An overview of the ATO's broad LB&I compliance model or framework (including the Risk Differentiation Framework) is provided in the initial part of this chapter, given its overarching relevance to this IGT review.

4.2. The stakeholder issues and concerns are then considered in this context and a number of IGT recommendations are made, to improve the transparency and delivery of the ATO's compliance approaches for the benefit of both taxpayers and the ATO.

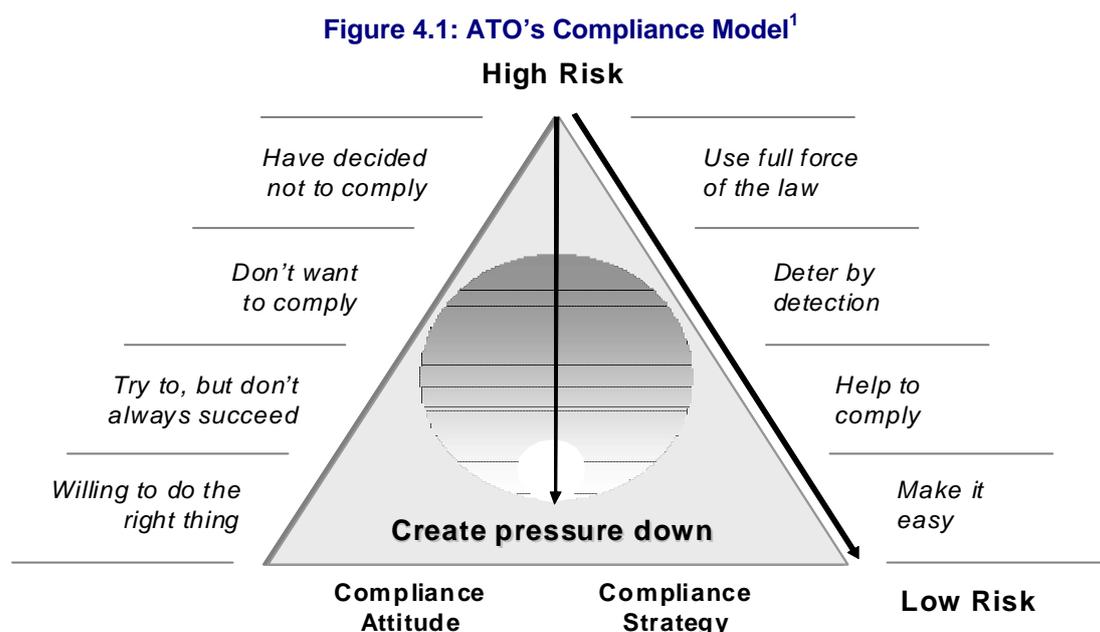
4.3. The ATO's specific risk reviews and audit processes and procedures (arising out of this compliance framework) are examined in Chapter 7 of this report.

4.4. It is also important to appreciate that the IGT has not had the opportunity to review the ATO compliance framework or the risk differentiation framework as such – these are large areas for potential review in their own right.

LB&I COMPLIANCE APPROACHES

Compliance Model and the ATO's end-to-end risk management framework

4.5. The ATO's broad approach to compliance is captured in its Compliance Model, as set out in Figure 4.1.



1 Large Business and Tax Compliance, p 6.

4.6. The Model provides the framework which the ATO uses to assess taxpayers and develop an appropriate response according to the nature and level of risk identified by the ATO, the cause of the non-compliance and the taxpayer's level of cooperation. It suggests an escalatory or responsive compliance strategy to create an incentive for a taxpayer to move towards a more engaged and compliant behaviour set. The Compliance Model was chosen to indicate the relative number of taxpayers that might be found at each level, the hierarchical and escalating nature of the engagement and to highlight the increasing focus towards the apex for the relatively few taxpayers that appear to deliberately not comply.

4.7. Building on the Taxpayers' Charter in the spirit of cooperation with large business, the Large Business and Tax Compliance (LBTC) booklet states that taxpayers can expect tax officers will:

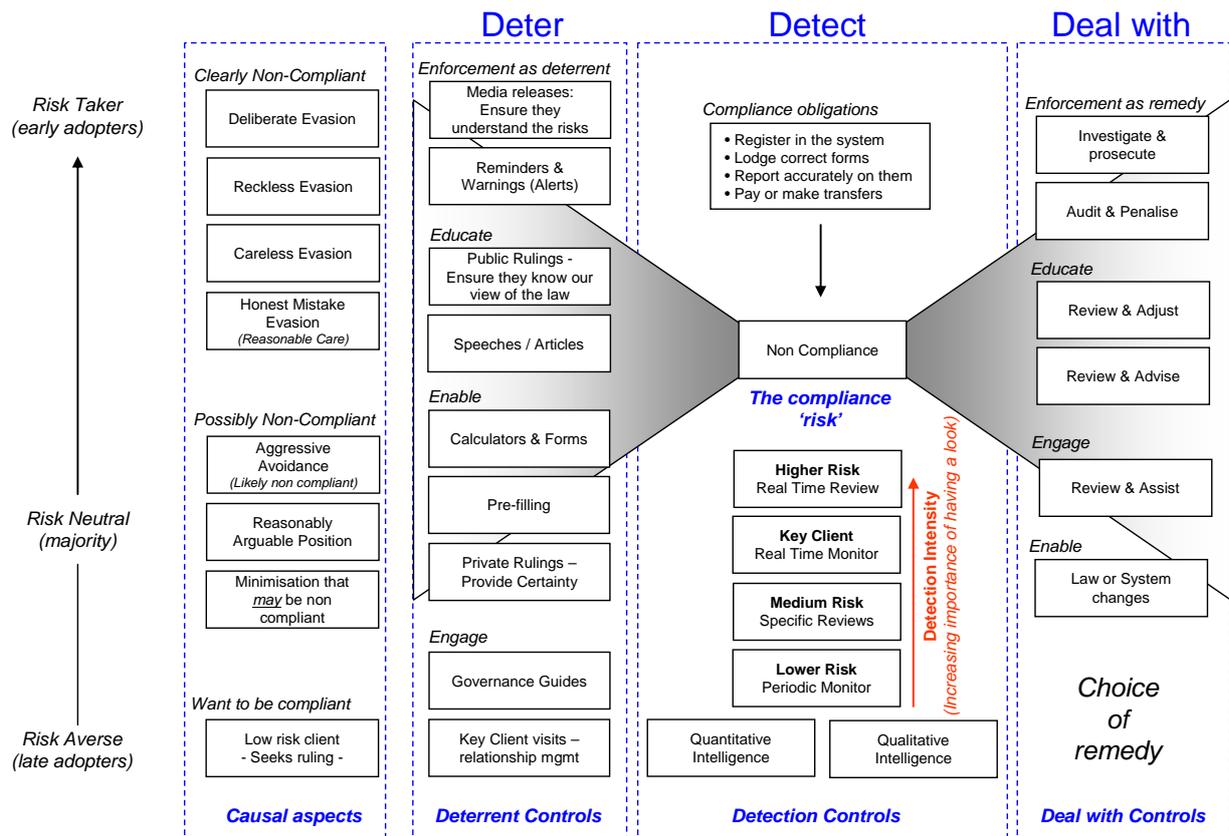
- act in a professional, courteous and respectful manner and demonstrate integrity, fairness and impartiality in the conduct of their duties;
- maintain open and frank dialogue, including informing taxpayers regularly of the progress of any compliance activity;
- aim to make information requests clear and unambiguous;
- complete a case in the shortest time practicable, with minimum inconvenience and disruption;
- advise taxpayers of delays or where timelines are extended and the reasons why;
- notify taxpayers where an error is detected that has resulted in a taxpayer paying more than the correct amount of tax;
- recognise taxpayers' rights to have advisers present during discussions and meetings and allow taxpayers to confer with them as necessary; and
- recognise taxpayers' right to claim legal professional privilege, accountants' concessions and confidentiality where appropriate.²

4.8. The ATO sets out compliance options for taxpayers from an administrator's perspective. Some taxpayers may adopt what the ATO considers to be a more aggressive attitude to compliance and choose not to comply while others will either try to follow the ATO view or choose otherwise.

4.9. Figure 4.2 sets out a diagrammatic representation of the ATO's end-to-end risk management framework.

2 Large Business and Tax Compliance, p 6.

Figure 4.2: ATO's end-to-end risk management framework³



4.10. The following paragraphs 4.11 to 4.17 set out some of the ATO's thoughts on compliance, as gleaned from publications such as the Large Business and Tax Compliance booklet.

4.11. This ATO framework is based on the premise that encouraging voluntary compliance requires effective engagement and a credible compliance program. It places an emphasis on:

- deterring non-compliance through a range of different methods such as media strategies, education, engagement and assistance;
- detecting potential non-compliance through quantitative and qualitative intelligence and ensuring that taxpayers meet their compliance obligations such as lodgement of tax returns; and
- dealing with potential non-compliance through enforcement (investigation, audit and prosecution), education and engagement. From a risk management framework perspective, the ATO states that an enforcement outcome indicates that the preventative and deterrent controls described above have been ineffective in encouraging voluntary compliance.

3 Large Business and Tax Compliance, p 23.

4.12. The ATO seeks to assist large businesses to comply voluntarily with their obligations through a number of strategies, including:

- clarifying the law and communicating ATO views through public and private rulings, products such as checklists, fact sheets and practice statements, taxpayer alerts and strategic litigation;
- consulting with industry bodies on issues affecting compliance;
- developing Annual Compliance Arrangements (ACA's) that provide taxpayers with the ability to manage tax risk cooperatively in real-time;
- forward compliance options including the mitigation of transfer pricing risks through Advance Pricing Agreements (APA's);
- providing access to ATO subject matter experts and senior leaders; and
- relationship management via client relationship manager and Lead Relationship Manager (LRM) roles.

4.13. The ATO states that its compliance actions need to provide both fair warning of the ATO's concerns (through rulings, publications and alerts) and firm, targeted and timely treatment of those that appear not to have complied.

4.14. The ATO notes that the success of its risk management framework requires that the large market community perceive it as reasonable, robust and rigorous.

4.15. Importantly, the ATO states that its choice of treatment must always be appropriate to a taxpayer's facts and circumstances otherwise its conduct or actions could undermine voluntary compliance in the longer term.

4.16. The ATO observes that well-advised taxpayers with good tax corporate governance systems are rarely non-compliant and this would generally be inadvertent. While large market taxpayers generally comply with the ATO view of the law if it is known to them or will have a reasonably arguable position, if errors do occur, the consequence can be very large because of the size of the largest taxpayers. This is the reason why the ATO conducts continuous monitoring and review in the higher consequence part of the market.

4.17. The ATO acknowledges that there is uncertainty associated with the application of some aspects of the law to the relevant facts and circumstances. The ATO believes that it is important in such instances that it supports and assists taxpayers by providing public guidance on its view of the law and what constitutes compliance.

Identifying compliance risk

4.18. The LBTC booklet states that the value, volume and complexity of transactions undertaken by large business have inherent risks for tax compliance. The ATO states that it applies a level of risk analysis to all large businesses and that its overall approach is to closely examine significant transactions and business results that show

inconsistencies between tax and the economic outcomes. The LBTC booklet and the ATO's Compliance Program provide more information on the specific compliance risks that the ATO is focusing on in the 2010-11 income year.

4.19. The IGT notes that in the course of this review a number of taxpayers raised concerns with the ATO's identification of specific compliance risks (or risk hypotheses). It was suggested that there are a high proportion of 'false' outcomes for ATO hypothesised risks (that is, the ATO risk raised with taxpayers was 'false' as there was in fact no risk realised). Taxpayers raised concerns with unnecessary cost of compliance and the potential for real problems in the ATO's risk identification process. This may well be a review topic in its own right which may be pursued at a later date by the IGT or other relevant government agency.

Risk Differentiation Framework

4.20. The ATO uses the Risk Differentiation Framework (RDF) approach to assess the tax risk of large business taxpayers. The RDF is based on the premise that the ATO's risk management stance will differ based on its perception of the taxpayer's estimated:

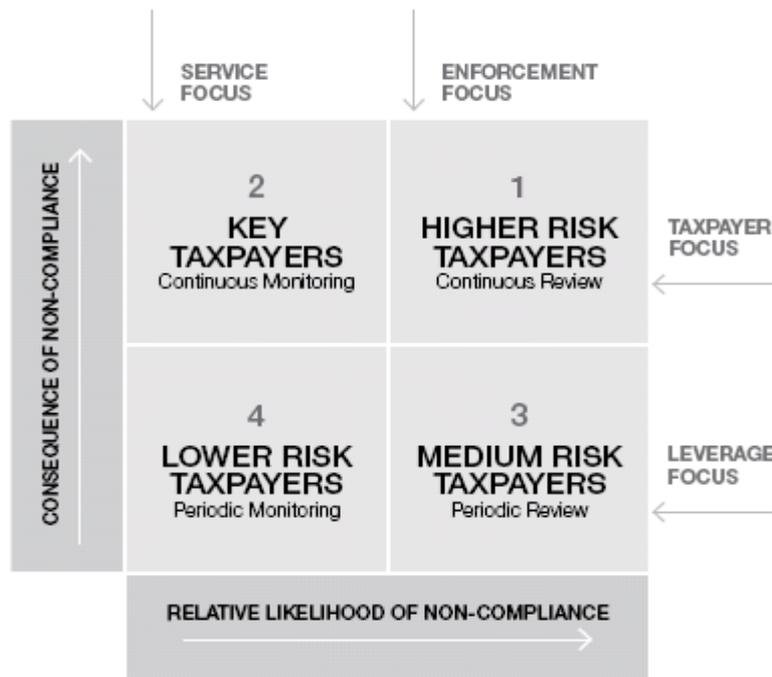
- likelihood of non-compliance (that is, having a tax outcome that the ATO does not agree with); and
- the consequence (dollars, relativities, reputation, precedent) of that non-compliance.⁴

4.21. Using the framework, the ATO places taxpayers into one of four broad risk categories (higher risk, key taxpayer, medium risk and lower risk) for each tax type. Figure 4.3 provides a diagrammatic summary of the main features of the ATO's RDF.⁵

4 Large Business and Tax Compliance, p 23.

5 Large Business and Tax Compliance, p 23.

Figure 4.3: Risk Differentiation Framework⁶



4.22. The ATO states that this risk rating does not in any way influence the outcome of a possible risk review, but that it does influence the likelihood of a review and the formality and intensity of it.⁷ The ATO, using a range of risk filters, profiles all large businesses twice a year to place them into one of the four risk categories.⁸

4.23. The ATO's RDF prescribes a different level of engagement for each quadrant. For those taxpayers with relatively high consequence (often the largest taxpayers) the ATO will invest more time and effort in trying to effectively reduce the likelihood of non-compliance.

4.24. Each quadrant of Figure 4.3 is considered in turn below.

4.25. Higher risk large business taxpayers (approximately 2 per cent of the total large business population), can expect continuous real time risk reviews for the ATO to identify and assess risks as they arise. In speeches, the Commissioner of Taxation has noted that:

Certainty for these taxpayers [higher risk] is not in relation to their tax position but rather a certainty that they will be reviewed by us. Such an experience will be fair and professional but may also be quite formal and intense.⁹

4.26. Key large business taxpayers (approximately 8 per cent of the large business population and including most of Australia's largest businesses) can expect continuous

6 Large Business and Tax Compliance, p 23.

7 Large Business and Tax Compliance, p 23.

8 Large Business and Tax Compliance, p 24.

9 Large Business and Tax Compliance, p 24.

monitoring. By definition, a key taxpayer represents a taxpayer that has a relatively lower likelihood of non-compliance, but the consequences of any potential non-compliance are higher given the significant value of their transactions.¹⁰

4.27. Medium risk taxpayers (approximately 18 per cent of the large business population) are subject to periodic review while lower risk taxpayers (the remaining 72 per cent of large businesses) are subject to periodic monitoring.¹¹

4.28. The ATO position is that it seeks to engage with taxpayers on a prospective, cooperative basis to identify tax risk and agree on mitigation strategies with the aim of improving practical certainty and outcomes. Where taxpayers are transparent and work co-operatively with the ATO, this is more likely to change the ATO view of their relative level of risk (eg, from higher risk to key taxpayer or from medium risk to lower risk).

Sharing of risk rating and engagement

4.29. The LBTC booklet states that an important part of the ATO's compliance relationship with taxpayers is communicating its view of a taxpayer's income tax risk rating (higher risk, key taxpayer, medium risk and lower risk). It notes that the ATO's approach is to be complemented by open discussions about a taxpayer's risk rating.¹²

4.30. The ATO directly notified taxpayers of their initial income tax risk ratings for the first time under this framework during the course of this review.

4.31. Taxpayers have indicated very mixed experiences with the ATO's communication of their income tax risk rating and the opportunity for discussion and re-evaluation. Some taxpayers have said that while they have received a letter advising them of their risk rating there was considerable uncertainty in this assessment process. Certain factors the ATO cited in drawing conclusions on risk assessments were in their view arbitrary, vague, illogical, disproportionate and inappropriate. Dialogue in relation to the risk assessments with the ATO was also mixed. Some taxpayers felt the dialogue with the ATO was unproductive and curt. Others believed that while the process has shortcomings, the dialogue was reasonable.

4.32. Other taxpayers indicated that the ATO has been pro-active in arranging to meet with them to discuss their risk rating while some have only received a letter and an invitation to meet if the taxpayer wants further clarification.

4.33. Taxpayers would like to see a more well-defined, transparent and consistent process in how the ATO both determines and communicates their income tax risk rating. This process should include a commitment by the ATO to meet with the taxpayer, discuss the findings and conclusions on a preliminary basis and, where appropriate, include a re-evaluation of a taxpayer's income tax rating based on those discussions.

10 Large Business and Tax Compliance, p 25.

11 Large Business and Tax Compliance, p 25.

12 Large Business and Tax Compliance, p 25.

4.34. As part of those discussions, taxpayers would also like to see better explanations of what a taxpayer can expect after receiving the outcome rating (what does a higher risk rating mean compared to a medium risk rating?) and practical examples and guidance on how a taxpayer may transition to a lower risk rating. This is particularly important given the ATO's comments that higher risk taxpayers should expect a more formal and intense ATO interaction. It is also important to appreciate that the ATO's risk classification is also dynamic, with classifications being reconsidered periodically, which in certain cases is expected to be half-yearly.

4.35. In addition, a higher risk rating may have significant implications for a taxpayer's reputation and also the professional standing of tax managers and advisers. In such instances, affected persons should have a right to reply and comment before the ATO adopts a final position on a taxpayer's risk profile. The delivery by the ATO of the risk classification assessment as a *fait accompli* was thought by some taxpayer's to be unhelpful if not improper.

IGT OBSERVATIONS

4.36. The IGT observed that certain taxpayers considered that due process or procedural fairness was effectively cut off from something as important as an administrator drawing a formal opinion on the taxpayer. If the assessment had been canvassed as a preliminary view for comment and a fuller opportunity for open and frank consideration afforded the outcomes may have been different in some cases.

RECOMMENDATION 4.1

Given the importance of the relationship between the ATO's risk classification of a taxpayer and its consequence, the ATO should continue to develop a more well-defined, transparent and consistent process in discussing and determining a taxpayer's ATO income tax risk rating at a given point in time under the ATO's Risk Differentiation Framework (RDF). This should include the ATO:

- making a risk classification for taxpayers in specific risk quadrants (at a minimum key and higher risk quadrant taxpayers but may be expanded depending upon taxpayer experience and needs);
- communicating the risk classification to the taxpayer disclosing all the relevant facts, metrics, weightings and reasoning underpinning this determination in writing;
- providing these taxpayers with an opportunity to meet face-to-face to discuss the determination;
- providing these taxpayers with a direct opportunity to reply in writing to this risk classification;
- appropriately reviewing and considering this taxpayer response; and
- allowing the taxpayer to escalate the matter to the Deputy Commissioner LB&I, if they are still dissatisfied with the rating.

ATO Response

Agree in principle.

We agree that it is important to communicate with taxpayers about their risk category, including explaining our reasoning and what being placed in that category means for their business. In 2010, we completed an initial roll out of discussions with and letters to higher risk and key taxpayers to convey and explain their risk category. Only a small number of taxpayers, mostly from higher risk groups, expressed concerns. We met with each of these taxpayers and also wrote to them about their concerns.

Building on our experiences in that initial roll out, we are continuing to develop and improve our approach to communicating risk categories in consultation with the large market. The process for higher risk and key taxpayers reflects the approach outlined in your recommendation. However, the second dot point in your recommendation assumes weightings and a scorecard approach, which is not consistent with approaches taken in the RDF.

We see the RDF as a tool to help us build more open and transparent relationships with taxpayers — it is a starting point for a discussion. The ATO provides taxpayers in the higher risk and key taxpayer categories with the opportunity to discuss their RDF risk category. We also listen to any feedback that taxpayers may wish to provide at this time. Ultimately we may agree to disagree as it is a matter of informed judgment. We think this agrees in principle with the thrust of your recommendation.

We are pleased to note that, in some cases, the risk category discussion has encouraged a greater level of interest in tax risk governance at the Board level. Some of those taxpayer groups are now working more actively with us towards a change of risk category.

We also note that the actions described in the recommendation are about communicating risk categories and do not relate to how the category is determined.

Your observations at paragraph 4.36 suggest that some taxpayers have a perception that the risk category in some way pre-determines the outcome of our compliance activities. That is not the case. Our view of a taxpayer's RDF risk category determines the likelihood that compliance activities will need to occur. It also suggests possible modes of interaction and a relative level of intensity.

Alignment of Risk Differentiation Framework and compliance products

4.37. The IGT considers that the understanding of behavioural effects and incentives in the design of a risk differentiation framework is vital. The ATO's application of its risk review and audit processes needs to be properly aligned so there are tangible benefits for taxpayers being rated as key or lower risk taxpayers. If taxpayers do not perceive a benefit in moving to a lower risk rating (for example, from higher risk to key taxpayer or medium risk to lower risk) or at maintaining a low tax risk profile then it may not necessarily improve corporate tax compliance behaviour.

4.38. Likewise, key taxpayers (which by definition will have a lower likelihood of non-compliance but a higher consequence) must have a different experience and level of engagement from a higher risk or medium risk taxpayer. If not, then the ATO's application of its risk review and audit processes and procedures will not support its corporate aspiration to develop an enhanced relationship with high levels of mutual transparency and trust with key taxpayers.

4.39. The IGT believes that one important tangible benefit for key taxpayers must be a demonstrated higher level of engagement and interaction with the ATO so as to minimise the taxpayer's compliance costs associated with continuous monitoring and review.

4.40. Equally important, the ATO needs to ensure that taxpayers that are rated as 'high risk' are not pre-judged as to a risk review or audit outcome and that they are always afforded due process. For example, risk reviews and audits should not be seen as focused on simply proving or confirming a risk hypothesis as opposed to objectively testing the risk hypothesis.

4.41. Naturally, where a taxpayer is uncooperative or resisting the informal provision of information, then the ATO may use formal information-gathering powers. The IGT understands that this is not a common concern in the large business context.

4.42. The IGT believes that it is appropriate in a self-assessment environment that taxpayers are provided the opportunity to discharge their taxation obligations in accordance with the law. Provided taxpayers are made aware of the ATO's views (as the tax systems administrator) they are entitled to select the relationship option that best meets their needs in discharging their obligations.

4.43. In supporting this sentiment the IGT notes that as 'higher risk' taxpayers will receive a higher level of ongoing active compliance activity, it places a greater importance on the ATO to ensure that the principles and processes set out in the LBTC booklet and LB&I Compliance Manual are fairly, consistently and professionally followed. For example, irrespective of a taxpayer's risk rating, the ATO should always ensure that it shares with taxpayers the ATO's risk hypothesis, provides regular updates on the progress of a risk review and audit, promotes engagement and discussion of the ATO's view of the transaction, risks and technical view and provides a reasonable opportunity for taxpayers to comment and respond.

4.44. The consistent application of these principles in a professional, fair and effective manner by the ATO actually provides a greater opportunity to develop enhanced relationships between taxpayers and the ATO as revenue administrator, particularly in the case of higher consequence taxpayers.

RECOMMENDATION 4.2

To promote greater consistency and proportionate ATO delivery of a risk review and audit in accordance with the principles set out in the latest LBTC booklet, the LB&I Compliance Manual and supporting LB&I work practices should be revised to reflect more clearly the different risk profiles of taxpayers and support the more differentiated approach. This should include details on the expected process, level and type of engagement and mutual transparency as it relates to higher, key, medium and lower risk taxpayers.

The ATO should enhance its quality assurance processes (including monthly reviews) to include specific criteria or questions that test whether the principles and processes set out in the LBTC booklet (as revised) and LB&I Compliance Manual are fairly, consistently and professionally followed in a manner that is proportionate to the taxpayer's risk profile.

ATO Response

Agree.

Following the launch of the revised LBTC booklet in 2010, work is underway to revise and update our training, instructional materials (including the *LB&I Compliance Manual*) and assurance processes to ensure they consistently reflect the principles in the booklet. There will also be follow-up training associated with this.

The updated guidance materials will provide improved support to our teams by suggesting approaches for each risk category. It is important to be aware that guidance material suggests (rather than mandates) particular approaches. Our compliance teams are required to exercise judgment, reflecting the widely differentiated nature of the large market.

We are currently updating the instructions and guidance to our staff for monthly reviews and Integrated Quality Framework (IQF) assessments to incorporate more specific questions and tests that will help us to ensure our approach is suitable to the case circumstances.

SCOPE, PURPOSE AND OUTCOMES OF THE ACTIVE COMPLIANCE PROCESSES

4.45. The ATO advises that there may be a number of reasons why taxpayers and the ATO may take different positions on an issue ranging from taxpayers applying the law incorrectly or taking a different view of the law from the ATO through to deliberate evasion or aggressive tax planning.

4.46. Where the ATO has detected potential non-compliance and the compliance risk warrants further action (due to the likelihood and consequence of that potential non-compliance), the ATO has two post-lodgement active compliance processes, namely risk reviews and audits.

4.47. The LBTC booklet states that risk reviews form a major part of the ATO's compliance work and are used to assess whether there may be tax risks arising from a taxpayer's self-assessment. Risk reviews assist the ATO to determine whether there are any compliance issues requiring a more in-depth investigation and response. It does so by seeking to test and refine an initial hypothesis using risk indicators developed as part of the ATO's initial internal risk profiling.¹³ Appendix 3 contains more detailed information regarding the risk review process.

4.48. The LBTC booklet states that the risk review process provides both taxpayers and the ATO with an opportunity to resolve concerns about compliance issues and prevent the need for an audit. The LBTC booklet provides that the type of risk review (client risk review or a specific review) will depend on the initial risk identified and a taxpayer's risk rating.¹⁴

4.49. A client risk review is intended to be a comprehensive review product, with the aim to:

- develop a better understanding of a taxpayer's business by integrating business and tax analyses;
- assess identified potential tax risks (current and emerging);
- build a year-by-year picture of a taxpayer's business; and
- build and maintain an ongoing dialogue.¹⁵

4.50. A specific review is intended to examine one or more specific risks that the ATO has identified and aims to:

- minimise the impact on taxpayers by concentrating only on risks that have already been identified;
- assess identified potential tax risks (current and emerging);
- gain a better understanding of a taxpayer's business through the integration of business and tax analysis; and
- build and maintain an ongoing dialogue with taxpayers.¹⁶

4.51. Both risk review products involve the ATO collecting and analysing information to help it understand a taxpayer's business, and reviewing identified risks by asking a taxpayer to explain the circumstances and provide information about any mitigation strategies implemented and assessing and evaluating identified risks.¹⁷

4.52. At the end of a risk review the ATO will discuss the outcomes with the taxpayer including whether it is satisfied with the taxpayer's compliance or considers

13 Large Business and Tax Compliance, p 27.

14 Large Business and Tax Compliance, p 27.

15 Large Business and Tax Compliance, p 42.

16 Large Business and Tax Compliance, p 42.

17 Large Business and Tax Compliance, p 42.

that further action is warranted including making recommendations for future compliance activity.¹⁸

4.53. The LB&I Compliance Manual contains significant detail and guidance to staff on the risk review process including the planning of a risk review, the developing and refining of the risk hypothesis, communicating with the taxpayer, gathering and analysing information and rating the risks.

4.54. Where the ATO identifies significant risks, it is highly likely an audit will follow. Where the risks are not deemed to be significant, the ATO will usually not proceed further unless there were other concerns raised. Where the issue is likely to proceed to audit, the ATO commits to keep taxpayers informed about its plans and timeframes.¹⁹

4.55. In contrast, audits are more comprehensive than risk reviews and involve a deeper level of information and case examination. Audits provide a means for the ATO to:

- verify whether in the ATO's view appropriate tax has been paid in cases where risks have been identified, including gathering evidence or proof as required;
- understand the causes of any non-compliance and address them for the past and the future; and
- identify areas where the law may need clarification or where audit processes can be improved.²⁰

4.56. For income tax purposes, an audit typically arises following a risk review and seeks to test the risk hypothesis that is established at the end of a risk review. The ATO may also broaden the scope of an audit if it identifies additional risks during an audit.²¹

4.57. Appendix 4 contains more detailed information regarding the audit process. An audit involves agreeing on a case plan, collecting detailed information and undertaking analysis with the view to refining the risk hypothesis and developing an ATO position. This is communicated to the taxpayer by way of an ATO position paper, with the taxpayer being provided an opportunity to respond (ATO position papers are the subject of separate discussion in Chapter 8).

Submissions and consultation

4.58. In submissions to the IGT, the view was expressed that traditionally a risk review was not seen as an audit but rather as a high-level review designed to assess whether there were tax risks arising from a taxpayer's self-assessment that warranted a more in-depth audit investigation. Uncertainty was also expressed about what

18 Large Business and Tax Compliance, p 42.

19 Large Business and Tax Compliance, p 27.

20 Large Business and Tax Compliance, p 28.

21 Large Business and Tax Compliance, p 28.

constitutes a risk review and how it differs from an audit, with a number of reasons having been suggested for this confusion:

- Release of Miscellaneous Ruling MT 2008/3 and the broad definition of tax audit although this has been partly clarified in the LBTC booklet which asserts that the risk review and audit processes are separate;
- Time delay and manner in which a risk review moves to an audit; and
- The existence of too many products such as client risk reviews, specific risk reviews and comprehensive risk reviews and now compliance assurance reviews.

4.59. Many taxpayers and advisers expressed a lack of understanding about what differentiates each of these risk reviews, the type of risk review being undertaken, and the reasons for the type of review being selected.

4.60. The uncertainty around the scope and purpose of a risk review was further evidenced by comments of a number of stakeholders that the ATO seems to proceed from a risk review to an audit without taking into consideration all the available information. Other taxpayers believe that if the ATO identifies an issue then it should seek to resolve it at the risk review stage and not proceed to an audit. On the other hand, concerns were expressed that the ATO was requesting far too much detailed information at the risk review stage and that if the ATO had identified issues or concerns then these should be addressed during the audit.

4.61. A number of taxpayers and advisers have suggested that in relation to post-lodgement active compliance work there is scope for the ATO to streamline its various risk review and audit products into three main stages:

- Preliminary risk review – involves internal risk profiling and ratio analysis, media profiling, tax compliance history and information requests going to ownership structures.
- Client risk review product – preferable for the ATO to have only one type of risk review product so as to minimise confusion.
- Specific issues audit product – involves the testing of a risk hypothesis arising from a risk review. Where there is a change in the scope of the audit then this could be reflected in a revised Audit Plan with a refined risk hypothesis. To ensure continuity and an understanding of the issues, it is important that the same team that conducts the risk review should also undertake the audit.

4.62. Each of these stages should be accompanied by a clearer articulation of the inputs (such as the nature and detail of documentation to be requested at each stage), process (the types and scope of activities), timeframes and outcomes.

IGT OBSERVATIONS

4.63. The IGT considers that achieving a cooperative relationship between the ATO and taxpayers requires taxpayers and advisers to have a good understanding of the

ATO's risk review and audit processes and the ATO's approaches and reasoning behind these processes. A more streamlined, transparent and well-defined risk review and audit framework would allow for more efficient and effective interaction between the ATO and taxpayers.

Guidance available to ATO staff, taxpayers and advisers

4.64. The IGT found that the ATO has available significant material and guidance to staff on the risk review and audit processes, in particular the LB&I Compliance Manual and its Siebel work practices. The IGT considers that the Compliance Manual is a positive addition to the ATO's suite of active compliance support materials and systems. For example, the Compliance Manual sets out how a risk review should be conducted and provides guidance on critical steps in that process such as:

- planning a risk review;
- understanding a taxpayer's business and collecting information;
- identifying and reviewing tax risks including holding the initial internal workshop;
- notifying the taxpayer of the commencement of a risk review;
- assessing and rating the risks (refining the risk hypothesis) and developing recommendations; and
- communicating the risk review outcomes to taxpayers.

4.65. In contrast, for taxpayers and advisers the only publicly available source of ATO guidance on the purpose, scope, conduct and outcomes of these processes is the LBTC booklet. It provides a high level explanation of the risk review and audit processes but taxpayers and advisers do not necessarily have a good understanding of the thinking, reasoning or judgements behind a number of important risk review and audit processes. This includes the development and refinement of the risk hypothesis, the level of expected engagement and communication and the role and responsibilities of the tax officers that may be involved in a risk review and audit.

4.66. It is also evident from submissions and consultations that there is some uncertainty around the scope and purpose of the various risk review and audit products. It was clear from discussions that taxpayers and advisers often have different expectations (from both the ATO and each other) of the inputs, process and outputs for the various ATO products. The uncertainty or mismatch of expectations around the inputs, process and outcomes of risk reviews and audits can contribute to strained relationships.

4.67. The IGT believes that there is scope for the ATO to provide more detailed information to taxpayers and advisers on the risk review and audit processes, along the lines of that already contained in the LB&I Compliance Manual. Greater

transparency in the risk review and audit processes will better support both the ATO and taxpayers to meet their mutual expectations during compliance activities.²²

RECOMMENDATION 4.3

To improve transparency and promote greater understanding, the ATO should publicly release the LB&I Compliance Manual so as to provide better guidance and detail to taxpayers and advisers on the risk review and audit processes. This would include more detailed ATO guidance on the:

- scope and purpose of risk reviews and audits;
- thinking, reasoning and judgements behind important aspects of the risk review and audit processes;
- inputs to the risk review and audit processes such as the nature and detail of documentation to be requested at each stage;
- details on the roles, responsibilities and expectations of the various tax officers that may be involved in a risk review or audit;
- ATO and taxpayer expectations regarding the conduct of a risk review and audit; and
- type and level of expected engagement.

ATO Response

Agree.

As noted in our response to Recommendation 4.2, work is underway to review and update our training and instructional materials, including the *LB&I Compliance Manual*. The manual is a large document, meaning that the process of review and update is a significant undertaking and is expected to take several months to complete. For efficiency and to avoid duplication of effort, the exact timing of publication will be co-ordinated appropriately with our work for publication of other documents to be released under the Information Publication Scheme in Part II of the (amended) *Freedom of Information Act 1982*.

NATURE AND SCOPE OF ACTIVE COMPLIANCE PROCESSES

4.68. The IGT accepts that there is a need to have progressively more intensive investigations as a compliance activity moves from a risk review through to audit. The IGT is of the view that the transition from risk review to audit needs to be clear and direct. The IGT does not believe that the ATO should conduct various forms of risk

²² Large Business and Tax Compliance, p 28.

review that prolong a process or are in fact an audit. If the ATO has reason to move the review to an audit footing (where the investigation requires more intensive and detailed information gathering) then it should do so and make the taxpayers aware of that decision contemporaneously. Where the ATO wishes to seek detailed information and documentation around a transaction (including section 264 interviews and third party requests) it is better that this is done under an audit. This establishes a clear understanding for the taxpayer of the nature of the investigation and the mutual expectations.

4.69. Currently, the ATO has a number of applicable products for post-lodgement review including specific review, client risk review, specific audit and comprehensive audit. The IGT considers that there is merit in rationalising the various ATO risk review and audit products for post-lodgement compliance activities along the lines proposed by a number of stakeholders. This would simplify the risk review and audit framework and allow for a clearer articulation and understanding of the inputs, process, outcomes and mutual expectations at each stage.

4.70. The IGT sees no benefit in continuing to have both specific reviews and client risk reviews given the uncertainty expressed by taxpayers and advisers regarding the scope and purpose of the different risk review products. Both products involve the collection and analysis of information to help the ATO understand a taxpayer's business and an assessment of the identified potential tax risks. The only observable difference between a specific review and a client risk review is the level of specificity of the identified risk with the ATO's ability to express a better articulated risk hypothesis at the outset of a specific issues review. The IGT notes that under the current risk review processes even a client risk review, which is designed to look at the whole business, now requires the establishment of the key issue for review.

4.71. The ATO advised the IGT that they support a high degree of clarity as to the scope and nature of these active compliance products. In this regard, and building on the information provided in the LBTC booklet to assist taxpayers' understanding of the process, the ATO noted that clear dialogue with taxpayers to explain the scope and purpose of a product at its outset will assist in this regard.

4.72. The IGT believes that the compliance process could be simplified and made more certain by consolidating specific reviews into a single client risk review product. The specificity of a specific review could be maintained through a more detailed identification of the specific risks under examination as compared to a more comprehensive review of a taxpayer's business.

4.73. Likewise, the IGT believes in the large business market context that there is no real benefit in continuing to have two different audit products (comprehensive and specific audits). All ATO audits (whether comprehensive or specific issue) should be framed around a number of specified risk hypotheses given that most large business audits arise from a risk review.

4.74. The IGT accepts that the provision and examination of more detailed information during an audit may lead to the identification of new specific issues or risks and a broadening of the scope of an audit. In that instance, the new risks or issues would be openly communicated to taxpayers along with the revised risk hypothesis.

RECOMMENDATION 4.4

The ATO should streamline its various post-lodgement risk review and audit products into three specific processes:

- Preliminary risk review – this stage would involve no contact with the taxpayer and be primarily focused on the identification of potential compliance risks through internal ATO risk profiling and ratio analysis, media profiling, tax profiling history and examination of ownership structures.
- Risk review – involves a specific or a broad investigation of various risk areas identified in the preliminary risk review. As more information is obtained and should new risks be identified, the scope of a client risk review may be broadened, although this would be accompanied by updating and communicating of the ATO's revised risk hypothesis to the taxpayer.
- Audit – involves the detailed testing and refining of each specific risk hypothesis arising from the risk review or in the course of the audit.

ATO Response

Disagree.

While we agree in principle that there is merit in streamlining our post-lodgment processes, we see a risk in limiting the flexibility to differentiate according to the circumstances.

Regardless of product type, we believe the key is to ensure that we communicate clearly the scope and purpose of any compliance activity from the outset and also any changes to scope that emerge as work progresses. This is in line with our commitments in the LBTC booklet and we believe it is consistent with your underlying intent in making this recommendation.

We have not agreed to the suggested product set at this time because we believe it is important to explore in more detail how this would work at a practical level. This analysis needs to consider how product names affect our interactions with taxpayers and any potential adverse impacts on our ability to produce meaningful performance reporting to support our case level governance.

As we move to the next stage of implementing the Risk Differentiation Framework, we are also working to redevelop our Large Business Engagement Model and the services we offer in consultation with the large market, including through our Large Business Advisory Group. As part of this work, we propose to consult with the large market to obtain a better understanding of how the naming of products affects their experience, and take your recommendation into account during this review.

In any event, we are encouraging more collaborative upfront approaches with large business, particularly those that want to pursue an enhanced relationship model. Fixed product type approaches may not be the best way to nurture and progress that relationship.

CHAPTER 5: RISK HYPOTHESIS

5.1 This chapter considers the ATO's processes and procedures regarding the development and refinement of the risk hypothesis. It discusses the issues and concerns raised by stakeholders and makes several recommendations to ensure that the development, refinement and sharing of the risk hypothesis during a risk review and audit accords with the Large Business and Tax Compliance (LBTC) booklet and Large Business and International (LB&I) Compliance Manual.

DEVELOPMENT AND REFINEMENT OF THE RISK HYPOTHESIS

5.2 The LBTC booklet states that the ATO develops a risk hypothesis for all cases selected for risk review.¹ The LB&I Compliance Manual states that the risk hypothesis is intended to form the basis for the ATO's investigations, and frame its queries and information requests. Throughout the active compliance process, from the commencement of a risk review through to the conclusion of an audit, the Compliance Manual provides that the risk hypothesis must be continually revised and updated as new information is obtained and new decisions are made.²

5.3 The *Cooperative Compliance Model* (2000) describes a risk hypothesis as:

an assertion proposing an explanation of particular facts, events or issues. It helps make sense of any information gained and provides a focal point for discussion and testing. The testing of the hypothesis provides the foundation for designing and implementing further activity.³

5.4 The Compliance Manual notes that a good risk hypothesis will have the following features:

- be written as a definite statement not a question;
- be based on observations and knowledge;
- capable of being tested with purposeful enquiry; and
- clearly state the area of potential mischief.⁴

1 Large Business and Tax Compliance, p 40.

2 LB&I Compliance Manual, Chapter 1, p 5.

3 ATO Co-operative Compliance Model.

4 LB&I Compliance Manual, Chapter 1, p 16.

5.5 The Compliance Manual goes on to state that if the Case Officer and Team Leader are not actively managing their case using a risk hypothesis approach there are a number of problems that could arise which could damage the ATO's relationship with the taxpayer and affect the ATO's reputation including:

- the case lacks focus;
- the areas of review or audit may be unclear to the Case Officer, the taxpayer or both;
- the Case Officer may not be adequately prepared to question the taxpayer and may spend too long on generic review activities or waste time building an in depth knowledge of a risk or issue that is immaterial; and
- the Case Officer may have already asked the taxpayer for information and interviewed them before properly understanding the material risks in the case resulting in the need to make further information requests.⁵

5.6 Appendix 3 provides a diagrammatic representation of the progress of the risk hypothesis in the end-to-end compliance process.

Commencement of risk review

5.7 The Compliance Manual states that the reason the case was initially selected becomes the initial risk hypothesis of a risk review and the description forming the initial risk hypothesis is required to be recorded on the Siebel case management system. By way of example, the Compliance Manual suggests that if a case was selected because a taxpayer had significant utilised and carried forward losses (through an analysis of the income tax return), the initial risk hypothesis might be:

The taxpayer group has significant carried forward and utilised losses and there is a potential risk that either:

- The income tax calculations leading to the loss are incorrect; or
- The Subdivision 165-A loss provisions (such as the Continuity of Ownership and Same Business tests) have been breached.⁶

5.8 The Compliance Manual provides that during the course of a risk review the Case Officer will test and refine the risk hypothesis. It should be refined and recorded throughout a case, in particular:

- after the Case Officer's initial analysis;
- after the initial workshop; and
- as the case progresses at points where there is a change or clarification in the risk hypothesis.⁷

5 LB&I Compliance Manual, Chapter 1, pp 5-6.

6 LB&I Compliance Manual, Chapter 1, p 6.

5.9 The ATO confirmed that the Team Leader is responsible for ensuring that the Case Officer has correctly understood, tested and refined the risk hypothesis throughout a risk review or audit, although in most cases, the Case Officer will also be assisted in this regard by one or more officers with specific technical experience.

5.10 The Manual provides that the refinement of the initial risk hypothesis will depend on the type of risk review or audit. For example, for a specific issue review or an audit an officer should research the taxpayer's profile, gain an understanding of their business and thereafter focus on testing a specific risk hypothesis.⁸

5.11 When conducting a comprehensive risk review or audit the Case Officer may have to undertake more thorough research of the taxpayer and the refinement of the initial hypothesis may include additional risks. The Case Officer must continue to refine the hypothesis for each risk until they have reached a conclusion.⁹

5.12 At the risk review stage, the ATO will seek to test and refine the risk hypothesis until it has determined that the potential risk is either not present or not material enough to warrant further action or should proceed to audit where the ATO is satisfied that the potential risk is sufficient to warrant more detailed testing.¹⁰

Commencement of audit

5.13 If an audit is commenced then the final risk hypothesis of the risk review becomes the initial risk hypothesis of the audit.¹¹

5.14 The Compliance Manual states that the Case Officer is required to further test and refine the risk hypothesis through more detailed information gathering and investigation and, where necessary, refine the scope of the audit.¹²

5.15 However, by this stage the ATO should have already developed an appropriate understanding of the taxpayer under review, researched the relevant issues, planned the audit, conducted initial audit interviews and formulated a clear risk hypothesis.

5.16 The Compliance Manual provides that at the audit stage, refining the risk hypothesis may include:

- clarifying issues;
- identifying and understanding the relevant legislative provisions;
- identifying key facts and related evidence required to determine the ATO position; and
- identifying the current ATO view, quantifying the issues and making the final decision as to whether to amend.¹³

7 LB&I Compliance Manual, Chapter 1, p 6.

8 LB&I Compliance Manual, Chapter 1, p 10.

9 LB&I Compliance Manual, Chapter 1, p 10.

10 LB&I Compliance Manual, Chapter 1, p 7.

11 LB&I Compliance Manual, Chapter 1, p 10.

12 LB&I Compliance Manual, Chapter 1.

5.17 Refining the scope of an audit may include eliminating certain issues, identifying new issues or refining the income years subject to audit.¹⁴

5.18 The Compliance Manual requires that all refinements in the risk hypothesis or the scope of the audit must be reflected in the ATO's Audit Plan. It provides that once the Case Officer has refined the hypothesis and scope of the audit so that the issues and income years under audit are clear then they can proceed to making a decision. Further information on this is contained in Chapters 7 and 8 of the report.¹⁵

5.19 During an audit, the ATO will seek to test and refine the risk hypothesis and scope of the audit until it has determined that the potential risk is either not present or not material enough to warrant further action, or the ATO is satisfied that the taxpayer has not complied with the ATO view of the tax law.¹⁶

SUBMISSIONS AND CONSULTATIONS

5.20 In submission and consultation, stakeholders raised a number of concerns in relation to the risk hypothesis. Stakeholders also highlighted some good examples of interaction with the ATO around the risk hypothesis.

5.21 Taxpayers and advisers submitted that, in certain situations their experience was that there was little or no discussion or refinement of the risk hypothesis during the course of a risk review or audit. It was submitted that sometimes a risk review or audit would start with a number of issues surrounding a transaction but thereafter the process of evolution or development of the risk hypothesis was not done in a transparent and cooperative manner, so that taxpayers did not share the ATO's understanding of the key issues.

5.22 A number of taxpayers and advisers indicated that it was only at the end of the risk review or audit process that the ATO provided them with the risk hypothesis. Affected taxpayers indicated that had this been shared with them earlier (rather than only issuing requests for further information) they could have provided targeted responses and potentially a lesser rating than the initial 'higher' risk rating may have been achieved.

5.23 More generally, doubts or concerns were raised about the management and communication of a particular issue and the perceptions about mischief or the underlying technical issues that the ATO may be investigating or considering, especially when an issue has been referred to a technical specialist or a Case Leader. Stakeholders see that there are many process elements and many different specialists in the overall management structure that give rise to delay and uncertainty particularly where communication is not effective.

13 LB&I Compliance Manual, Chapter 1.

14 LB&I Compliance Manual, Chapter 12, p 9.

15 LB&I Compliance Manual.

16 LB&I Compliance Manual.

5.24 Taxpayers and advisers indicated that risk reviews and audits are often accompanied by broad information requests or lines of enquiry that make it difficult to discern the ATO's exact concern. It was also submitted that there is often little or no communication of any changes to the ATO's risk hypothesis after a taxpayer has responded to an information request. For more discussion on 'information gathering' reference should be made to Chapter 7 which canvasses stakeholder and ATO issues.

5.25 Taxpayers and advisers with these experiences would like to see the ATO share and discuss the risk hypothesis more effectively so as to better understand the ATO's concerns around an issue or transaction.

5.26 The ATO in discussion with the IGT provided results from the ATO Client Feedback Questionnaire, as outlined in the table below showing relatively strong results. The ATO did express some surprise in relation to the IGT consultations and submissions when comparing these to their survey results:

Year	Question	Result (average out of 5)
09-10	Initial views on any risks were explained to you (audit and risk review)	4.2
08-09	Initial views on any risks were explained to you (risk review)	4.2
08-09	Reasons for commencing the audit were adequately explained to you	4.8
07-08	Initial views on any risks were explained to you (risk review)	4.1
07-08	Reasons for commencing the audit were adequately explained to you	4.7
06-07	Explanation of the reason for the audit (audits in progress)	4.0

5.27 As noted previously in the report, the IGT has not had the opportunity to consider the use or effectiveness of Client Feedback Questionnaires or other external market surveys. While the IGT supports the ATO's attempt to gain insight around their service delivery performance, it may be that certain response collection methods may be more effective than others. It may also be that there is potential bias in survey results from respondents even if arranged through third party agents due to factors that may not be completely appreciated, including underlying concerns about anonymity amongst others.

5.28 The IGT, as noted, also appreciates that there are some good stakeholder experiences, but an opportunity to further improve outcomes for both the ATO and stakeholder alike still remain given the submission and consultations made.

IGT OBSERVATIONS

5.29 The IGT found that the LB&I Compliance Manual places an appropriate level of importance on the development and refinement of the risk hypothesis during a risk review and audit.

5.30 The ATO advises that it may not have sufficient information from the tax return materials or otherwise have an incomplete understanding of the transaction in question at the beginning of a risk review, such that a detailed and well-articulated risk hypothesis is not available without further enquiry.

5.31 The IGT believes that there may be good reasons why the risk hypothesis may be stated in general or broad terms based on this understanding.

5.32 In the course of a risk review, the ATO requests and obtains considerable information and documentation that allows it to begin to develop a more refined risk hypothesis. This is primarily achieved through the use of workshops which seek to bring together the relevant subject experts and special advisers to discuss the issues, and the scope of the risk review and consider further information requests. By the time the ATO finalises a risk review it should have a well-articulated hypothesis that is set for further testing if audit is required and reached a conclusion on the nature and level of risk associated.

5.33 At the audit stage, the IGT also saw some evidence of the refinement of scope, issues or risks primarily through the use of workshops involving Case Leaders (formerly Special Advisers) and technical specialists such as TCN and COE. Workshop discussions would often lead to requests for further information to test a particular issue or better understand aspects of the transaction in greater detail.

5.34 However, the IGT found that while some in the ATO may have a good understanding of the technical issues and the potential direction of the risk review or audit, this does not necessarily lead to an articulation of a risk hypothesis as set out in the Compliance Manual. Specifically, the IGT found:

- The focus of audits was often set out in very broad terms with the statement of the risks not satisfying the requirements of a good risk hypothesis. For example, a significant proportion of audit plans would identify the broad issue that was under consideration rather than the specific risk hypothesis that was to be tested and refined during an audit. Also, the risk hypothesis was often not written as the definite statement that was to be tested and did not clearly set out the potential non-compliance.
- Audit plans were not being revised to reflect the development or refinement of the risk hypothesis during an audit.
- The refined risk hypothesis was not being communicated in writing to taxpayers in the course of an audit.

5.35 The IGT found that it was often assumed that taxpayers and advisers could easily infer the risk hypothesis from discussions or the nature of information requests. On the other hand, it is clear that taxpayers and advisers do not always understand the specific concern or issue under investigation even though they would know the broad area of focus.

5.36 The IGT believes that the lack of consistency, transparency and discussion around the risk hypothesis has contributed to perceptions that the ATO's risk reviews and audits lack focus (moving from one issue to another without explanation). The IGT recognises that there is tension between stakeholder perceptions that the ATO engages in random 'fishing expedition' style information requests, and the ATO's need to understand all of the issues at hand. The IGT believes that ATO transparency, communication and education is the best manner in which to dispel these concerns where broad requests are necessary.

5.37 The IGT believes that the development, refinement and communication of the risk hypothesis, in accordance with what is set out in the Compliance Manual, is an important part of the risk review and audit process. There are significant benefits in the ATO developing and refining a good risk hypothesis and then sharing this with taxpayers as early as possible, such as:

- allowing the ATO to express, both internally and externally, its areas of focus in the form of a clear written statement which is capable of being tested with purposeful enquiry;
- providing a platform for discussion between the ATO, taxpayers and advisers on the scope of the audit, the type and availability of documents and information and the progress of the audit; and
- better establishing the relevance of the information being requested or gathered to the potential risk

5.38 Given the importance of the development, refinement and communication of the risk hypothesis in the ATO's end-to-end compliance process it is critical that the ATO's assurance processes ensure that the expectations and requirements of the LBTC booklet and Compliance Manual are being followed by all officers involved in risk reviews and audits.

5.39 It should be the responsibility of the Team Leader allocated to the risk review or audit (being an Executive Level officer under the ATO management structure) to ensure that such an important part of the ATO's end-to-end compliance process is being followed. This could be achieved through regular dialogue with the taxpayer including their participation in key discussions with technical leaders (or specialists) and Case Officers.

RECOMMENDATION 5.1

The ATO should supplement its commitment to open dialogue in the LBTC booklet by providing additional guidance to LB&I staff and taxpayers on how it will develop, refine and communicate the risk hypothesis during a risk review and audit.

This should include a commitment to share the risk hypothesis with taxpayers in writing and discuss the risk hypothesis at certain stages in the course of a risk review and audit.

The implementation of this recommendation should consider whether the taxpayer should be notified and or consulted:

- where a risk hypothesis has been materially refined or changed (or a new risk hypothesis is identified) at appropriate management action points (for example after an ATO internal workshop);
- where a taxpayer provides additional or new information that results in a change in the ATO's risk hypothesis (either due to the risk hypothesis being refined or a new risk being identified);
- at the preliminary audit interview; and
- prior to issuing draft finalisation letters.

ATO Response

Agree.

Our commitment to open dialogue, including sharing the risk hypothesis, is well established in the LBTC booklet and supporting materials for ATO staff. Our teams are expected to develop a considered communication strategy that is appropriate to the circumstances of the case, and the timing of communications will be determined as part of that strategy.

The natural points where communication should be considered (as reflected in your recommendation) will be included in the updated guidance to be provided in the LB&I Compliance Manual (our response to Recommendation 4.3).

The updates to the manual will also reflect that correspondence with taxpayers will include, where appropriate, an explanation of the risk hypothesis and how it relates to any information requested. It is important that expectations are clear about the level of detail that is necessary in written communication, noting that the discussion is the primary mode of communication. This will also be a matter of judgment.

RECOMMENDATION 5.2

The ATO should enhance its assurance processes (including the Integrated Quality Framework) to ensure audit teams develop, refine and communicate a risk hypothesis in accordance with the expectations and requirements of the LBTC booklet and Compliance Manual.

This should include Team Leaders (and where appropriate Technical and Case Leaders):

- ensuring that the risk hypothesis has been correctly understood, tested and refined throughout the risk review or audit;
- examining and refining the risk hypothesis as part of the LB&I monthly review process;
- attending initial workshops to ensure that the risk hypothesis is expressed as a clear statement to be tested, and that it is understood by the audit team; and
- signing off that the risk hypothesis meets the requirements of the LBTC booklet and Compliance Manual, at key stages of the risk review or audit.

ATO Response

Agree.

Work is already underway to enhance our monthly review and IQF processes for LB&I active compliance cases. This will include specific questions or guidance to assist Team Leaders (in the case of monthly reviews) or assessors (in the case of IQF assessments) to determine whether the risk hypothesis has been properly understood, tested and refined during a case.

CHAPTER 6: PROJECT MANAGEMENT AND ACCOUNTABILITY

6.1 This chapter considers the ATO processes and procedures on case management and also relevant relationship management aspects. It sets out the issues and concerns raised by stakeholders regarding the ATO's management of risk reviews and audits and outlines a number of recommendations that seek to strengthen transparent leadership, accountability and communication in the context of ATO project management.

6.2 Chapter 7 of this report considers in greater detail a number of key aspects linked to the project management of risk reviews and audits including timeframes and taxpayer engagement.

BACKGROUND

ATO Roles and responsibilities

6.3 The ATO adopted a new management structure for Large Business and Tax Compliance (LB&I) during the course of this review. The new structure is outlined in summary below and shown in diagrammatic form at Appendix 1.

6.4 The former ATO LB&I management structure was raised both in consultation and in submission by stakeholders. Accordingly, to facilitate aspects of the discussion in this context the former LBI structure is described below for reference.

6.5 Segment Leaders played an important role as a link between the large business taxpayers and LB&I senior management. Specifically, they managed large business taxpayer relationships, and conveyed ATO views, addressed issues and concerns including conflicts and disputes and complex technical issues.

6.6 Formerly, the Special Adviser role reported to the Deputy Commissioner LB&I Operations. Their primary role was to support Segment Leaders by providing senior leadership to industry segments on key cases and issues. This was achieved in a number of ways including:

- case level – making specific interventions from an early stage in some of the more complex, sensitive and potentially difficult cases or issues and conducting independent six monthly call-over of cases; and
- building capability – attending workshops for selected cases including initial workshops for new risk reviews and audits and providing guidance on areas for overall improvement.

6.7 Special Advisers operated with a high degree of flexibility in terms of the nature and extent of the interventions they made in specific cases.

6.8 Importantly, the Special Advisers did not take on the role of Team Leaders. Rather, they provided guidance, counsel and leadership in managing the technical

issues and the case to ensure that it was progressing appropriately. Where Special Advisers did intervene in a risk review or audit they could assume the role of the Segment Leader.

6.9 Special Advisers may be engaged by Segment Leaders at any stage of a risk review or audit. Interventions varied from short term guidance or intervention to longer term detailed and ongoing involvement. However, very detailed ongoing intervention was limited to ensure that Special Advisers had an appropriately broad coverage of cases and issues, maintained an appropriate strategic focus and had availability for more urgent issues or cases. Some examples of specific activities that Special Advisers may undertake to provide assistance include:

- workshop cases to help teams understand complex issues, identify more specific information requirements and develop more detailed case plans;
- work closely over extended periods with teams to help them develop and implement appropriate strategies to manage the resolution of the technical issues and risk;
- assist teams to ensure that appropriate technical and other specialists (including external specialists) are engaged and to make best use of that specialist knowledge;
- provide detailed input to the development of information requests, position papers and briefings; and
- mentor teams and case managers to develop their technical, case planning and case management capability.

6.10 The ATO also established a small number of Case Leadership positions that intervene primarily in cases from a pool of work identified by a set of criteria. The Case Leadership positions are corporate roles that report directly to the Commissioner of Taxation.

ATO Lead Relationship Manager

6.11 In June 2009 the Commissioner of Taxation announced that the ATO was to provide a Lead Relationship Manager (LRM) role for the largest businesses who make a significant contribution to Australia's tax revenue and who demonstrate a willingness to work collaboratively with the ATO.

6.12 The aim of the LRM role is to build relationships and trust in order to facilitate voluntary compliance, improve client service and reduce compliance costs. It seeks to better enable large businesses to manage their taxation, employer and superannuation obligations through cooperative and purposeful relationships. It is also intended to provide the 'cut through' to achieve more timely resolution of tax issues by:

- facilitating, coordinating and prioritising high level engagement across the ATO;
- fast-tracking critical technical decisions and the resolution of escalated issues, blockers and irritants;
- involving taxpayers early in planning and scheduling of compliance activities; and
- arranging access to technical specialists and decision makers for significant issues.

6.13 The ATO offered an LRM on a priority basis to large businesses that showed a genuine desire to work collaboratively with the ATO, made a significant contribution to the Australian economy (turnover, contribution to revenue and the effective running of the tax system) and had complex taxation, employer and superannuation obligations. Alternatively, an LRM role may have been put in place for a specific period of time or circumstance, such as for a major transaction or joint venture.

6.14 Eight large businesses participated in an ATO pilot to co-design the LRM role, from July 2009 to April 2010. The Large Business Advisory Group and a range of ATO stakeholders were also consulted.

6.15 The ATO advises that the pilot was an investment in continuing to develop whole-of-client and whole-of-ATO approaches. It also supported the ATO's strategic shift to working in real time and encouraging early and open engagement. A key element of the role was the early and timely access to interpretative advice and coordination of review and audit activity to reduce compliance costs.

6.16 The ATO advises that benchmark surveys undertaken at the start of the pilot and follow-up surveys indicate improvements in key deliverables such as coordination of ATO activity, access to decision makers and the timely resolution of technical issues.

6.17 In June 2010 the Commissioner announced the expansion of the LRM service to up to 20 large businesses. The ATO has stated that it remains a challenge and a priority to become more consistent in the way that it engages with large businesses so as to bring to life the ATO's organisational and relationship principles. One way of doing this was to involve a broader group of compliance staff in the next implementation phase of the LRM rollout.

ATO processes and procedures

6.18 The ATO's LB&I Compliance Manual has two chapters dedicated to planning a risk review and audit. It states that planning and actively managing a case is the key to completing the case effectively and in a timely manner.¹

6.19 The Compliance Manual recognises the importance of planning and stresses that Team Leaders are required to play a vital role in the planning of risk reviews and audits, including signing off on a case plan and bearing ultimate responsibility for the plan being effective.² The ATO has indicated that a range of skilling and capability initiatives directed towards improving case management and planning have been effected or are in progress.

6.20 As a way to ensure that compliance work is well planned, it is mandatory at the commencement of an audit that the case officer prepares an Audit Management Plan (AMP) and that this is discussed with the taxpayer by a senior tax officer at the preliminary audit interview. The purpose of the AMP is to provide taxpayers with a clear understanding of the scope of the audit, the tax risks being examined, the audit process and the proposed audit project plan timelines. It is highly recommended that

1 LB&I Compliance Manual, Chapter 2, p 3.

2 LB&I Compliance Manual, Chapter 2, p 4.

the senior tax officer that attends the preliminary audit interview also participates in the audit planning workshop.³

6.21 The ATO also advises that active case management is achieved through monthly case reviews and call-overs.

6.22 The purpose of monthly case reviews is to facilitate the timely management of risk reviews and audits so as to achieve the planned outcomes. This involves the identification of issues that may delay case progression and to advance those issues to a resolution. Monthly case reviews involve:

- monitoring case progression to case plan;
- supporting critical case events;
- reviewing and updating the expected case outcomes;
- providing timely and regular review and support;
- identifying and implementing interventions; and
- regular review to determine if a case warrants early exit.⁴

6.23 The Compliance Manual states that the monthly case review is a pivotal governance point that supports the delivery of LB&I's compliance program and must be conducted in a purposeful, rigorous and disciplined manner. The outcome of the monthly case review is intended to provide segment and line management with assurance that the appropriate outcomes for each compliance case are being achieved by pro-active case management such as appropriate resources and capabilities being allocated to the case, consultation with other stakeholders and subject experts and ensuring that all aspects of the case adhere to established work practices.⁵

6.24 The ATO also uses case call-overs for significant audits, risk reviews and objections that are conducted by senior technical officers such as LB&I Case Leaders. As part of the call-over process an audit team must document the key issues, identify any blockers and review findings.

6.25 The ATO has advised IGT that where monthly reviews are conducted in line with management's intent, cases will be actively managed and teams should be able to progress the majority of casework in appropriate timeframes and in line with the commitments made in the Large Business and Tax Compliance (LBTC) booklet.

6.26 The ATO uses call-overs (or case governance panels) as one of its assurance mechanisms around the effectiveness of teams in actively managing their cases through day-to-day activities and monthly reviews.

6.27 Call-overs occur three times a year and involve a review of the stock of casework with certain cases selected for an in-depth panel discussion. Senior and

3 LB&I Compliance Manual, Chapter 10, p 16.

4 LB&I Compliance Manual, Chapter 10, Appendix 8 (p 48).

5 LB&I Compliance Manual, Chapter 10, Appendix 8 (p 48).

experienced officers take part in these panel discussions and provide direction to teams on the case direction, including around managing any need for escalation or plans to resolve blockers.

SUBMISSIONS AND CONSULTATIONS

6.28 The issues and concerns raised by stakeholders in the course of this review are outlined in this section.

6.29 Some advisers and taxpayers have complained of ineffective and inefficient decision-making processes with audit teams struggling to progress issues or remove blockers due to a clear absence of strategic direction and leadership.

6.30 Others have suggested that it is often unclear who the decision-maker is given the large number of tax officers that are involved in a risk review or audit. In addition, tax officers that are ultimately responsible for a decision do not always have direct contact with the taxpayer and also initiate audit processes that are perceived to be unnecessary or did not have a clear purpose.

6.31 A number of taxpayers and tax advisers submitted that without this direct contact, tax officers may often not be aware of the consequences of their decision (such as a taxpayer experiencing unnecessary delay and incurring significant costs). If the 'real' decision maker was directly engaged then other viable alternatives would be better understood, appreciated and considered and there would be greater accountability.

6.32 Others have remarked that even where there is direct contact with these relevant tax officers, it is often unclear what their role is and taxpayers and advisers believe that they are not able to provide an adequate explanation of the ATO audit processes or the status of particular matters.

6.33 A number of taxpayers and advisers also raised concerns with certain aspects of the ATO's audit plans, including:

- audit plans being extremely general in nature and often involving unrealistic timeframes (in one example raised with the IGT, the ATO committed to an audit plan but on the same day issued information requests and section 264 notices to third parties that would make it impossible to adhere to the plan);
- multiple revisions of audit plans, departure from agreed case plans and processes, inconsistency between agreed process and subsequent ATO action;
- lack of transparency from audit teams (for example, not keeping taxpayers informed of the escalation of technical issues within the ATO); and
- no updates during the audit with no clear timetable or guidance around risk review and audit outcomes, with some taxpayers receiving information requests 15 months after the start of an audit.

6.34 Advisers and taxpayers believed there to be a disconnect between auditors, senior management and technical areas leading to time delays and uncertainty. This

has been attributed to the segregation of responsibilities (such as technical decision making and information gathering) across various parts of the ATO. Further, they have a clear impression that no one person is responsible or has sufficient authority for bringing these functions together, which can lead to the inefficient handling of risk reviews and audits.

6.35 Others suggested that the organisational shift in the ATO from functional groups (such as audit and appeals) to a market segment approach has meant that it is very important to ensure that the appropriate technical and legal resources and expertise are directly available during a risk review and audit.

6.36 A number of taxpayers and advisers pointed to the case leadership role and noted that it had evolved to allow greater oversight around key issues and provided dedicated senior management time and energy to resolve these issues.

6.37 While there was ready acknowledgement that the involvement of case leaders has led to the resolution of some outstanding audits, a number of taxpayers and advisers have expressed the view that the LB&I case leadership initiative is not achieving optimal results.

6.38 Other advisers and taxpayers believed that case leaders are not always taking an active role in managing the audit process and are not acting as an appropriate escalation point. Advisers are frustrated that they often get push back from case leaders whenever they seek to escalate an issue or concern. Where case leaders are becoming involved, taxpayers believe that they are not looking to resolve the audit but rather are prolonging the process by exploring new issues, arguments, positions and issuing further information requests.

6.39 A number of problems that arose in this context were demonstrated by way of examples provided by taxpayers and advisers. The ATO also raised with the IGT certain examples where the information gathering with the taxpayer was a very difficult process, where in their view the delay and need for further information was due in no small part to taxpayer actions. In this regard it may be helpful to look at some examples that test the extremities of application.

6.40 One such example raised by a taxpayer with the IGT referred to an audit where after 12 months of dealing with the Case Officer and providing a significant amount of information to the ATO, a Case Leader became involved resulting in a change of direction with further information requests and additional costs for taxpayers with no appreciation of the prior audit history. Another taxpayer referred to an audit where they had provided the ATO with a voluntary information paper as well as approximately 65 lever arch folders of information and source materials. Following the involvement of a senior ATO officer, the taxpayer was advised that the ATO did not have a sufficient understanding of the facts to finalise its technical position and the audit team embarked on a new round of information gathering to address the technical issues raised by the senior ATO officer. This led to the taxpayer providing an additional 23 lever arch folders of information and source materials and the ATO interviewing 14 former employees. The taxpayer asserts that this highlights that the activities of the audit team prior to the appointment of the senior ATO officer did very little to assist the ATO to finalise its position.

6.41 More generally, taxpayers and advisers also believed there is a lack of clarity around the role of Case Leaders. Many believe that the ad-hoc involvement of Case Leaders, where they can seemingly drop-in and drop-out of an audit, creates significant delays, uncertain and contentious positions, an overly secretive and aggressive approach and in certain instances excessive resort to formal information powers. Some advisers and taxpayers have suggested that these negative impacts arise due to the Case Leaders wanting to take an audit in another direction notwithstanding the significant amount of time and resources already incurred by the taxpayer. Others have asserted that there is often a lack of dialogue with these officers because they act from behind the scenes and exercise their influence and decisions without direct engagement with the taxpayer.

6.42 The IGT observed that there was significant stakeholder confusion and uncertainty about the Case Leader role under the former LB&I management structure in terms of authority and application both formally and in practice.

Taxpayer and adviser expectations

6.43 Taxpayers and advisers broadly want greater transparency, accountability and improved communication in the audit and decision-making process (with particular emphasis on personal accountability, delegation of decision-making power and senior officer involvement and responsiveness).

6.44 Advisers and taxpayers strongly believe that there is a need to have a single senior executive ATO officer who is ultimately responsible for a risk review or audit and identified to them as such. The role of such officers would be to provide end-to-end leadership and accountability, ensure that there is proper dialogue and engagement with the taxpayer, be the key escalation point and ensure that due process is being followed in the conduct of a risk review or audit.

6.45 These senior tax officers should also be responsible for ensuring that the various aspects of the ATO audit process (such as technical decision-making and information gathering) are well-coordinated, and be able to cut through both internal and external blockers to ensure the timely conduct of a risk review or audit.

6.46 Taxpayers and advisers would also like to see more active management and leadership of the risk review and audit processes by the various Team Leaders, with adequate oversight by the senior executive officers to ensure that Team Leaders are conducting the risk review or audit in a manner that is consistent with the spirit of the LBTC booklet.

IGT OBSERVATIONS

Senior leadership and accountability

6.47 The IGT has found that the ATO's processes, procedures and audit teams do place an importance on ensuring that case plans are prepared and followed, with evidence of case plans on the Siebel case management system. In addition, the IGT has found that the ATO does seek to actively manage risk reviews and audits through monthly case reviews and call-overs.

6.48 The ATO Compliance Manual acknowledges that the risk assessment of 'higher risk' and 'key' taxpayers requires proactive management and that project management is a skill in its own right. The IGT believes that pro-active management in an LB&I environment requires an officer with sufficient clout, technical expertise and leadership qualities to ensure that risk reviews and audits are being conducted in a manner consistent with the LBTC booklet.

6.49 Under the previous ATO management structure, there were a large number of tax officers who could be involved in a risk review or audit ranging from Segment Directors, Segment Leaders, Special Advisers, Case Leaders, Team Leaders and Technical Leaders along with the potential involvement of technical decision-making areas (Tax Counsel Network (TCN) and the Centres of Expertise (CoE)). The IGT has found that executive level officers (such as Special Advisers, Case Leaders and Segment Leaders) have significant input in developing strategies to manage and resolve technical issues and risks, identifying information requirements and providing direction on case plans and position papers.

6.50 However, the IGT has also found that it is often unclear what the roles and responsibilities of each of these officers are in the context of managing a risk review or audit. Feedback from a range of stakeholders suggests that it is often left to the case officer to manage these internal interactions and relationships when it would appear that these officers are the least empowered to do so.

6.51 The IGT agrees with taxpayers and advisers that there is a need for transparent leadership and accountability around the risk review and audit processes. While it is important that executive level officers be actively involved in risk review or audit cases, the IGT believes that the high degree of flexibility in terms of the nature and extent of this involvement has brought about uncertainty. It is difficult for taxpayers and advisers to identify a tax officer with overall responsibility and authority for a risk review or audit to act as a single point of contact. In certain cases, this can have a detrimental impact on the ATO's efforts to move towards early engagement and to engender greater trust.

6.52 It is clear from submissions and consultations that taxpayers and advisers want an executive level officer who is ultimately responsible and can bring together key components of a risk review or audit (such as the technical decision-making and information gathering). The role of such officers would be to provide end-to-end transparent leadership and accountability, ensure that there is proper dialogue and engagement with the taxpayer and be the key escalation point. In addition, these officers should be responsible for the technical component of the audit so as to ensure that critical technical decisions are made and escalated issues, blockers and irritants are addressed.

6.53 The IGT also believes that it is important to have senior executive level officers maintaining adequate oversight of key aspects of a risk review or audit, especially where they may impact upon the ATO-taxpayer relationship. Where there are a number of different people or areas involved in a risk review or audit (such as TCN, COE or other LB&I specialists) it should be possible to readily identify on the ATO's Siebel case management system who is involved, the nature and extent of their involvement and the expected timeframes.

RECOMMENDATION 6.1

To provide greater leadership, transparency and accountability involving higher consequence taxpayers, the ATO should allocate a tax officer of executive level or higher as Team Leader with sufficient authority, technical expertise and leadership qualities to ensure there is a strong project management focus and that due process is followed in the conduct of any risk review and audit.

The Team Leader role should have the following responsibilities and expectations:

- end-to-end accountability for a risk review and audit including ensuring that key stages of a risk review or audit (such as technical decision-making and information gathering) are well-coordinated, timely and effective. This will necessarily involve being responsible for the technical components of the audit to ensure that critical technical decisions and the resolution of escalated issues, blockers and irritants are managed effectively;
- effective oversight of Case Officers and active management of other ATO officers involved in the process, to ensure the consistent and proportionate delivery of a risk review and audit in keeping with the ATO LBTC booklet requirements and the ATO's Risk Differentiation Framework; and
- ensuring that there is proper dialogue and engagement with the taxpayer by actively participating in key workshops and meetings.

The Team Leader should also work closely with their senior executive officer to ensure the latter is regularly appraised of case progress and emerging risks for the case plan, so they can develop and implement strategies to mitigate those risks.

The senior executive officer will also:

- act as the key escalation point for taxpayer concerns with the conduct, progress or direction of a risk review or audit; and
- consider and decide whether alternative dispute resolution is appropriate and ensure that genuine steps are taken to resolve potential disputes.

ATO Response

Agree.

All our team leaders in the large market are executive level officers.

The *LB&I Compliance Manual* identifies who is responsible for different aspects of active compliance casework. In our response to Recommendation 4.3, we noted that we are updating the manual prior to its public release. We will develop clearer statements of roles and responsibilities for our senior officers in the updated manual.

We will evaluate how senior officers are meeting these expectations through annual performance reviews; feedback from our internal assurance processes (such as callovers); as well as external feedback from Client Feedback Questionnaires (CFQs), client visits and consultative forums.

6.54 In the context of managing a risk review or audit, the IGT believes that there are a range of options that could be considered in implementing this recommendation. One option could be to rationalise the various pre-existing senior roles and responsibilities as they relate to risk review and audits (such as Case Leaders, Special Advisers, Segment Leaders and Segment Directors) and build them into the current LRM role. The LRM role should be expanded to include all 'high risk' and 'key' taxpayers that are subject to a risk review or audit. Given the nature and importance of these taxpayers to the operation of the tax system, it is important that risk reviews and audits have a strong and effective project management focus so as to minimise delay and taxpayer compliance costs.

6.55 In relation to the LRM role, discussions with taxpayers and advisers that were part of the LRM pilot indicated that the role normally formalised a pre-existing strong working relationship with the ATO. While the overall consensus was that the LRM role had great potential and had led to improvements in the ATO-taxpayer relationship, feedback also suggested some uncertainty regarding the extent of responsibility and authority of the LRM in the context of a risk review or audit.

6.56 In one case the LRM was quite active in seeking to resolve a blocker and bring together the taxpayer and ATO technical specialists. In other instances taxpayers were left with the impression that the LRM did not see it as their role or responsibility to be involved in the risk review or audit and that some appeared reluctant to escalate or resolve blockers in the audit.

6.57 A number of taxpayers suggested that they did not want to see the LRM lead the audit team or have carriage of the day-to-day management of a risk review or audit. It was considered important to have a senior tax officer who can objectively review and resolve taxpayer concerns with the conduct, progress or direction of a risk review or audit.

6.58 The ATO's former management structure had Segment Leaders and Directors with general management responsibilities, but Special Advisers were allowed to intervene and assume decision-making responsibilities in certain circumstances.

6.59 Another suggestion would be for these senior tax officers to be separate from the LRM role and only involved in risk reviews and audits. A number of taxpayers and advisers noted that given the ATO's current LB&I resourcing it may be difficult to allocate such a large number of senior tax officers to large businesses and believed there were benefits in reinforcing the responsibilities and expectations in the LRM role.

Team Leader roles

6.60 It is important that Team Leaders continue to have carriage of the day-to-day management of a risk review or audit. However, the IGT believes that greater emphasis should be placed on the responsibility of Team Leaders to ensure they actively manage key aspects of a risk review or audit. This requires greater guidance

on the role and expectations of Team Leaders as well as effective assurance mechanisms (such as oversight and guidance from senior tax officers) to ensure that risk reviews and audits are conducted in a manner in line with the LBTC booklet and the ATO's Risk Differentiation Framework.

6.61 This should be supplemented with appropriate skilling and training to ensure that Team Leaders can provide effective leadership and mentoring and ensure that the values and relationship principles embedded in the LBTC booklet are consistently brought to life. On this front the ATO has advised the IGT that it is working through a program of capability enhancement including various training packages for LBI&I staff to support them in carrying out both the Team Leader roles and other responsibilities.

RECOMMENDATION 6.2

The ATO should provide greater guidance on the Team Leader's role and its responsibilities and expectations in the conduct of a risk review or audit, to better support consistent and proportionate delivery of the processes in conformity with the requirements of the LBTC booklet.

ATO Response

Agree.

As noted in our response to Recommendation 6.1, this will be achieved through updated guidance on roles & responsibilities in the *LB&I Compliance Manual* and associated training and dialogue.

Monthly case reviews

6.62 The IGT observed audit teams completing the monthly case review template. The IGT considers that monthly case reviews represent an important governance process by promoting a regular discussion between Team Leaders and Case Officers on the progress of the case.

6.63 The IGT believes that there is scope to build on these templates so as to provide greater assurance that key aspects of a risk review or audit are being effectively and efficiently managed. Currently, the monthly case reviews seem to place emphasis on identifying issues that are causing or will cause case delays. In addition, a number of the questions in the monthly case review template lend themselves to simple yes or no answers with a risk that the monthly case review process becomes a 'tick and flick' exercise.

6.64 The IGT agrees that identifying such issues and blockers is an important facet of managing a risk review or audit. However, the IGT also believes that there is scope for the monthly case review process to be used as an assurance tool around other important relationship aspects of a risk review and audit.

6.65 These aspects could include assurance around the refinement and communication of the risk hypothesis, the nature and quality of the engagement

around the facts, issues, evidence and guidance around information requests and the cooperative development of position papers.

6.66 The IGT believes that a more targeted monthly case review process will also ensure that Team Leaders better actively manage these key aspects of risk review or audit.

RECOMMENDATION 6.3

The ATO should revise its monthly case management review practices to capture a more diverse range of activities so as to ensure that all aspects of a case are adhering to established work practices and the expectations set out in the LBTC booklet. This should include revising the case review template to develop more targeted questions addressing audit teams regarding:

- frequency, mode and content of communication with the taxpayer during the month;
- risk hypothesis discussions with the taxpayer, including communication of material changes to the existing hypothesis or any new risk hypothesis raised during that month; and
- extent of engagement with the taxpayer to:
 - i) explain information requirements;
 - ii) identify relevant information; and
 - iii) develop a plan for information delivery to the ATO.

ATO Response

Agree.

We are updating our assurance processes to reflect the expectations set out in the LBTC booklet. As part of this process, we are developing and testing new questions for the monthly review template. These will include a specific focus on the quality and nature of the team's communication and engagement with the taxpayer and its effectiveness.

CHAPTER 7: INFORMATION GATHERING

7.1. This chapter considers the ATO's informal and formal information gathering approaches. It discusses the issues and concerns raised by stakeholders and makes several recommendations to ensure that the information gathering process promotes transparency and dialogue and seeks to minimise compliance costs.

BACKGROUND

7.2. The ATO's approach to information gathering is set out in a number of its key publications. The Taxpayers' Charter, the Large Business and Tax Compliance (LBTC) booklet and the Access and Information Gathering Manual provide public guidance on how the ATO ensures it takes a fair, professional and (as far as possible) open approach to using its information gathering powers in the large market. The following principles are sourced from these documents:

- Consulting with taxpayers first – preference to consult with taxpayers and to obtain information cooperatively. The ATO prefers to use formal powers only where necessary. For example, for higher risk groups where the need to understand the business is paramount; or when it's requested by the taxpayer, or where other attempts to obtain the required information have failed. There are, however, some situations where the ATO may adopt a formal approach in the first instance.
- Telling taxpayers their rights and obligations – if the ATO is asking for information or documents, then it will inform taxpayers about their rights and obligations under the law as early as possible. It will also tell taxpayers why it is seeking access or information unless this may affect the audit.
- Giving taxpayers prior notice – in most cases the ATO commits to let taxpayers know in advance that it intends to access a taxpayer's premises or documents and it is only in exceptional circumstances that it will not give prior notice (such as a reasonable belief that the documents may be destroyed).
- Taking into account any possible costs to taxpayers – when the ATO decides what information or documents it requires access to, then it will also consider ways of minimising taxpayers' compliance costs.
- Giving taxpayers time to comply – the ATO will provide taxpayers with a reasonable time to comply with its notices requesting information or documents. This will generally be 28 days although, in some circumstances, the ATO may negotiate a shorter or longer time period.
- Respecting taxpayers' legal rights – the ATO commits to respect a taxpayer's right to claim legal professional privilege for certain communications between them and their legal adviser. In certain circumstances, the ATO will also allow some advice given by a professional accounting adviser to remain in confidence between the

taxpayer and that adviser (the so-called 'accountants' concession'). Taxpayers may also choose to have a representative or adviser present at a formal interview.

- Telling taxpayers when the ATO asks for third party information – if the ATO asks third parties about a taxpayer's affairs, the ATO will normally tell the taxpayer before it makes the enquiry, although there are certain circumstances where this may not occur such as where the ATO has already tried to obtain that information from the taxpayer.

7.3. The LB&I Compliance Manual¹ provides further guidance to ATO staff on information gathering during a large market audit. It notes that effective information gathering is vital to both the quality and timeliness of any compliance activity result. It emphasises that appropriate planning including an understanding of evidentiary requirements, limitations and blockers and ways to overcome them and good communication with the taxpayer is highly relevant to the successful completion of a risk review or audit.²

7.4. The Manual states that the ATO's main approach is, wherever possible and effective, to use an informal approach to information gathering based on the risk hypothesis. Audit teams are encouraged to gather information in cooperation with the taxpayer that is relevant to testing the hypothesis, as that is the basis of the audit.³

7.5. Information gathering including informal information requests, formal information requests and dealing with legal professional privilege and accountants' concession claims is primarily undertaken by the Senior Case Officer with active participation and management by the Team Leader and Technical Leader. It may also involve input from other ATO personnel external to the audit team including Case Leaders, TCN and CoE staff, LB&I Access Network members, external consultants and experts to assist with the gathering of information.⁴

7.6. The Compliance Manual lists a number of aspects of the information gathering process that can cause delays in the timely and efficient collection of information or documents, including:

- unclear information requests resulting in the wrong or inadequate information being supplied;
- taxpayer-caused delays;
- breakdowns in communication and relationship between the ATO and the taxpayer;
- insufficient planning that does not effectively manage the ATO-taxpayer relationship;

1 Please note that during the course of this review the ATO advised the IGT that the LB&I Compliance Manual is in the process of being revised and updated. The discussion and reference in this report are to the current version and may not be reflective of the revised version when it is released.

2 LB&I Compliance Manual, Chapter 11, p 4.

3 LB&I Compliance Manual, Chapter 11, p 7.

4 LB&I Compliance Manual, Chapter 11, p 7 and p 13.

- escalating to a formal approach without appropriately considering and trying other options such as escalation to senior officers;
- failing to escalate to a formal approach in a timely manner when an informal approach is not working, resulting in blown out timelines and a lack of information to make a valid decision;
- information and documents subject to legal professional privilege and accountants' concession claims; and
- the taxpayer has a matter before the courts and further action by the ATO could be construed as being in contempt.⁵

7.7. The Compliance Manual states that the planning of the information gathering stage of a risk review or audit is critical to the effectiveness and success of the ATO's compliance activities and in maintaining a positive relationship with taxpayers. The Manual lists a number of elements that support good planning:

- developing a hypothesis that will make information gathering more purposeful;
- building a clear understanding of the information required to test the ATO's risk hypothesis and how it should be obtained;
- progressively refining information gathering requirements as the hypothesis is refined;
- considering evidentiary needs including the development and progressive completion of the facts and evidence worksheet;
- considering the taxpayer's business, the records the taxpayer is likely to keep, who is likely to control those records and who has custody of the records and whether the required information is publicly available;
- identifying key personnel in the taxpayer's organisation that may provide relevant information;
- developing contingency, risk and mitigation approaches including how to deal with claims for legal professional privilege and the accountants' concession; and
- using appropriate tools and techniques to manage evidence.⁶

7.8. Whenever gathering information, the Manual states that it is important that the ATO discuss its approaches with the taxpayer and seek agreement on the process to gather the particular information. Those discussions should always include a discussion on informal and formal approaches and the circumstances that would trigger a shift from an informal approach to a formal approach. The circumstances

5 LB&I Compliance Manual, Chapter 11, p 7.

6 LB&I Compliance Manual, Chapter 11, p 8.

should be agreed between the parties and confirmed in writing thus mitigating any potential delays in the future.⁷

7.9. The Compliance Manual reinforces that the starting point for planning information gathering is the initial (case selection) risk hypothesis. It states that it is critical that auditors link the information gathering to the hypothesis as it makes information gathering far more purposeful. Auditors must also progressively refine the risk hypothesis and use this as a framework for their ongoing information gathering.⁸

Informal information gathering

7.10. The Compliance Manual requires all auditors to use an informal approach to information gathering at the outset of a risk review or audit unless there are exceptional circumstances that require the use of formal powers.⁹

7.11. Informal information gathering is the process of gathering information without recourse to any formal powers – that is, without compelling the taxpayer to provide information, attend interviews or provide access under the relevant statutory provisions.¹⁰

7.12. Underpinning the informal approach are the assumptions that there is full cooperation between the ATO and the taxpayer and that full, complete, relevant and timely information is being provided. Cooperation is therefore more than meeting timeframes for the provision of information. It includes working together to ensure the efficient and timely progress of the compliance activity through the provision of full, complete and timely information.¹¹

7.13. In the context of information gathering, the ATO expects that its auditors will act in a professional, courteous and respectful manner and demonstrate integrity, fairness and impartiality in the conduct of their duties. They are also expected to maintain an open dialogue and ensure information requests are clear and unambiguous. Likewise, the ATO expects large market taxpayers to actively engage with and assist the audit team in developing realistic plans, milestones and timeframes, to advise the audit team as early as possible of any delays in providing information and take all reasonable steps to provide the information requested including those relating to business context.¹²

7.14. The Compliance Manual states that informal requests for information, whether by interview or via written request, still have an expectation of a full, complete, timely and accurate response (although legally the taxpayer is under no obligation to respond to the request). It is expected that taxpayers will exercise the

7 LB&I Compliance Manual, Chapter 11, p 8.

8 LB&I Compliance Manual, Chapter 11, p 4.

9 LB&I Compliance Manual, Chapter 11, p 8.

10 LB&I Compliance Manual, Chapter 11, p 16.

11 LB&I Compliance Manual, Chapter 11, pp 17-18.

12 LB&I Compliance Manual, Chapter 11, p 18.

same level of diligence and best endeavours in meeting informal requests for information as they would if the information was requested using formal powers.¹³

7.15. The Compliance Manual also encourages face-to-face meetings as the preferred approach to initial requests for information so as to facilitate an agreed and effective information gathering process. This includes:

- the auditor outlining what information is required and its relevance to the risk hypothesis; and
- the taxpayer providing details of what information is available, when it will be provided and, if the information is not available but held by third parties, then agreeing on what is the most efficient method to obtain it.¹⁴

7.16. Where the informal information gathering approach is not leading to the timely provision of information then the Manual states that consideration should be given to escalating to a senior tax officer or adopting a more formal approach.¹⁵

Escalation to senior officers

7.17. The Compliance Manual notes that early intervention is critical in avoiding ongoing problems during the information gathering stage of a risk review or audit.¹⁶

7.18. In the first instance it is expected that a discussion should take place between the audit team and the taxpayer's nominated contact in order to identify and resolve any issues including the clarity and intent of the original request. Besides exploring the current issues the discussion should also canvass future action should resolution not be reached.¹⁷

7.19. The Compliance Manual states that the desire to maintain a cooperative relationship should not impede raising matters of concern during the course of the review or audit. The nature of a cooperative approach requires both parties to work together to resolve issues as they arise and failure to do so can lead to greater longer term damage to the relationship and achieving quality outcomes.¹⁸

7.20. Where problems cannot be resolved through a discussion between the audit team and taxpayer, it is open to either party to escalate the matter to more senior management.¹⁹

7.21. The aim of the escalation process is the timely resolution of any issues regarding the provision of information without resorting to the use of formal powers while maintaining a good ATO-taxpayer relationship. The escalation process should be

13 LB&I Compliance Manual, Chapter 11, p 16.

14 LB&I Compliance Manual, Chapter 11, p 16.

15 LB&I Compliance Manual, Chapter 11, pp 23-24.

16 LB&I Compliance Manual, Chapter 11, p 23.

17 LB&I Compliance Manual, Chapter 11, p 23.

18 LB&I Compliance Manual, Chapter 11, p 23.

19 LB&I Compliance Manual, Chapter 11, p 23.

discussed at the preliminary interview and should include the identification of escalation points within the respective organisations.²⁰

7.22. At the end of the escalation process, if the matter is not resolved, each party should clearly understand each other's respective positions, the issues and the next course of action.²¹

Moving from an informal to formal information gathering approach

7.23. The formal approach involves compelling taxpayers to provide access to information under statutory provisions.²² The Compliance Manual notes that the use of the ATO's formal powers only occurs in a relatively small number of cases and generally only after the informal approach has not been successful. It also states that given the emphasis placed in the LBTC booklet on the importance of timely taxpayer cooperation and responses, the ATO's current approach is to escalate to the use of formal powers more promptly than it may have in the past.²³

7.24. Where the informal approach and escalation to senior officers is not leading to the timely provision of information (either due to a lack of full cooperation or ongoing delays in providing information), the Compliance Manual states that the consideration and subsequent use of the ATO's formal information gathering powers is warranted, provided that the ATO has followed its commitments outlined in the Taxpayers' Charter and the LBTC booklet.²⁴

7.25. The LBTC booklet sets out examples of where the ATO may adopt a formal information gathering approach either at first instance or in the course of a risk review or audit where the ATO believes that an informal approach is not leading to full cooperation. The booklet also sets out what taxpayers can expect when the ATO decides to use its formal powers:

- treat the taxpayer fairly and, as far as possible, in a non-intrusive way;
- give the taxpayer reasonable notice of the ATO's intention to use its formal powers;
- clearly identify the objects of the examination and keep information requests relevant and focused;
- explain why the ATO is requesting information; and

20 LB&I Compliance Manual, Chapter 11, p 23.

21 LB&I Compliance Manual, Chapter 11, p 23.

22 Generally, for income tax purposes the formal approach involves using:

1. Section 263 of the ITAA 1936 for access to buildings, places, books, documents and other papers;
2. Section 264 of the ITAA 1936 for compelling taxpayers or individuals to furnish information, attend and give evidence (including sworn evidence) and produce documents; or
3. Section 264A of the ITAA 1936 for requests for the production of documents or information where there is reason to believe that such information or documents may be held offshore.

23 LB&I Compliance Manual, Chapter 11, p 25.

24 LB&I Compliance Manual, Chapter 11, p 25.

- respect the taxpayer's rights to legal professional privilege or the accountants' concession, such that it will not adversely impact the ATO's view of a taxpayer's cooperation.²⁵

7.26. The Compliance Manual also states that the intention to use formal powers and the reasons for doing so should be discussed with the taxpayer beforehand unless there is a good operational reason for doing otherwise. It notes that the process leading up to the use of formal powers must have included a full and frank discussion about the consequences of not meeting informal requests for information. In this discussion, the taxpayer must be advised that if the information is not provided in response to informal requests, the information may be requested using the ATO's formal powers. This discussion provides the opportunity to raise any issues, to escalate the matter if required but also to clearly understand why the use of formal powers is considered necessary.²⁶

7.27. A decision to issue a formal ATO notice can be made by a duly authorised officer. In practice this generally rests with an executive level tax officer. It is normal practice for this officer to inform and consult with a senior executive tax officer before doing so. Procedures for the use of formal powers are contained in the Access and Information Gathering Manual that is published on the ATO website.²⁷

7.28. In discussions with the IGT the ATO has confirmed this approach. The ATO stated that it needed to balance its preference to work informally and cooperatively with taxpayers against its responsibilities as a regulator to conduct compliance work efficiently. Where ATO experience and the circumstances indicate an informal approach is unlikely to be effective and will result in a delay in obtaining the full facts, the ATO will look to using formal powers at an earlier stage and, in some cases, from the outset of a case as is explained in the LBTC booklet.

Legal professional privilege and accountants' concession

7.29. Legal professional privilege attaches to confidential communications passing between a client and their lawyer if the communications were made for the dominant purpose of enabling the client to obtain or the adviser to give legal advice, or made in relation to litigation that is actually taking place or was in the contemplation of the client.

7.30. Legal professional privilege is the privilege of the client, not that of the lawyer, and may be waived as a right by the client only. Legal advice that is provided to other parties including auditors may mean that privilege is waived.²⁸

7.31. If it is properly claimed, the ATO cannot compel the taxpayer to disclose the information (even with its formal access powers). However, if it is not claimed

25 Large Business and Tax Compliance, p 30.

26 LB&I Compliance Manual, Chapter 11, p 24.

27 LB&I Compliance Manual, Chapter 11, p 24.

28 LB&I Compliance Manual, Chapter 11, p 31.

properly, the ATO can still require disclosure of the information using its access powers.²⁹

7.32. The Compliance Manual and the Access and Information Gathering Manual provide guidance to ATO staff and taxpayers on how the ATO will assess the veracity of any legal professional privilege claims. They also provide instructions to auditors to ensure that privilege in relation to legal advice received by the ATO is not waived.³⁰

7.33. The Commissioner has wide legislative powers to request access to most documents and legal professional privilege does not extend to communications in other confidential relationships like the one between accountants and their clients.³¹

7.34. As an administrative concession, the Commissioner has accepted that there is a class of documents which should (in all but exceptional circumstances) remain within the confidence of taxpayers and their professional accounting advisers. This is known as the accountants' concession.³²

7.35. The Commissioner allows clients to claim exemption from access and information gathering powers in relation to certain documents prepared by external, professional accounting advisers.³³

7.36. For the purposes of the accountants' concession, documents can be classified in three categories:

- source documents (records of transactions);
- restricted source documents (advice documents shedding light on transactions); and
- non-source documents.³⁴

7.37. Generally, the accountants' concession applies only to restricted source and non-source documents. However, the Access and Information Gathering Manual provides that in exceptional circumstances (such as where there is insufficient information to resolve the issue), an auditor may seek written approval from a relevant Senior Executive Service (SES) officer to such documents. The accountants' concession does not apply to source documents.³⁵

7.38. The Compliance Manual requires that auditors contact a LB&I access network member as soon as a taxpayer indicates that they may be making an accountants' concession claim.³⁶

29 LB&I Compliance Manual, Chapter 11, p 31.

30 LB&I Compliance Manual, Chapter 11, p 31.

31 LB&I Compliance Manual, Chapter 11, pp 32-33.

32 LB&I Compliance Manual, Chapter 11, p 33.

33 LB&I Compliance Manual, Chapter 11, p 33.

34 LB&I Compliance Manual, Chapter 11, p 33.

35 LB&I Compliance Manual, Chapter 11, p 33.

36 LB&I Compliance Manual, Chapter 11, p 33.

Access to corporate board documents on tax compliance risk

7.39. While recognising that the Commissioner has the legislative power to request access to most documents, the ATO accepts that there is a class of documents which should, in all but exceptional circumstances, remain within the confidence of company directors and their advisers on tax compliance risk. The ATO calls these documents 'corporate board documents on tax compliance risk'. Full details of this policy as well as the process for dealing with taxpayers claims that particular documents are corporate board documents on tax compliance risk are set out in Practice Statement LA 2004/14.³⁷

SUBMISSIONS AND CONSULTATIONS

7.40. All taxpayers and advisers support the ATO's need for information gathering and accept it is of paramount importance in the ATO's review of large taxpayers by allowing the ATO to better understand the entity and group structure or the facts pertaining to its activities.

7.41. A strong theme across nearly all submissions is that there is considerable room for improving the efficiency (taxpayers incurring significant and unnecessary costs associated with information gathering requests especially where the request is broad and there has been little engagement by the ATO around scope and purpose) and objectivity (searching for information to confirm the risk hypothesis rather than understanding the matter or transaction) of information requests.

7.42. Taxpayers and advisers have expressed a range of concerns relating to the information gathering process including the level of engagement, the scope of information requests, the timeframes for taxpayers to respond, the use of section 264 notices and the ATO's approaches to legal professional privilege and the accountants' concession.

7.43. The issues and concerns raised by stakeholders in the course of this review are outlined below.

Process

7.44. Taxpayers in submission and consultation with the IGT generally believed that the current information gathering process is very inefficient, unnecessarily costly to the taxpayer and poorly focused.

7.45. Taxpayers accept that in some instances responses to information requests have taken a considerable time (up to 6 months for some of the larger, complex requests). Taxpayers have said that while the ATO may point to this as taxpayer-caused delay, there are good reasons for these timeframes, including:

- the broad and imprecise nature of the initial request that often leads to multiple follow-up requests;

³⁷ LB&I Compliance Manual, Chapter 11, p 33.

- lack of a project plan and the 'fishing' nature of questions resulting in significant waste of resources and duplication;
- lack of understanding of business results in requests for information that are onerous and untargeted substantially lengthening the audit;
- requests relating to arrangements that were put into place many years ago and as a result it is extremely time consuming to locate documents and find relevant information; and
- ATO practice to request information for every year even where the issue under audit does not change for each subsequent year leading to a need to provide additional information.

7.46. A range of taxpayers and advisers believe that some of the ATO's approaches to information gathering (as catalogued below in greater detail) are not consistent with an open and transparent relationship or a cooperative exchange of information as set out in the LBTC booklet.

7.47. Taxpayers would also like to see greater accountability in the ATO's information gathering process. They feel aggrieved when they spend significant resources and time to provide information that is ultimately irrelevant or disregarded with no resulting consequences for the audit team. They believe that there is little appreciation of the resources required for information gathering, particularly in large business. They generally expressed a view that in reality tax is not the driver of transactions and that the bulk of the documents and requested materials will be located in many different areas of the business.

7.48. A number of taxpayers and advisers believed ATO information gathering should be modelled on techniques and processes used by external auditors. This involves developing a solid understanding of the business and then focusing resources on perceived risks, combined with regular discussion and interaction with the taxpayer. Taxpayers also wanted the ATO to take into account major transactions (such as acquisitions) or processes (like year-end) when seeking to request large amounts of information.

7.49. Taxpayers and advisers submitted that they were aware of their obligations to comply with ATO information requests on a full and frank basis and to assist the ATO with its enquiries in accordance with the law. However, they believed that it was fair and reasonable to expect that the ATO will afford them an equivalent degree of commitment to ensure the efficient conduct of an audit in line with the stated objectives.

Engagement

7.50. Many taxpayers asserted that the ATO does not readily engage with them to discuss and explain the reasons for seeking information and does not adequately consider the impacts of particular information requests. Some taxpayers also complained of receiving information requests without any prior dialogue or notice.

7.51. In particular, taxpayers and advisers strongly asserted that the ATO does not readily engage to discuss how the information requested relates to the ATO risk hypothesis and how the information provided has influenced the risk hypothesis. Some taxpayers have said that on some occasions the case officers themselves did not know why the requested information is relevant, merely saying that the need for the information was identified at a workshop with technical specialists and advisers.

7.52. Some taxpayers raised examples where ATO case officers have been unwilling to meet to discuss the key risks or information request despite numerous attempts. These taxpayers are left with the impression that ATO case officers simply want the information and are not interested in adopting a cooperative approach to information gathering. Where this arises taxpayers are unclear about how to escalate their concerns while others doubt whether escalating will have any benefit.

Scope of information requests

7.53. Stakeholder submissions raised strong concerns with the scope of information requests.

7.54. These requests were said to be often framed in very broad or imprecise terms through the use of expressions such as 'all materials relating to ...' or requesting information that is largely irrelevant such as 'all bank account details for the period'.

7.55. On other occasions taxpayers said that they received unduly complex and detailed information requests with multiple clustered questions. Taxpayers have said that the ATO can also be unwilling to specify with sufficient clarity the particular documents in which they may be interested. Taxpayers also noted that every record of the business is not necessarily kept that may or may not relate to a given transaction. This places taxpayers in a very difficult position as it is a time-consuming and extremely onerous process to try to identify all the potential documents that fall under the information request with no clear understanding of the underlying purpose behind the request.

7.56. Taxpayers also indicated that broad and imprecise information requests were often accompanied by short timeframes, placing an unreasonable burden on taxpayer's internal tax functions. Taxpayers find it very difficult to comply with such requests absent a discussion with the ATO to confine its scope. In some instances, where a taxpayer sought to question the relevance or scope of a request they believed that the case officers drew an adverse inference regarding the taxpayer's level of cooperation.

7.57. Taxpayers expressed the view that the ATO appears more concerned about making sure no piece of information is missed rather than determining what information it requires to make an informed decision. Where there was insufficient clarity around the scope of information requests a number of stakeholders summarised the underlying concerns by saying that it contributes to a perception that the ATO either adopts a 'scatter gun' or 'smoking gun' approach to information gathering.

7.58. These stakeholders suggested that prior to requests being made for 'all transaction documents, emails and other records', the ATO should have a view on what the potential tax issues are and these should be clearly articulated to the taxpayer.

7.59. A number of taxpayers also suggested that the ATO's approach seemed to be just directed at proving their risk hypothesis, without any regard for difficulties involved in providing information (time and cost). These taxpayers believed that their responses to ATO information requests were only looked at to support the ATO's risk hypothesis, with any material that supported taxpayer views being largely ignored or discounted.

Relevance of information and documents sought

7.60. Taxpayers and advisers submitted that it is often unclear how the information requested is relevant to the risk hypothesis. This made it necessary for taxpayers and their advisers to query case officers as to the relevance of the information requested. There were also some examples where this was managed effectively and this tended to be in situations where the dialogue and engagement was high or there was strong senior relationship management.

7.61. Taxpayers were particularly concerned when the ATO requires detailed information for a transaction that took place a number of years ago without any guidance on how the information is relevant to the ATO's risk review or audit. Taxpayers state that such information requests impose an enormous compliance burden on them given that certain information would have been archived or not readily accessible and that key personnel may no longer be employed by the taxpayer.

7.62. Submissions also suggested that there is a tendency for the ATO to request information that is ultimately irrelevant to the risk or issue – but that for taxpayers the provision of such information is both time-consuming and costly.

7.63. Some advisers submitted that the level of documentation requested around transactions suggests a real lack of trust in taxpayers especially where there is little detail around the risk hypothesis or issue. By way of example, one adviser referred to an ATO request that required a large publicly listed taxpayer to provide bank details to demonstrate the actual movement of monies. The adviser asserted that unless the ATO's risk hypothesis alleged fraud then such documentation was irrelevant, but that the taxpayer was required to provide this information and incur unnecessary costs.

7.64. In another example raised with the IGT, an adviser referred to an audit where the ATO sought access to a large number of taxpayer emails. The taxpayer's adviser said that despite numerous attempts to obtain greater clarity on the relevance of the information, the ATO instructed them to provide the emails and allow the ATO to determine its relevancy. The adviser suggested that this conduct indicates that the ATO is merely looking for what they believe is a smoking gun and placing an enormous and potentially unnecessary compliance burden on the taxpayer. In such instances advisers are also unsure whether the ATO has formed a view on potential tax issues or whether they are simply gathering all the information they can as they are worried time is running out.

Availability of information requested

7.65. Taxpayers and advisers raised concerns regarding the ATO's request for information and documents that are unavailable, difficult to locate due to the passage of time or not generated in the ordinary course of business.

7.66. Taxpayers and advisers also expressed concern with the quantity of information requested by some audit teams. One taxpayer example related to an ATO request for information going back 11 years and covering 2,000 files. The taxpayer indicated that after significant discussions the ATO refined its request to information going back only three years and on specific entities. The taxpayer indicated that it was difficult for them to satisfy the burden of proof where the ATO seeks to go back so many years given the general unavailability of documents and also given that many of the people involved in the transaction would have moved on.

7.67. Taxpayers and advisers submitted that some audit teams have an unrealistic expectation of the processes that are adopted by taxpayers and the associated documents that are produced. For example, certain taxpayers suggested that some audit teams will request information relating to the precise purpose of funding that was put into place even though there is no apparent relevance of purpose of the loan to the risk or issue identified by the ATO. Taxpayers state that it is unreasonable from a commercial perspective to expect the relevant business unit to have reported on the precise way in which the funds were used in operating its business. To determine the precise purpose and use of the funds retrospectively would require a detailed forensic analysis of the expenditure of the relevant subsidiary, which would be a costly and time-consuming exercise that would serve no apparent purpose.

Project management

7.68. Taxpayers and advisers submitted that some information requests do not appear to follow any logical order and do not accord with any overall project plan. Rather, taxpayers assert that various lines of enquiry are pursued for a period of time where the ATO requests information regarding a particular issue and indicates to a taxpayer that it is critical and of high priority (even causing the audit team to threaten to use section 264 notices). After this information is provided there is often a new line of enquiry pursued with no clarification or resolution of the previous issue or any indication of the relevancy of that earlier information.

7.69. Taxpayers and advisers would like to see a distinct narrowing of the scope of information requested. Initial information requests would contain broad or general questions with subsequent requests narrowing the scope of the information to specific areas of concern. It was submitted that such a phased approach would lead to a far more efficient information gathering process especially for more complex issues. Taxpayers and advisers suggested that the ATO's assurance processes should monitor risk reviews and audits to ensure that this narrowing of scope is occurring.

7.70. Taxpayers and advisers have also expressed concern with the perceived random and continual nature of information requests with no prioritisation or narrowing in scope. In addition, they have said that the ATO does not track

information requests and information that taxpayers have provided in a document that could be easily shared.

7.71. Advisers believed that there are few checks and balances between the front-line case officers sending the information requests and senior officers leading the review or audit. Some suggested that all decisions to issue information requests, including informal requests, should be reviewed by a senior level ATO officer before the information request is sent.

7.72. Repetition of requests for information provided previously to the ATO was another concern raised by taxpayers.

Costs

7.73. Taxpayers stated that the ATO does not often appreciate the significant resources and interruption to staff's existing duties caused by poorly targeted and ill-defined information requests. It was not uncommon for these costs to run into the hundreds of thousands of dollars with a few citing costs greater than \$500,000 in dealing with a multitude of both formal and informal information requests.

7.74. Taxpayers have said that the ATO does not appreciate the assurance processes that they have to go through (such as review by external lawyers to ensure that the taxpayer did not waive legal professional privilege) every time they receive an information request. Where requests are broad, imprecise and poorly focused it imposes significant compliance costs on taxpayers. In addition, responses can become expensive not just because of the questions asked but because of the time and cost needed to carry out the 'negative assurance' processes (that is, to ensure that a document requested by the ATO does not exist).

Timeframes

7.75. Taxpayers and advisers submitted that the ATO often imposes unrealistic timeframes for the return of information, usually 28 days, irrespective of the level of complexity or the age of the information requested.

7.76. Taxpayers want greater understanding from the ATO in relation to the practical difficulty with gathering information that is a number of years old. Taxpayers and advisers believe this places further emphasis on the need for ATO risk reviews and audits to be contemporaneous.

7.77. Taxpayers and advisers raised concerns with the practice of issuing substantive information requests just before Christmas with the expectation that a response will be received by the end of January when many ATO staff return from leave. If a taxpayer does not meet the ATO timeframe, then taxpayers suggest that the ATO then asserts that the taxpayer is the party delaying the audit. Some have submitted that this practice is not within the spirit of the Taxpayers' Charter and demonstrates that the ATO does not factor in taxpayers' business imperatives and ignores the fact that January is historically the busiest time for some taxpayers in attempting to meet their lodgement requirements.

7.78. A number of submissions noted long delays between the provision of information by taxpayers and ATO responses or follow-up. In one example, and after a full year had elapsed, the ATO made a request for an extensive amount of information and documentation (all emails, letters, facsimiles, diary or book entries, mandates or directions, records of meetings or telephone conversations, working papers, files, calculations, financial or mathematical models or formulae, fee invoices or schedules and any other documents relating to the transaction) and required a response within 28 days.

7.79. Some taxpayers expressed frustration at the volume of information required by the ATO on certain issues together with the timeframes for provision of this information. Taxpayers and advisers asserted that although the ATO often appears to do little with the information that taxpayers provide to them for long periods, the ATO has on a number of occasions only given taxpayers 28 days to respond to detailed information requests. They suggest that this indicates that the ATO applies different time standards to itself than it demands from taxpayers and does not understand or take into account the impact on taxpayers.

Section 264 notices

Purpose and circumstances of issuing notices

7.80. Taxpayers and advisers suggested the ATO's increasing use of section 264 notices, especially where the audit team did not first adopt an informal information gathering approach was also arising in a situation where there had not been any prior indication that the ATO would resort to issuing such formal notices.

7.81. Some observed that although the LBTC booklet states that information requests will be on an informal basis and formal powers will only be used if the informal process fails, they have had recent experience of the ATO issuing section 264 notices in a fully cooperative audit.

7.82. One example shared with the IGT is where the ATO issued section 264 notices notwithstanding that the audit had been ongoing for 19 months and the taxpayer had been assured that the information gathering stage was coming to an end. Of significant concern to the taxpayer was that they had endeavoured to fully cooperate with the audit team, received no prior indication of the use of the ATO's formal powers and had not received any draft discussion or position paper. The taxpayer was also concerned that the basis for issuing the section 264 notice seemed to be to ensure that the ATO had possession of as many documents as possible should the audit proceed to litigation. The taxpayer's advisers did not believe this was appropriate or contemplated by law notwithstanding the ATO's broad information gathering powers.

7.83. Other taxpayers and advisers submitted that the ATO issued amended assessments and then proceeded to request further information from them by way of a section 264 notice. In one instance a taxpayer indicated that the section 264 notices contained requests for information that had been previously provided to the ATO, suggesting that the ATO had not considered information already provided and raised concerns around the care taken by the ATO in the exercise of its formal collection powers.

7.84. Some taxpayers and advisers also raised concerns that some audit teams have suggested that they would issue a section 264 notice if the taxpayer did not extend the timeframe for amending assessments. One taxpayer indicated that they felt threatened by such an approach especially given prior cooperation and the broad information request.

Costs of compliance with notices and impact on taxpayers

7.85. Taxpayers submitted that being issued with a section 264 notice placed onerous obligations on the public officer to comply with the notice and that there is no justification for the ATO responding in this manner without prior discussion. Of particular concern to taxpayers is that the issuance of a section 264 notice may connote a level of non-cooperation (and potentially non-compliance) despite a taxpayer seeking to fully cooperate with an information request. Taxpayers in these situations have suggested that sometimes the audit team does not understand the difficulties they face in obtaining the requested information as key personnel may have left the taxpayer, documents may be overseas and often a taxpayer has to consider legal professional privilege issues so external advice may be required.

7.86. Taxpayers noted that the cost of complying with a section 264 notice can be significant. Taxpayers and advisers indicate that the cost and time involved in dealing with a section 264 notice was not so much in relation to the production of information but in the time it took to carry out the 'negative assurance' investigations especially if it involves the inspection of thousands of documents due to the wide scope of the notices and the age of the transaction.

7.87. Other taxpayers expressed concern where the ATO issues section 264 notices on advisers and third parties without the taxpayer having been asked for the information or being informed that the third party would be approached. Taxpayers are concerned that the issuing of such notices can cause significant damage to the commercial relationship between the taxpayer and the third party.

7.88. Given the potential for taxpayer reputational concerns in these circumstances, it was suggested that the ATO should limit the use of their formal powers to clear instances of non-cooperation. Where a taxpayer has been cooperative, the issuing of a section 264 notice should require pre-approval at the Deputy Commissioner level and only be authorised in circumstances where it can be established that there is a real basis for forming the view that not all relevant information had been provided in response to an information request.

Conduct of section 264 interviews

7.89. Taxpayers and advisers commented that section 264 interviews have not been conducted well, with many questions asked being either irrelevant or inadmissible in further disputes. They also questioned the usefulness of such interviews given the significant costs imposed on them (external lawyers and accountants, distraction for management) and the limited information from those interviews that actually finds its way into position papers. In one example, a taxpayer said that the ATO interviewed 16 people and produced over 2,000 pages of transcript but this information was never used as evidence. The taxpayer expressed frustration that no one in the ATO was held

accountable over the time and resources spent by the taxpayer dealing with the ATO. Rather, the taxpayer was subject to further information requests.

7.90. Others observed that company directors and senior executives were brought into the information gathering process in instances where any information they provide could be sourced directly from other documentation, or it turns out that their involvement was irrelevant. Advisers have said that there is often no prior discussion regarding the scope and nature of information that the ATO wishes to obtain from company directors and senior executives leading to perceptions that these interviews are used as a bullying tactic.

Legal professional privilege and accountants' concession

7.91. Taxpayers and advisers suggested that legal professional privilege and accountants' concession claims can sometimes generate suspicion and negative inferences and that in some instances legal professional privilege and accountants' concession claims have become a major point of agitation between the taxpayer and the ATO even where the taxpayer has a clear and well-founded basis.

7.92. Some taxpayers and advisers expressed concern that the ATO's approach to handling legal professional privilege claims is not appropriate. For instance, a taxpayer submitted that the audit team would seek additional information on the nature and content of documents that were subject to a legal professional privilege claim in an effort to identify other issues for further investigation. The taxpayer said that they were informed by the audit team that the ATO needed to know the subject matter and issues that the taxpayer was taking advice on so as to identify potential risks. The taxpayer believes that this demonstrates an entrenched view that obtaining advice indicates some form of wrongdoing on the part of the taxpayer and reveals a lack of respect for the policy that underpins the doctrine of legal professional privilege. More importantly the taxpayer said that it does not assist in building trust in the ATO-taxpayer relationship. This is especially so where the audit team indicates that if this additional information on the nature and content of documents is not provided then there will be a level of inference drawn as to why it has not been provided which may carry over to the draft position paper.

7.93. Advisers have also expressed concerns with the ATO's approaches to accountants' concession claims, with the following comments being made:

- the ATO wants access to audit files not just tax working papers, corporate finance statements and valuations;
- the ATO makes very broad, substantial and burdensome requests for accountants' files;
- audit teams asking for accountants' concession to be lifted globally where taxpayers are unclear why the ATO wants access to accountants' working papers anyway;
- audit teams are not familiar with the rules, guidelines and process around the accountants' concession; and

- a perceived lack of independence around management of accountants' concession claims – when advisers raise concerns with aspects of the audit teams conduct or actions, it is handled by a junior officer from the access team and often referred back to the audit team for comment and response.

7.94. Taxpayers and advisers submitted that delays in responding to information requests that are broad ranging and unfocused is often because a large number of documents need to be reviewed for legal professional privilege and accountants' concession claims.

7.95. Taxpayers and advisers indicated that the process of evaluating legal professional privilege and accountants' concession claims is extremely time-consuming and requires them to commit substantial resources (such as seeking advice from external counsel) on the appropriateness of claims prior to them being made. Taxpayers are frustrated when the ATO seeks to blame taxpayers for this delay notwithstanding the ATO's broad information request.

ATO comments on information gathering

7.96. The ATO in discussion with the IGT provided a range of specific comments on information gathering which have been included in this section. Given the importance of this particular matter for both parties the IGT has outlined some of the more important comments for mutual reference below.

7.97. The ATO commitment in the LBTC booklet is to engage with taxpayers in a cooperative manner to ensure that information gathering is conducted efficiently and in a way that minimises the costs to the taxpayer while enabling the ATO to obtain the documents and information it needs to perform its obligations as an administrator.

7.98. The ATO notes that the LBTC booklet sets out mutual obligations, as the efficiency and effectiveness of the information gathering process depends upon both sides working together.

7.99. The ATO acknowledges the concerns raised by taxpayers regarding the age of information requested. As the ATO works with the large market to obtain a more current picture of tax risks, it would like to see this issue diminish. However, there are some areas of the law and transactions where there is a requirement that taxpayers keep the relevant records for a number of years and taxpayers have an obligation to comply with those requirements (for example CGT events).

7.100. The ATO agrees that if certain practices that are not within the spirit or intent of the Taxpayers' Charter or the LBTC booklet (in the manner suggested by stakeholders to the IGT) do arise then this is not an appropriate outcome. The LBTC booklet commits the ATO to working cooperatively with taxpayers to ensure that information requirements can be satisfied taking into account their business needs and, as far as possible, minimising costs and delays.

7.101. ATO management indicated that if taxpayers are concerned that audit teams have not adequately taken into account their circumstances and they are unable to

resolve this with the team, they are encouraged to escalate the matter to the senior officer nominated as their escalation point at the start of the case.³⁸

7.102. The ATO advised that the issuing of formal notices does not necessarily imply a lack of cooperation from an ATO perspective. The LBTC booklet outlines circumstances in which these notices may be issued, including where a taxpayer requests it (which sometimes occurs where there is an offshore parent) or where the information relates to third parties.

7.103. In addition the ATO will use formal powers in situations where:

- the informal process is no longer productive or where your circumstances, history or behaviour indicate that a formal approach is warranted; or
- in some situations a formal approach may be adopted at the first instance, including where:
 - i) you are a higher risk taxpayer;
 - ii) you have a history of being uncooperative;
 - iii) there are privacy, contractual, or confidentiality obligations (for example, former employees or third parties); or
 - iv) you request a formal approach in relation to third party information requests. In these cases, the ATO will work with the taxpayer to ensure that the information is sought efficiently while being mindful of the obligations of all parties.³⁹

7.104. The ATO acknowledged that complex audits can take considerable time, especially where additional facts provided by the taxpayer as the audit progresses reveal the need for further enquiries. This can also occur where the taxpayer provides additional material or argument the ATO was previously unaware of, particularly at the draft or final position paper stage.

7.105. The ATO also said that taxpayers have the ability to influence the level of costs they incur, for example by engaging with the ATO in real-time to identify and mitigate tax risks and by providing early access to relevant documentation. The ATO noted that some taxpayers prefer to develop their own summaries of information in addition to that which the ATO requests, and this choice will usually involve additional cost for them when compared with providing the primary documents that the ATO has sought.

7.106. The ATO also suggested the Commissioner is entitled to seek all potentially relevant information and determine its relevance. If information is subsequently found to be superfluous or only indirectly relevant to the decision, the ATO suggests that this does not necessarily mean that seeking that information in the first place was inappropriate.

38 Large Business and Tax Compliance, pp 29-30, 44.

39 Large Business and Tax Compliance, p 30.

7.107. The ATO noted that it provides support to its compliance teams through the ATO Access Network as previously discussed with the IGT and also in reference to ATO responses to information requests. Where it is likely that a case will proceed to litigation, teams are also required to engage early with ATO Legal Services who assist the team to ensure that information gathering and other aspects of the case are conducted to ensure that evidentiary requirements are met.

7.108. ATO LB&I management also advised that it had established an Objections and Litigation network and that the LB&I Objections coordinator is working more closely with compliance teams to assist and support them in ensuring information gathering was appropriately targeted.

7.109. In addition to matters raised above the ATO also indicated that there are other reasons why a request may be framed broadly, including:

- the ATO team may be seeking to develop a good overall understanding of the business and/or significant transactions occurring during a period;
- the situation is one where in the ATO's view there has been a lack of cooperation in discussions about information gathering. In such cases, teams need to ensure they are able to obtain all potentially relevant information, and to avoid repeat requests, may well seek a wider range of information and documents than may have been requested had a more cooperative approach been taken previously; and
- a need to understand transactions in a level of detail appropriate to the case. For example, the ATO may need to establish the flow of funds in transactions to have a proper appreciation of what has happened. Bank details help to evidence the flow of funds and are primary documents. The ATO advised that requests for primary documents of this nature should not imply a lack of trust. The ATO has an obligation to verify information to a certain level and that will vary depending on the case circumstances.

IGT OBSERVATIONS

7.110. The IGT notes that information gathering in an LB&I compliance environment is a complex matter. Under a self-assessment tax system, the information required by the ATO to ensure that a taxpayer has correctly assessed their income tax liability resides with the taxpayer and third parties rather than the ATO.

7.111. During consultations with taxpayers and their advisers, there was recognition that information gathering is central to and of paramount importance to the ATO's compliance activities in this system. However, the manner in which the ATO gathers information from taxpayers has a significant bearing on the ATO-taxpayer relationship.

7.112. Where the ATO adopts a more transparent and cooperative approach to information gathering, the ensuing relationship is more likely to be productive and ongoing. However, where the ATO does not engage with taxpayers in an open, transparent and cooperative manner, it creates considerable uncertainty for taxpayers,

increases their compliance costs and causes significant damage to the relationship between the ATO and taxpayers.

7.113. While taxpayers accept that the ATO should seek and obtain all the information that is required to make an assessment of a taxpayer's compliance, there is a strong belief that it should be required to do so in a way that minimises the costs to the taxpayer and does not require the production of unnecessary information.

7.114. The IGT found that the underlying principles behind the ATO's information gathering approach, as expressed in the revised LBTC booklet and Compliance Manual, are appropriate and balanced. For example, they emphasise the need to:

- wherever possible, adopt an informal information gathering approach with constructive dialogue so that the ATO's information requests are clear and unambiguous;
- ensure that information gathering is planned around the risk hypothesis and clearly stated evidentiary needs with auditors also progressively refining the risk hypothesis; and
- notify and engage with taxpayers before moving to a formal information gathering approach so as to ensure there is transparency and due process when a decision is made to use formal powers (allowing for the LBTC booklet exceptions as listed).

7.115. The IGT believes that a major source of tension in risk reviews and audits is when the principles and commitments found in the LBTC booklet and Compliance Manual are not consistently followed during risk reviews and audits, especially where it leads to a breakdown in the consultative approach to obtaining information.

7.116. The IGT also found that there continues to be a tendency for some audit teams to rely on written queries when requesting information without any previous constructive dialogue with the taxpayer. This is at odds with the LBTC booklet which seeks to move away from an over-reliance on such written queries in the audit process towards a more 'face-to-face' and purposeful dialogue and has a significant impact on the efficiency of risk reviews and audits. As was noted in the Compliance Manual:

The most effective way to progress a case is to have face to face contact as frequently as possible, supplemented by written queries where necessary. It can be very difficult to phrase the 'perfect question' in written correspondence. Engaging in a conversation allows [the ATO] to work through issues without the undue delays that can occur if the same matter was raised in a written query or often several written queries. Wherever possible written requests should supplement information obtained through discussion rather than being the primary method to obtain information.⁴⁰

7.117. The IGT considers that greater consideration must also be given to ensuring that those who are external to the audit team who provide guidance and assistance with the gathering of information (such as Case Leaders, technical specialists and other senior tax officers) remain accountable for how that information is collected and

40 LB&I Compliance Manual, Chapter 11, p 16.

considered in the context of refining the risk hypothesis. For example, if a senior tax officer has been engaged in the planning for the information gathering and they advise the audit team that further information is required on a particular issue, then that senior tax officer must remain responsible for ensuring that:

- the risk hypothesis is refined to reflect the information request;
- the manner in which the information is requested minimises taxpayer compliance costs; and
- after receipt and consideration of the requested information, the risk hypothesis is further refined to reflect this information and communicated to the taxpayer.

7.118. Discussions with ATO auditors also revealed some concerns with how taxpayers respond to information requests. Certain auditor teams expressed some frustration that information that should be readily available, especially at the risk review stage is often provided after much delay. This information is typically high level, pre-existing and would be prepared in the ordinary course of a taxpayer's business such as financial statements or a break-up of significant items on a taxpayer's income tax return or schedules.

7.119. Auditors expressed the view that the timely provision of information of this nature would allow them to quickly come to an assessment on whether a particular issue should be pursued further or whether no further action is warranted.

7.120. Auditors also expressed concern that some taxpayers, whilst responding to ATO requests, do so in a minimalist manner, possibly with the intent of delaying or frustrating the conduct of the audit.

7.121. The IGT supports the desire of ATO auditors to be able to quickly obtain key information and documentation that should be readily available at the outset of a risk review. The IGT considers that a fundamental aspect of a good relationship with the ATO must be the timely availability of this information especially where it is pre-existing and would be prepared in the ordinary course of a taxpayer's business.

7.122. The IGT considers that improved transparency, consultation and communication during the information gathering stage will significantly mitigate the issues and concerns raised by taxpayers and advisers in the course of this review. Importantly it will also minimise the significant taxpayer costs associated with information requests by allowing for the timely identification of scope, relevance and availability of the information.

7.123. Discussions with taxpayers, advisers and ATO auditors indicated that good consultation generally involved advance notice of information requests, constructive dialogue around the scope and relevance of the information requested and flexibility in meeting reasonable requests especially where the information is aged or not readily available. Following such a process greatly assisted in minimising compliance costs, while unnecessarily broad information requests lead to significant and unwarranted costs.

7.124. The IGT believes that this should be accompanied by enhancements in the ATO's assurance processes (such as its monthly reviews and IQF) to ensure greater conformance with the principles and commitments found in the LBTC booklet and Compliance Manual. As noted by the Compliance Manual, the shift from a cooperative to a less cooperative relationship is often difficult to judge as generally it is a result of a series of minor incidents or actions rather than a clearly identified point in time.⁴¹ Ultimately this is a question of judgement, to be exercised by those senior tax officers that have the delegated authority to request information pursuant to the Commissioner's formal powers.

7.125. Large business suggested that the move to use formal powers may have important reputational and commercial impacts. It is therefore important that when the ATO seeks to use its formal powers that expectations set out in the LBTC booklet and Compliance Manual have been met.

7.126. The IGT notes that auditors play a very important role in undertaking the Commissioner's duties. This role is not only critical to the Commissioner's adherence to the Federal Court rules for tax litigation, but fundamental to the ATO undertaking its risk review and audit functions in a professional, efficient and effective manner. As was noted in the ATO's Facts and Evidence Worksheet Guide:

That process of the identification of the issue, and the process of identification of and collection of the facts and material relevant to that issue, starts not during an appeal, not during trial and not even during preparation of trial...that process of ascertaining what the case is really about starts at the very earliest stage that the Commissioner deals with a taxpayer – whether that be through a risk assessment review, application for a ruling or an audit. As the High Court indicated, the ATO must identify 'taxable facts'. The ATO auditors must start the process of identifying the 'taxable facts'.

... the ATO and its advisers must acknowledge and accept the importance of the work done by the auditors and business line. The steps taken and questions asked by them will have a direct impact upon whether the legal and factual issues are correctly identified and investigated as early as possible. The processes adopted by the ATO and their legal advisers need to be focused and directed, and that process must commence at the earliest possible opportunity.⁴²

7.127. Similar to the availability of technical specialists to assist in determining the ATO view or access specialists to assist with issues around legal professional privilege, the IGT believes that the ATO should provide greater legal support to auditors in determining the information and evidentiary needs for an audit.

41 LB&I Compliance Manual, Chapter 11, p 23.

42 Facts & Evidence Worksheet Workshop Participant Guide, p 10.

RECOMMENDATION 7.1

The ATO should provide further details on its informal and formal information gathering processes, including its guidance on the section 264 notice issuance and legal professional privilege and accountants' concession claims, by publishing the ATO's 'Information Gathering in the Large Market' document on its website.

ATO Response

Agree.

We are currently reviewing the *Information gathering in the large market* paper to determine the most appropriate format for its publication.

Taxpayers and advisers can read details of our processes relating to section 264 notices, Legal professional privilege and the accountants' concession in the *Access and Information Gathering Manual*, which is available on our external website.

RECOMMENDATION 7.2

The ATO should incorporate appropriate checks and tests into existing assurance processes for informal information requests.

The ATO should:

- provide the taxpayer with an information request;
- give the taxpayer the opportunity to discuss the information request's scope, appropriateness and relevance with the ATO;
- work with the taxpayer to identify acceptable substitute documents, where the documents requested are not readily available; and
- make known to the taxpayer the reason for making the request, including a reference to the relevant risk hypothesis where appropriate (this may not be appropriate for certain third party information requests).

ATO Response

Agree in principle.

As you have noted in your report, the Taxpayers' Charter and LBTC booklet set out our commitment to work consultatively, cooperatively and our preference to use informal approaches wherever possible. Our Client Feedback Questionnaires and other feedback processes indicate that, in general, we have made significant improvements in this area.

In response to Recommendation 6.3, we noted that we are currently updating our monthly review process. This will include an appropriate focus on communication and engagement, including in relation to information gathering.

In relation to the third dot point in your recommendation, it should be noted that while we will discuss alternative information sources to assist in minimising compliance costs, there are times when we require specific documents and cannot always accept alternatives or substitutes.

RECOMMENDATION 7.3

To improve taxpayers' understanding and to provide transparency in the evidence gathering process, the ATO should provide more guidance on this process in the LB&I Compliance Manual.

ATO Response

Agree.

This will be achieved through our work to implement Recommendation 4.3, where we have agreed to publish the *LB&I Compliance Manual*. The manual is currently being revised and updated and this will include appropriate guidance on evidence gathering.

RECOMMENDATION 7.4

Where the ATO adopts a formal information gathering approach, the assurance processes need to ensure expectations set out in the LBTC booklet and Compliance Manual are properly met.

ATO Response

Agree.

This will be done in conjunction with updates to assurance processes referred to in our responses to Recommendations 6.3 and 7.2.

RECOMMENDATION 7.5

The ATO improve legal support to audit teams in preparing information requests and providing advice on the evidentiary needs of an audit.

ATO Response

Agree.

During the course of this review, we developed and commenced implementation of a number of changes that will improve technical and legal support for our teams in relation to preparing and managing information requests, including in relation to meeting evidentiary requirements.

These changes include:

- strengthening the role of our technical networks within the business line to provide greater support to compliance teams
- improved and earlier access to specialists outside the business line
- revised arrangements for the engagement of Case Leaders

RECOMMENDATION 7.6

The ATO should in consultation with the Large Business Market consider whether an ATO publication be developed, that is more expansive than the LBTC booklet and yet narrower and more targeted in focus than the ATO's Compliance Manual, and is directed at 'Audit and Risk Review' issues with a taxpayer-specific audience.

ATO Response

Agree.

As part of our planned work to review and consult on the development of the next LBTC booklet, we will also work with our Large Business Advisory Group and other stakeholders, where appropriate, to determine the need for such a publication.

CHAPTER 8: RISK REVIEW AND AUDIT PROCESSES

8.1 This chapter considers the ATO's risk review and audit processes. The risk review processes are addressed first and followed by the audit processes. Issues and concerns raised by stakeholders are set out in each part along with recommendations to improve the level of transparency and engagement and promote greater certainty in the progress of risk reviews and audits for stakeholders.

8.2 The IGT received submissions directly and via the consultation process about the ATO's audit and risk review processes. Many stakeholders expressed a view that the ATO's approach to risk review processes had improved in more recent times. Stakeholder views on audit processes were much more varied.

8.3 Taxpayers and their advisers have also shared a number of concerns about these processes with the IGT. There was a broad consensus that while certain aspects were working reasonably, there was room for improvement in these processes. This chapter primarily focuses on these stakeholder concerns and aspects of the processes where there is an opportunity for improvement.

8.4 The ATO has also agreed with the IGT that there is room for improvement in this area. The IGT and stakeholders have broadly supported the ATO's efforts to improve and in particular the development and release of the Large Business and Tax Compliance (LBTC) booklet.

8.5 It is important to appreciate that both the risk review and audit processes are largely administrative processes designed by the ATO. Some aspects of these processes or core documents are designed with input from external stakeholders (for example, the LBTC booklet) but this chapter analyses the aspects of the processes designed by the ATO. This IGT review did not consider the underlying ATO risk identification or creation process itself, although that may be considered for future IGT review. A specific discussion on the administration policy approaches to the implementation and management of the audit and risk review processes is outlined in Chapter 1 of this report.

RISK REVIEW PROCESSES

Background

8.6 As previously stated, the ATO source guidance for risk review or audit teams on how to create, plan, implement and manage a risk review is outlined in the ATO's LBTC booklet and Large Business and International (LB&I) Compliance Manual. The details of the ATO's risk review product are discussed in Chapter 5 of this report.

Submissions and consultation

8.7 A number of stakeholders expressed the view that ATO risk reviews had improved in more recent times. A common theme amongst these stakeholders is higher levels of genuine ATO engagement. These stakeholders felt the ATO clearly communicated the issues it was focusing on. Information requests were specific and succinct, and clearly referable to the issues of focus and perhaps more importantly, understood by the taxpayers who were actioning them. Another feature was the agreement of sensible timeframes for response upfront between the taxpayer and ATO.

8.8 Taxpayers and advisers also commented that the risk review process went particularly well where the ATO audit team sought to build a direct and continuing relationship with the taxpayer. This was in evidence where the ATO team engaged in meaningful dialogue with the taxpayer, seeking to understand and take account of the taxpayer's particular business circumstances regarding resourcing, access and timing difficulties in an open manner with an appropriate degree of flexibility.

8.9 Taxpayers and their advisers have also submitted that the risk review process worked best when there were opportunities to engage and discuss issues throughout the risk review process. One taxpayer referred to the ATO's willingness to meet and discuss the taxpayer's governance structures and to outline the potential risks early in the risk review process. The taxpayer felt that that this allowed them to explain the risks and discuss their control systems in relation to those risks. The taxpayer also organised meetings between representatives of its various business units and the ATO, to provide the ATO with a better understanding of the taxpayer's business. Importantly, the taxpayer submitted that the ATO took into account what was discussed in those meetings as reflected through a change in the scope of the risk review.

8.10 However, other taxpayers expressed concern that there had been very little engagement during a risk review.

8.11 Some taxpayers and advisers suggested that an essential starting point for all review and audit processes should be a discussion of the taxpayer's corporate and tax governance policy and of the ATO's initial reasons for selecting the taxpayer. They submitted that if the ATO has prepared a risk profile or analysis of the taxpayer then this should be openly shared and discussed in detail with the taxpayer and documented as part of the case plan. Others suggested that there was no collaboration or engagement with them in relation to key milestone events, while a significant number expressed concern that they were not informed of the ATO's risk hypothesis even after they had provided the ATO with information. Some taxpayers and advisers submitted that it was only at the end of the risk review that the ATO provided them with the risk hypothesis.

8.12 A number of taxpayers also felt that some audit teams only engaged in the formality of a process, where real dialogue and exchange was missing. The stakeholders expressed considerable frustration in these circumstances. These taxpayers felt that they were in an information void and in trying to understand the ATO's situation wondered whether there were skilling, confidence or empowerment issues that prevented audit personnel from responding. A concern was also expressed

that engagement seemed to be measured by a ticking-off exercise on a check list sheet and that 'real' decision-making power was expressly said or implied to be elsewhere.

8.13 A number of taxpayers expressed concern that the lack of engagement and discussion during the risk review process is leading to incorrect or higher risk ratings at the conclusion of risk reviews.

8.14 Taxpayers believed that there would be significant benefit if the ATO shared the risk hypothesis with them earlier in the risk review process as it would allow them to better understand the ATO's concerns. They suggested that this would allow them to provide the ATO with far more targeted responses that could potentially lead to a lower risk rating. It would also encourage a discussion between the ATO and taxpayers about the type of information that would be readily available in relation to the risk hypothesis and would minimise perceptions that the ATO was 'fishing' for issues.

8.15 A number of taxpayers raised concerns with the limited opportunity to meet and discuss risks and issues with senior tax officers and technical specialists especially where these officers have been involved in internal ATO workshops. Taxpayers asserted that the nature and purpose of these workshops was not generally discussed with taxpayers, nor were they given an opportunity to present or participate. However, after a workshop taxpayers would receive information requests which were often very broad in scope. Taxpayers also indicated that these information requests were hardly ever accompanied by a refined risk hypothesis. Taxpayers expressed concern that the attendees at these workshops had no accountability for the information being requested and that there was no opportunity to discuss the scope of the information requests with them despite the large compliance costs associated with these.

Scope of information requests

8.16 A significant concern amongst taxpayers and their advisers was the scope, nature and detail of documentation required at the risk review stage.

8.17 A number of taxpayers submitted that they sometimes received requests for an extremely broad range of documents (even source documents) with some information requests containing over 100 questions. Taxpayers asserted that the concerns associated with such broad information requests were compounded by the uncertainty about the exact nature of the ATO's concerns and the limited timeframes (usually 28 days) to provide this information.

8.18 These taxpayers believed that this made the risk review stage seem more like an audit. Taxpayers and advisers suggested that risk review information requests should be consistent with the role and purpose of a risk review and not that of an audit.

8.19 Some advisers suggested that the risk review stage was being used as the commencement of an audit and as a means to extend the audit period beyond the two year timeframe.

8.20 For more discussion in relation to ATO information requests served on taxpayers and related issues please refer to Chapter 7 of this report.

Taxpayer certainty in outcome of ATO risk review

8.21 Submissions expressed concern with a proliferation of open issues with some risks being placed into a 'wait and see' pool meaning that the ATO is able to review the issue at any time depriving taxpayers of certainty. Taxpayers affected indicated that the only closure available to them in such circumstances is to wait until the amendment period has expired. A considerable number of taxpayers suggested that the outcome of a risk review should be certain – that is, a risk issue is either flagged as subject to audit or closed for that particular year and only open for re-examination in circumstances of fraud or evasion.

Transparency in ATO risk review rating and process

8.22 Taxpayers questioned the transparency and consequence of risk review rating in providing certainty. In one example, a taxpayer noted that despite most risks being rated at the lower end of the risk rating scale, a significant number of the issues went to audit. Feedback from the board and senior management was that the risk rating provided at the end of the risk review and the inferred level of comfort provided was misleading. In particular, it placed the taxpayer in a very difficult position with other external parties such as auditors, investors and analysts to whom the taxpayer had conveyed the ATO's initial low risk rating.

8.23 Taxpayers want more certainty and clarity at the end of a risk review given the significant time and resources they expend to comply with the ATO's requirements. They state that no less intensity, time or effort is expended on a risk review than an audit. Taxpayers also want greater transparency and clarity around the meaning and consequence of each risk rating with clear expectations of the likely ATO response.

IGT OBSERVATIONS

8.24 The IGT observed that clarity as to issues of ATO concern and clarity of ATO process made for a strong starting point in the risk review process. Where the ATO clearly identifies the issue of concern that is the potential risk then taxpayers are better placed to understand it and better placed to respond to it.

8.25 The IGT in discussion with the ATO has raised this issue. The ATO has indicated that the risk review process may not always be clear as to what the nature of the issue may be on initial enquiry. The ATO suggested that by way of example there may be a pattern or anomaly against a body of data that they observe in their risk identification processes, which they need to understand in more detail.

8.26 The ATO also advised that these preliminary enquiry situations were not necessarily taxpayer risk as such but that they were a risk for the ATO because they do

not know enough about it. To put it another way, it may not be a 'risk' in the sense that it would be an issue of concern once it is understood by the ATO.

8.27 This preliminary risk hypothesis identification process is one that taxpayers have expressed some difficulty and frustration with. This has the potential for communication breakdown and misunderstanding or worse, if taxpayers do not appreciate the nature of this kind of initial enquiry.

8.28 The IGT believes that there is scope to further enhance the risk review process by providing more opportunities for engagement and discussion.

8.29 The IGT also believes that the ATO can improve the manner in which a risk review changes into an audit (that is, the risk review ends but an audit begins) by providing greater guidance and certainty to taxpayers at the completion of a risk review.

8.30 Currently, taxpayers receive a risk review finalisation letter from the ATO informing them of the risk, a risk description and the risk rating. Risks may be rated as Trivial, Low, Moderate, Significant, Major, High or Severe. However, the finalisation letter does not provide guidance on which risk issues will be selected for audit or when an audit may commence.

8.31 The LB&I Compliance Manual requires that a risk assessment workshop be held where the risk will proceed to audit. This originated from earlier taxpayer concerns that some audits may have become unnecessary if the ATO had undertaken more complete internal workshopping of the commercial and technical issues before a risk review was completed.

8.32 The purpose of these workshops is to bring together appropriate ATO technical leaders and relevant specialists prior to finalising a risk review to determine whether the risks warrant further action.

8.33 Under the previous LB&I management structure, where a recommendation to proceed to audit had been supported by the risk assessment workshop, the audit team had to prepare a business case. The business case had to contain key taxpayer information, value of the risks, focus years, reasons for audit, expected duration of the audit, technical support requirements and expected start date. The business case was considered by a Segment Risk Management Committee where it could be approved, placed on a contingency list or rejected. After a Segment Risk Management Committee considered that a case warranted further examination, it would be listed for approval by the Segment Leaders Forum. This forum met every three months, ensured that prospective audits would meet ATO priority requirements and made decisions to approve, make contingent or reject proposed audit cases.

8.34 Cases on the approved list would then be allocated to a segment, a projected commencement date would be nominated and they would be placed in an approved pool awaiting allocation to a particular audit team.

8.35 Given that this audit approval process occurs after a taxpayer may have been notified of the risk review outcomes, there is potential for a delay between the risk review finalisation letter and the commencement of an audit. This delay contributes to

taxpayer uncertainty regarding whether and when an identified risk will proceed to audit. In addition, it prevents taxpayers from being able to plan for future ATO audit activity by identifying likely resourcing and capability requirements.

8.36 The IGT believes that the case selection process should be brought forward and occur prior to the ATO communicating the risk review outcomes to taxpayers. This will allow the ATO to create risk rating definitions that better explain (via indicative next steps) what a taxpayer can expect after receiving the outcome rating and the expected timeframe (for example, audit to commence in first quarter of 2010/11 or issue placed on contingency list).

8.37 The ATO has advised that under the new management structure, the business case provides a summary of key information about the taxpayer and the risks the team is recommending for audit. Senior officers independent of the compliance team consider business cases for audits as part of LB&I's normal operational management arrangements to ensure resources are allocated efficiently and directed to the highest priority risks. Where a case is approved to proceed to audit, the timeframe in which the audit commences will depend on the current available resources and the nature and priority of other work being undertaken.

RECOMMENDATION 8.1

To improve taxpayer certainty, after completion of the risk review the ATO should make the decision as to whether it will proceed to audit promptly. If the decision is made to proceed to audit, then the audit should be commenced as soon as possible. The ATO should also nominate an appropriate contact officer who will maintain regular contact with the taxpayer, to keep them informed of the progress of their case.

ATO Response

Agree.

AUDIT PROCESSES

Background

8.38 Appendix 6 to the LBTC booklet contains a diagrammatic representation of the ATO's audit process.

8.39 The LB&I Compliance Manual provides additional guidance to audit teams about how to plan the audit and make audit decisions.

8.40 The Manual notes that a good audit plan clearly sets out:

- the objective of the audit, namely to prove (or disprove) a risk hypothesis;
- who is responsible for various aspects of the conduct of the audit;

- when key tasks are to be completed and by whom;
- key risks and the planned mitigation of those risks; and
- key case review points.¹

8.41 The Compliance Manual states that planning for the audit should commence at the outset of the audit (preferably before the finalisation of the risk review). It notes that inadequate planning has been recognised as a weakness in LB&I case work and that without proper planning it is likely that audit activities will slip and expected timeframes will not be met. Further, poor planning results in inefficiencies and increased cost to both the ATO and taxpayers.²

8.42 The Manual also states that Team Leaders play a vital role in planning for the cases done by audit teams. In addition to bearing the responsibility for the plan, team leaders must also ensure that case officers have adequate planning capability.³

8.43 There are a number of fundamental planning documents and activities that must be completed at the outset of an audit.⁴

Audit Planning Workshop

8.44 The Audit Planning Workshop is required to be held prior to the preliminary audit interview with the taxpayer. The purpose of this workshop is to:

- confirm the hypothesis the audit will test for each of the issues;
- determine the scope of the audit (income years and risks covered);
- determine the initial information, documents or evidence that will need to be requested from the taxpayer;
- identify the relevant technical issues;
- plan the timeframes and resource requirements for the audit;
- determine who needs to be involved on an ongoing basis such as the Tax Counsel Network (TCN) and Centre of Expertise (CoE); and
- plan strategies to achieve audit goals.⁵

8.45 The Compliance Manual also states that the discussions from this workshop should assist audit teams identify:

- what they need to know about the business (wide survey) and what they need to know about the issue (exact scrutiny);

1 LB&I Compliance Manual, Chapter 10, p 4.

2 LB&I Compliance Manual, Chapter 10, p 4.

3 LB&I Compliance Manual, Chapter 10, p 4.

4 LB&I Compliance Manual, Chapter 10, p 4.

5 LB&I Compliance Manual, Chapter 10, p 20-21.

- the 'elements' to be proved and the evidence necessary to prove each issue; and
- the information to be requested, the manner in which it should be obtained (discussion, written query) and the approach to be adopted (formal or informal).⁶

8.46 By the end of the workshop the audit team should have considered and planned both the operational and technical aspects of the case, and have briefed any senior tax officers who will be attending the preliminary audit interview.⁷

8.47 The Manual states that another key function of this workshop is the early engagement of technical experts in audits ensuring that senior technical specialists, including from the TCN and CoE, are brought into the process early to assist with focusing the audit team's information gathering and contributing to forming the ATO view on the facts.⁸

Preliminary audit interview

8.48 Before an initial audit interview, where the ATO will discuss the issues under audit and its information needs with the taxpayer, a scheduled preliminary audit interview focused on planning and logistics is to be held. This is to ensure the smooth running of the audit and is a crucial part of planning for the audit both for the ATO and the taxpayer.⁹

8.49 The LBTC booklet states that at the preliminary interview the ATO will:

- provide a copy of the audit plan for discussion;
- discuss the audit scope, the periods under audit and the expected completion date;
- discuss the information gathering processes;
- discuss any ATO guidelines relevant to the issues and years to be audited, including procedures in relation to voluntary disclosures;
- outline facilities and assistance that the ATO may require; and
- give the taxpayer contact details of a senior officer in the event that the taxpayer wishes to raise any concerns during the audit.¹⁰

8.50 The Compliance Manual also states that it is mandatory that a senior ATO officer discusses the Audit Management Plan with the taxpayer at the preliminary audit interview.¹¹

8.51 The purpose of the Audit Management Plan is to provide taxpayers with a clear understanding of the scope of the audit, the tax risks being examined, the audit

6 LB&I Compliance Manual, Chapter 10, p 21.

7 LB&I Compliance Manual, Chapter 10, p 20-21.

8 LB&I Compliance Manual, Chapter 10, p 21.

9 LB&I Compliance Manual, Chapter 10, p 22.

10 Large Business and Tax Compliance, p 44.

11 LB&I Compliance Manual, Chapter 10, p 22.

process and the proposed audit project plan timelines and to also take into account taxpayer planning considerations.¹²

8.52 The discussion should provide a good basis for considering all operational issues involved in the audit and reaching agreement with the taxpayer on timeframes and processes. It is highly recommended that the senior tax officer who attends the preliminary audit interview and discusses the Audit Management Plan with the taxpayer also participates in the initial audit interview.¹³

Initial audit interview

8.53 The Compliance Manual states that the purpose of the initial audit interview is to discuss the technical issues and information gathering needs in relation to the audit. It notes that it is common for the preliminary audit interview to also include a discussion of the technical issues and information gathering requirements. The Manual states that this is an acceptable practice providing the requirements of the preliminary audit interview, such as the discussion of the Audit Management Plan with the taxpayer, occur first.¹⁴

Making an audit decision

8.54 The Compliance Manual sets out the key steps in making an audit decision:

- refining the hypothesis and scope of the audit until the issues and income tax years under audit are clear;
- for each issue determining the relevant provisions, the elements of the provisions, the material facts and the evidence required to establish those facts and the applicable ATO view;
- escalating issues where appropriate;
- developing and receiving clearance on the initial ATO view (prior to communicating the initial view to the taxpayer) – often in the form of a draft position paper;
- presenting the initial ATO view to the taxpayer;
- seeking the taxpayer’s response to the initial ATO view;
- responding to the taxpayer’s views and contentions as appropriate;
- reaching a final decision as to the ATO view; and
- at all times ensuring that the plan, at either the audit level or an issue level, is appropriately updated for developments.¹⁵

12 LB&I Compliance Manual, Chapter 10, p 16.

13 LB&I Compliance Manual, Chapter 10, p 16.

14 LB&I Compliance Manual, Chapter 10, p 23.

15 LB&I Compliance Manual, Chapter 12, p 4.

8.55 All audit decisions must be made in accordance with the ATO Good Decision Making Model and Judgement Model. These models were developed to assist decision makers exercise judgement to make sound decisions.¹⁶

8.56 Applying the ATO's Decision Making Model means that all ATO audit decisions must satisfy the following principles:

- Legal – by considering and complying with all relevant legislation, regulations, determinations, and practice statements;
- Ethical;
- Equitable – ensuring that audit decisions apply equally to all people and do not discriminate. For example, where transactions by different taxpayers have the same facts, circumstances and evidence then the law should not be applied differently;
- Overt – the reason for audit decisions must be open and transparent;
- Sensible – audit decisions must be commonsense;
- Timely – audit decisions must be made within an appropriate timeframe and the people affected have a right to know the outcome as soon as possible. The complexity of large business audits means that this can sometimes be challenging, so it requires careful planning and active management of casework; and
- Natural justice – when making audit decisions the auditor must act fairly, in good faith and without bias.¹⁷

8.57 The ATO Judgement Model is used to assure quality of the ATO's technical decisions. It is part of the Integrated Quality Framework that LB&I uses for quality assurance reviews. The principles of both the Judgement and Decision Making Models are also built into the quality assurance points of the Siebel case management system. The Compliance Manual states that it is important that case officers use the Judgement Model (in addition to the Decision Making Model) as self-assessment tools throughout the audit to ensure that audit decisions can stand up to scrutiny.¹⁸

8.58 The Judgement Model says that in preparing technical decisions a case officer must continually check that they have:

- correctly identified and clearly understood all of the relevant issues;
- provided an accurate and consistent answer to each of the taxpayer's issues; and
- provided a logically organised and properly reasoned argument for each response to every issue.¹⁹

16 LB&I Compliance Manual, Chapter 12, p 14.

17 LB&I Compliance Manual, Chapter 12, p 14-15.

18 LB&I Compliance Manual, Chapter 12, p 15.

19 LB&I Compliance Manual, Chapter 12, p 15.

8.59 The Compliance Manual also notes that in forming a view on the audit issues, case officers must ensure that they:

- identify the facts and issues;
- research, identify and interpret the relevant law;
- if there is an applicable precedential ATO view, then apply the law and ATO view to the facts and reach a conclusion; and
- if there is no applicable precedential ATO view the issue will need to be escalated to establish an ATO view.²⁰

Facts and Evidence worksheet

8.60 To assist case officers identify the facts and issues the ATO has developed a series of Facts and Evidence worksheets. The purpose of the worksheets is to:

- assist in planning initial and follow-up information requests for audit cases;
- ensure that all the requirements of the provisions being applied have been considered – these requirements are sometimes referred to as the elements, integers or ingredients of the provision;
- ensure that all the requirements of the provisions being applied have been satisfied – that is, sufficient facts each of which is supported by evidence have been obtained to support the application of the particular provisions;
- assist the case officer to consider and catalogue what additional facts and evidence are required and the possible sources for obtaining that evidence; and
- allow the case officer to reference the evidence to the specific elements of the provisions being applied.²¹

8.61 The worksheets are intended to be used throughout the audit process to assist with developing arguments, identifying problems with arguments, identifying evidentiary gaps and analysing the provisions.²²

8.62 The Compliance Manual states that the information contained in the worksheet will form the basis of the arguments in the position paper. The use of the worksheet is also intended to assist in structuring the position paper and developing the arguments. The worksheet is also intended to assist the objections officer where the facts and evidence need to be re-examined as a result of the taxpayer objecting to an assessment and with other technical areas if at some stage the issues need to be referred for specialist advice.²³

20 LB&I Compliance Manual, Chapter 12.

21 LB&I Compliance Manual, Chapter 12, Appendix 8.

22 LB&I Compliance Manual, Chapter 12, Appendix 8.

23 LB&I Compliance Manual, Chapter 12, Appendix 8.

8.63 The Manual also notes that the completion of the Facts and Evidence worksheet is not intended to result in any additional work being created for case officers as it will merely document the process which case officers already follow when establishing whether the Commissioner's case is proven to the requisite degree.²⁴

8.64 Researching information and reaching an initial view generally involves conducting workshops and holding meetings with internal stakeholders such as Case Leaders, TCN, CoE and external experts.²⁵

8.65 It is mandatory under the Manual to hold at least one audit workshop (in addition to the audit planning workshop) before the ATO presents its initial findings to the taxpayer. The purpose of these workshops is to bring together relevant internal stakeholders (such as subject matter experts and senior tax officers) to assist in the progression of the audit and confirm the initial ATO view.²⁶

8.66 The primary case officer is responsible for developing the ATO view and interacting with the taxpayer to obtain their views and take them into consideration. The primary case officer is also responsible for determining the final ATO view. In reaching decisions the primary case officer is supported by a range of internal support including specialists such as CoE or TCN staff, segment leadership and Case Leaders, who may contribute to or sign-off on decisions made in the course of the audit. The Team Leader (who needs to approve the audit decision) is ultimately responsible for the technical correctness and quality of the decisions reached in the course of the audit.²⁷

Submissions and consultations

8.67 Taxpayers and advisers submitted that while the ATO has made improvements in how it handles audits, elements of the ATO audit processes continue to be inefficient, giving rise to unnecessary costs for taxpayers. They believed that aspects of the ATO's audit processes take too long to complete, they impose significant compliance costs and do not provide adequate certainty for taxpayers. Some suggested that the primary causes for this inefficiency were the lack of direction from senior tax officers regarding the scope of the audit and the audit teams not being able to narrow the scope of an audit.

8.68 A few stakeholders indicated that while they disagreed with ATO audit decision outcomes in the process, they could not fault a given audit team's application of the stated ATO processes. However, the same stakeholders did raise concerns that the experience was not universal and invariably depended on the calibre of ATO officers involved.

8.69 Taxpayers expressed frustration when they perceived the ATO was pursuing lines of enquiry or initiating audit processes that appeared to be unnecessary or

24 LB&I Compliance Manual, Chapter 12, Appendix 8 (p 55).

25 LB&I Compliance Manual, Chapter 12, p 20.

26 LB&I Compliance Manual, Chapter 12, p 20.

27 LB&I Compliance Manual, Chapter 12, p 7.

inappropriate, especially where it led to information requests that did not seem to be relevant to any technical issue.

8.70 Taxpayers and advisers also raised a number of concerns with aspects of the audit process, including:

- timeframes for finalising audits and extension of time requests;
- the level of engagement especially in relation to facts, evidence and issues; and
- escalation and access to technical specialists.

Timeframes for finalising ATO audits and ATO extension of time requests

8.71 Taxpayers raised concerns that amended assessments were being issued just before the end of the two year timeframe, even though there had been little time for taxpayers to respond to position papers. Where taxpayers managed to respond in the short time available to them, there was little or no time to debate the merits of the competing positions. Taxpayers submitted that this forced them to have to prepare and lodge an objection to protect their position, notwithstanding that the ATO position was still a work in progress. This also required the taxpayer to incur additional costs by having to respond to the position paper and prepare the grounds for objection.

8.72 Taxpayers and their advisers also expressed concern with the manner in which the ATO requests taxpayers for an extension of time to the amendment period. Taxpayers stated that they expect that the ATO will review their tax affairs within the statutory limitations (currently four years) timeframe contained in the law. They submitted that on some occasions the ATO has sought to extend this period but in a manner that created uncertainty and was, at times, unfair on the taxpayer.

8.73 Taxpayers submitted that in the ordinary course of dealing with the ATO when the four year timeframe is nearing, they must choose between granting an extension of the statutory review period and dealing with the ATO issuing protective assessments. In such instances, consenting to the extension request is seen as the only means of deterring the ATO from issuing an amended assessment. Taxpayers suggested that the latter option is least desirable, particularly as public companies are required to report disputed protective tax claims in their published accounts. For this reason very few ATO extension requests are refused by a public company. Currently, where the taxpayer has no practical alternative other than to grant the extension, the taxpayer must extend the amendment period for all issues, not just those identified in the audit.

8.74 In addition, taxpayers and their advisers submitted that the ATO does not show sufficient cause as to why it is necessary to extend the limitation period and does not consider the cause of the delay. This means that a taxpayer is forced to make a decision without full comprehension as to the causes for the delay, the appropriateness of the extension or the matters that will be reviewed if and when the taxpayer consents to the extension.

8.75 Taxpayers believe that as a matter of ATO practice and policy the approach to obtaining a taxpayer's consent should broadly mirror the requirements for a Federal

Court order. Taxpayers also believe that the ATO should be precluded (by at least administrative policy) from issuing protective assessments unless the ATO has issued a position paper. Taxpayers were also mindful that in a different market risk segment situations may arise for the ATO where this approach may need to be differentiated from certain serious non-compliance situations where fraud or evasion may be present.

Level of engagement — ATO with taxpayers

8.76 Submissions noted mixed experiences with the ATO's level of engagement with taxpayers during an audit. Some observed that case officers have been cooperative and that it is now less difficult to discuss issues and refine the scope of an audit. However, this was not a uniform experience.

8.77 A concern raised by some stakeholders was that requests for further explanation from the ATO about information requests or explanation as to what was going on in the process sometimes led to perceptions that the taxpayer was being uncooperative. The ATO noted in discussions with the IGT that there are occasions where deciding to meet is a question of judgement. The ATO commits to taxpayer engagement but situations can arise where the ATO does not believe it has sufficient understanding of the facts or issues to meet with the taxpayer. Accordingly, the ATO did not wish to waste taxpayer or ATO time in meeting until such time as it could have a meaningful discussion.

8.78 Taxpayers complained that there is an absence of timely communication around key milestone events during an audit. An adviser made the observation that an overriding concern is the ATO's failure to identify and communicate the key issues in dispute, despite an extensive information exchange process.

8.79 A number of stakeholders expressed the view that certain audit teams had been reluctant to meet with taxpayers to discuss and better understand the audit issues. Taxpayers and advisers suggested that some audit teams only seem interested in obtaining documentation and demonstrated a tendency to simply repeat the same questions in multiple information requests where they had not understood a particular matter. Others submitted that it was often the case that after the initial audit meeting, the only engagement between the ATO and taxpayers was when the ATO sent out information requests.

8.80 It was suggested that it was not until the issuing of a position paper that taxpayers may realise that the ATO continued to have concerns about a particular issue. It may also be the first opportunity the taxpayer has to better understand the ATO's technical position on the issue.

8.81 The ATO raised situations with the IGT where certain taxpayers indicated that they did not wish to meet in this context. In these instances the taxpayer felt it was better to wait until a position paper was issued before they met.

8.82 In addition, affected advisers expressed frustration when audit teams only tell them that the taxpayer or issue is considered high risk and needs to be investigated without providing any further details. Some taxpayers indicated that they would receive information requests from the ATO, without any prior consultation or

discussion, where the response date fell within their busiest reporting period. Taxpayers asserted that the lack of engagement makes it difficult for them to appropriately plan their responses and ensure that sufficient resources are available.

8.83 A number of taxpayers submitted that the ATO was reluctant to discuss the facts, evidence or legal basis for their views during an audit. Taxpayers and advisers submitted that there was often no opportunity for them to engage and provide input prior to the issuing of the position paper. They expressed concern that by this stage there was limited opportunity for the ATO to change its view given the significant time and technical resources it may have already allocated to preparing the position paper. This was even though the facts identified by the ATO may be incorrect or suggest an erroneous understanding of the matter. Taxpayers submitted that in such circumstances they are often faced with the need to progress the dispute to objection stage. The underlying issue of potential organisational inertia around the technical decision making process by the ATO has been raised with the IGT previously by various stakeholders and may be considered for future IGT work programs.

8.84 The ATO expressed the view to the IGT that the gathering of information or facts was not always a linear approach. The ATO also commented that it was a situation where the ATO experienced an asymmetry of knowledge about the facts.

8.85 A taxpayer submitted that they offered to meet with the ATO audit team on three occasions but on each the audit team refused and simply sent out another information request. The taxpayer suggested that the audit team seemed to prefer to obtain information through a question and answer approach rather than seeking to have a meeting to try and resolve, or at least narrow, the scope of the audit. Some other taxpayers suggested similar experiences, but generally not to this extent.

8.86 Taxpayers and advisers submitted that it is uncommon for audit teams to seek to clarify the facts before commencing the technical legal analysis. Given that a correct understanding of the facts expedites legal analysis for all, taxpayers and advisers indicated that this was a constant cause of disquiet. Where ATO audit teams took the initiative in clarifying facts in this manner it was generally encouraged and applauded by stakeholders.

8.87 It was suggested by stakeholders that the ATO should issue a 'Statement of Facts' to the taxpayer once the information gathering process is completed and prior to commencing detailed technical analysis so as to assist both the ATO and the taxpayer to clarify all material facts. It was submitted that the ATO could ultimately save both itself and the taxpayer significant time and resources by settling the relevant facts before preparing their position paper.

8.88 Advisers also pointed to the draft 2006 version of the ATO LBTC booklet which contained an undertaking to provide a statement of facts where issues were complex or contentious – although this was later dropped by the ATO from the final publication. Also earlier audit guidelines provided that 'auditors were encouraged to clarify facts before moving to an exchange of legal interpretations'.

8.89 Other advisers believed that the ATO mindset was such that it was never sure that it had all the relevant facts or whether it had all the documentation relating to the matter. However, the consequence was that this had the potential to impose significant

compliance costs on taxpayers especially where the ATO does not clearly communicate its concerns.

8.90 Taxpayers want to be able to meet with the ATO at the early stages of the audit process to present and discuss the issue subject to audit so that both the ATO and the taxpayer can get to a position of agreed facts. Taxpayers also want the ATO to take into account their business circumstances when planning an audit. If there is disagreement about an issue between the ATO and taxpayer, then taxpayers want the ATO to be clear about the point of disagreement and the reasons for it. They also want it to be raised at an appropriate time in the process so that they have a genuine opportunity to engage and respond.

Access to ATO technical specialists

8.91 It was submitted by stakeholders that the most important part of the escalation process that is often missing is the appropriate level of direct communication and engagement between the taxpayer and advisers with technical specialists in a CoE or TCN.

8.92 Taxpayers and advisers indicated that there were some examples of very good practices adopted by ATO compliance teams, such as having TCN and CoE officers attend meetings and teleconferences with taxpayers and advisors, which have led to more certainty in the audit process and better relationships between the ATO and taxpayers.

8.93 However, some taxpayers submitted that it was difficult to discuss technical issues with the audit team because it:

- lacked adequate technical capability itself to engage in this type of discussion;
- was not sufficiently empowered to definitively deal with technical issues in this type of discussion; and
- could not take accountability for the line of enquiry that it was pursuing especially where it was acting under the direction of a technical specialist or other senior tax officer.

8.94 Taxpayers and advisers also observed that the ATO technical specialists are not members of the audit team and do not often have direct contact with the taxpayer. They believed that this can give rise to further issues such as the technical specialist lacking personal accountability for the actions that he or she directs the audit team to take or not forming an objective view of the tax risk associated with the issue.

8.95 Some taxpayers complained that it is too difficult to obtain access to technical specialists or key decision-makers during an audit and that some technical specialists were reluctant to meet and discuss issues. This can create uncertainty as taxpayers are not aware of the ATO's exact concerns except that an issue has been referred to TCN or a CoE.

8.96 Other taxpayers observed that technical specialists are sometimes brought into an audit too late and do not critically review key aspects of the position paper (such as

the facts and evidence) resulting in the technical specialist providing their views based on incorrect facts.

8.97 Some taxpayers believed that the management and control of the audit process was uncertain at times. The process was often dependent on a Case Officer explaining the facts and transaction to technical specialists and decision-makers rather than encouraging discussion between taxpayers and the ATO, where taxpayers did not have the same direct specialist access. Similarly, certain taxpayers also felt that the case leadership function was something that was not clear in application in this context. In these cases considerable additional work has arisen, often much later in the process, which if it was necessary should have been undertaken much earlier on.

8.98 Taxpayers indicated that where technical specialists were brought into an audit at an early stage, this was a good thing. Holding workshops between auditors and specialists from which position papers are developed on the issue is critical. However, facts pertaining to the issue are more grounded and settled for internal ATO workshops in development of the technical legal position, where those facts have first been agreed with the taxpayer.

8.99 Other taxpayers noted that sometimes the referral of issues to technical specialists can lead to long delays or bottlenecks, especially where the audit team are waiting on the availability of certain technical experts to resolve a matter.

Escalation process

8.100 Taxpayers complained that there is no clear and effective escalation process. Advisers submitted that it can be difficult to escalate an issue relating to the conduct of an audit in a manner that does not have negative repercussions for the taxpayer.

8.101 Taxpayer and advisers would like to see a formal escalation process that allows frank and open discussion of concerns about the overall management of audits in circumstances where there is a disagreement.

8.102 The ATO has indicated to the IGT that they are particularly keen to ensure the LBTC process works well in relation to escalation. The ATO management position is that stakeholder concerns need to be addressed effectively in this context.

Due process

8.103 Taxpayers expressed concerns where the ATO seeks to raise significant issues, such as the application of Part IVA (the general anti-avoidance provision) of the ITAA 1936, late in the audit process.

8.104 A number of taxpayers and advisers expressed concern about what they believed was an absence of due process in how an audit was conducted and finalised, especially where it leads to the issuing of amended assessments.

8.105 One taxpayer discussed an instance where an issue had been referred to the General Anti-Avoidance Review (GAAR) Panel which concluded that it could not give final advice regarding the possible application of Part IVA but the issues presented

were sufficiently important to justify further work. The taxpayer submitted that despite the GAAR Panel's conclusion, the ATO proceeded to issue an amended assessment seemingly due to the expiration of the ATO's amendment period.

8.106 Further, the ATO then continued to ask for information for almost two years after the matter first went before the GAAR Panel and it appeared that the ATO was seeking to retrospectively justify its amended assessments. The taxpayer expressed concern that this suggested that not all the relevant and material information was considered by the ATO when the matter was referred to the GAAR Panel or when the determination were issued to the taxpayer. The taxpayer stated that it considers any claim by the ATO in relation to the applicability of the general anti-avoidance provisions as a serious matter and its processes for dealing with such claims include the retention of external advisers to prepare and appear for the GAAR Panel, at significant cost. But given the ATO response to the GAAR Panel conclusion, the taxpayer questioned the ATO's commitment to the GAAR Panel process.

8.107 The example related above may be one of a more limited number with certain extremities, but the specific underlying concerns raised, were echoed more broadly by affected taxpayers in relation to general anti-avoidance or Pt IVA matters.

8.108 Other taxpayers also noted that the ATO's approach of issuing amended assessments in such instances suggests a disconnect between Parliament's intention to give the taxpayer certainty regarding the tax affairs within the statutory limitation period (currently four years excluding fraud or evasion) and the ATO's use of amended assessments to preserve to itself time rather than follow due process.

Taxpayer certainty

8.109 A range of taxpayers expressed various concerns in relation to certainty in their dealings in this context in submission and consultation with the IGT.

8.110 These taxpayers complained that issues subjected to audit are not always finalised at the commencement of an audit, especially where issues identified at a risk review are still being considered by ATO specialists (CoE or TCN).

8.111 Frustration was expressed by them about the uncertainty this creates for taxpayers regarding audit issue identification, the time frame to resolution, the resource allocations required and their taxpayer risk profile.

8.112 Taxpayers also submitted that given that most large business taxpayers have statutory accounting and continuous disclosure requirements, it is unacceptable to be placed in a position of not being able to confirm board items about the ATO's proposed tax audit activity. They suggested that the ATO should only commence an audit when they have completed their review of all matters identified during the risk review and have identified the specific issues to be subject to audit. This will provide better clarity and certainty to the taxpayer as well as minimise the costs of compliance incurred in complying with the ATO's requests.

IGT observations

8.113 The overarching theme was one of taxpayers needing to get to an understanding of the ATO's specific issues of concern and to be able to respond to these at the earliest opportunity. Taxpayers wishing to engage with the ATO to ensure they have a full understanding of the ATO position at issue are to be encouraged. They also appreciate that both parties may not always agree and a more formal dispute may arise. However, taxpayers are keen to ensure there is a genuine understanding for both parties as to their respective positions, and to have this established at the earliest opportunity to minimise costs and related uncertainties.

8.114 The IGT notes that absence of engagement and communication between the ATO and taxpayers is not conducive to an efficient audit. It is important that the ATO maintains good dialogue with taxpayers and keeps them informed about the progress of an audit, especially given that taxpayers may not be aware that the ATO has serious concerns in relation to particular aspects of a transaction.

8.115 During the IGT review into the underlying causes and management of objections to ATO decisions, the ATO acknowledged the need to take a more 'whole of dispute' approach with an emphasis on moving dispute resolution closer to the point of the original decision²⁸. It has recognised that there was a tendency in the past to focus compartmentally on the particular stage of the progression of the case (audit stage, objection stage or litigation).

8.116 The report found that the audit work practices must adequately support the role and aims of objection. The Ralph Review of Business Taxation emphasised the need for an administrative regime that is seamless and keeps disputes, and their associated costs and delays, to a minimum. It suggested that ATO processes need to be considered on an integrated, 'whole-of-transaction' basis, for the best administrative regime design and implementation. Audit work practices need to align with and adequately meet the needs and expectations of the objections process. In turn, the work practices and outcomes of objections need to properly feed into litigation. This means that reworking, duplication of tasks or having to rectify inadequate work or analysis from earlier stages should not occur.

8.117 The report outlined a number of audit work practices that would encourage open and direct communication between the parties and the timely exchange of relevant information:

- Constant opportunity for an exchange of views and the refining of the issues to ensure that the entire process is more efficient and effective, including face-to-face discussion between the parties prior to an amended assessment which may allow for disputes to be settled at the earliest possible stage.
- Taxpayers that are affected by a proposed audit decision should have an opportunity to express their views to auditors and to respond to adverse information, including having sufficient information to understand the case to

²⁸ Review into the underlying causes and the management of objections to Tax Office decisions, IGT, p 8 (publicly released on 11 August 2009).

which they are responding. These requirements should be critical steps toward the finalisation of an audit case. Taxpayers were also mindful that, in a different market risk segment, situations may arise for the ATO where this approach may need to be differentiated from certain serious non-compliance situations where fraud or evasion may be present.

- Information requests during audit should clearly articulate the type of information being sought, its purpose and the relevance of the information to the issues under examination.

8.118 By adopting such practices, at the end of an audit, taxpayers should have a clear understanding of the issues in dispute, the material facts that are agreed and disputed and the evidence that the ATO is relying upon to support its view and any amended assessments. This is not only beneficial to the taxpayer but also to any ATO objections officer should the audit go on to dispute. In addition, these practices align with the requirements of the *Federal Court Practice Note TAX 1* should the objection decision proceed to litigation.

8.119 The IGT believes there is scope to improve the audit process and encourage the open and direct communication between taxpayers and the ATO with the timely exchange of relevant information and views, including:

- clearer milestone events including timeframes and expectations around these milestone events;
- better engagement on facts and evidence;
- better engagement on issues; and
- better timely access to technical specialists.

8.120 The IGT also believes that greater emphasis must be placed on the Facts and Evidence worksheet in the audit decision-making process as it is a key operational tool. The IGT found that currently the worksheet tended to be viewed by audit teams as duplicating an already occurring process, namely the formulation of the decision as part of the position paper. This has sometimes led to the worksheet only being populated near the conclusion of the audit and only as an internal process point that needs checking-off for file completion. These approaches significantly diminish the benefits of using the worksheet throughout the audit process to assist with developing arguments, identifying problems with arguments, identifying evidentiary gaps and analysing the provisions.

8.121 The IGT believes that two ways of ensuring that proper emphasis is placed on the worksheet during the audit process are to:

- require that team leaders and senior tax officers ensure that the worksheet is being properly used as part of the ATO's monthly review process; and
- require that the worksheet form the basis of discussions between the ATO and taxpayers prior to the issuing of the ATO's position paper.

8.122 The IGT considers that the Facts and Evidence Worksheet is a key operational tool that should be completed in similar form for risk reviews.

8.123 The ATO has discussed the function of these Worksheets with the IGT. The ATO management have confirmed the intention that the Worksheets be used as a key operational tool during the course of a risk review and audit (not simply at the end). As the Facts and Evidence Worksheet is a working document that is developed from an early stage in the case, it will contain some information about facts or issues that were examined as the case progressed but may not ultimately be relevant to the final issues in dispute (if any).

8.124 The IGT has seen situations where extracts of these Worksheets have been provided to taxpayers in certain circumstances. The IGT also wishes to ensure taxpayers appreciate that there may be a lot of material in these Worksheets that is irrelevant to a given matter or dispute. As such, it could give rise to significant cost in review and enquiry that may not ultimately assist the taxpayer. Nevertheless, the IGT believes that these Worksheets should be made available wherever requested by the taxpayer.

8.125 Taxpayers should also be aware that they may be entitled to obtain such documents from the ATO under the Freedom of Information law.

8.126 The IGT also believes that the audit process could be enhanced to provide an opportunity for taxpayers and their advisers (should they wish), to attend appropriate ATO workshops to provide them with an opportunity to explain the facts of the transaction before any detailed technical consideration of the ATO position is undertaken. The IGT believes the key issue is to ensure the taxpayer has the opportunity to engage in the process of the ATO developing of its understanding of the facts. The same should occur at such later time on the technical legal issues that the ATO may have in consideration.

8.127 The IGT is aware that taxpayers and the ATO also appreciate that from time-to-time establishing a fact or finding of fact may not always be as clear cut a process as one may wish. In these situations the key is to ensure that both parties understand the points of concern or dispute and the nature of evidence or explanation that may be required to persuade the other party to accept their understanding of the position that is being put as a matter of fact.

8.128 The IGT believes a process of early engagement around this process to seek an agreed understanding of the facts would assist in maximising understanding and would also mitigate unnecessary dispute related costs. It makes no practical or commercial sense to have a detailed technical legal wrangling if the facts are genuinely not in support of either party. It may be that in very complex cases this process of establishing the facts is iterative for both the ATO and taxpayer.

8.129 Taxpayers and their advisers appreciate that the ATO may need to undertake some preliminary technical legal analysis to gain a basic understanding of whether there is an application of tax law to be tested. Their primary concern is to avoid a situation where a costly and elaborate internal ATO analysis is undertaken on a misunderstanding of fact at first instance. Where this occurs in any large organisation there is at minimum a perception that organisational inertia or processes can operate to

prevent a genuine reappraisal of the analysis. As noted it may also raise questions of due process.

8.130 In addition, the enactment of the *Civil Dispute Resolution Act 2011* on 12 April 2011 will have a significant impact on the ATO's alternative dispute resolution approaches. It requires the ATO to articulate the steps it has taken to resolve a dispute, including the steps taken during the audit process. This will necessitate a consideration of the ATO's alternative dispute resolution processes and how they have been applied to the audit at hand so that the ATO can be assured that they have taken all reasonable steps to resolve a dispute to a court's satisfaction.

RECOMMENDATION 8.2

Agreeing facts assists in maximising understanding of issues and minimising dispute-related costs and better directs evidentiary needs, therefore, the ATO should implement a process that is designed to:

- establish the facts and issues at the early stages of the audit process, by providing taxpayers with a draft Statement of Facts before conducting significant detailed technical legal analysis;
- provide the taxpayer with an opportunity to clarify and correct the draft Statement of Facts by way of explanation or provision of additional information;
- revise this statement as is considered appropriate; and
- communicate the Statement of Facts (as revised) to the taxpayer, noting particularly where there may be a disagreement as to facts or findings of fact.

ATO Response

Disagree.

We think there is merit in settling the facts up-front and would welcome a draft statement of facts from the taxpayer — given that they are best placed to provide the full facts. However, often the relevant facts have to be determined by reference to the technical issues and discussions.

For our part, the ATO position paper includes a statement of the relevant facts (as we understand them) and is provided to the taxpayer for comment prior to us concluding our view. It is developed through progressive consultation and discussion with the taxpayer to assist us in establishing the relevant facts.

This is consistent with our commitment to open, ongoing and frank dialogue in the LBTC booklet and a considered engagement strategy tailored to the circumstances of the case. Where the taxpayer is willing to work co-operatively with us, this is usually an iterative process from an early stage in the audit.

While we appreciate the sentiment and underlying intent of this recommendation, we consider that it reflects a linear approach that does not adequately recognise the complexity of large market casework. It suggests the facts can be established independently of and prior to undertaking our analysis. The facts are not at large. They need to be relevant and that relevance is determined by the legal issues in dispute²⁹. Your recommendation 8.8 recognises this.

In the large market context, disputed 'facts' are frequently about conclusions of fact, which themselves are only developed through the technical analysis. It is neither realistic nor practical to suggest that a meaningful Statement of Facts can always be developed in advance of that analysis.

The imposition of a linear approach would present opportunities for the small number of taxpayers and advisers who choose to adopt a less than co-operative stance to engage in tactics designed to delay our teams in being able to settle such a statement.

RECOMMENDATION 8.3

To improve audit case management the ATO should set clearer benchmarks for key events within the two year audit timeframe.

These benchmarks should include the following:

- the ATO provide the taxpayer with a draft Statement of Facts (within 9 months from audit commencement date);
- the ATO to provide an opportunity for an ATO-taxpayer workshop to discuss the draft Statement of Facts and taxpayer response, that is also attended by relevant technical specialists and key decision-makers (within 3 months after the step above);
- the taxpayer to respond and clearly set out the material facts agreed, material facts in dispute along with appropriate supporting evidence (within 3 months after the step above);
- the ATO to issue a draft position paper (within 3 months after the step above); and
- the ATO to provide an opportunity for an ATO-taxpayer workshop to discuss the draft position paper, which should be attended by technical specialists and key decision-makers (within 2 months after the step above).

²⁹ Gordon, J - Speech to ATO staff on information and evidence gathering (2007).

ATO Response

Disagree.

Our response to Recommendation 8.2 explains why we consider it is not appropriate to try to establish the facts as a theoretical construct separate from the technical analysis. However, if the taxpayer and the ATO are in a position to settle on the issues and facts, then we would encourage that to occur as early as possible. The remainder of our response is directed to the additional issues of benchmarks, timeframes and your recommendation that the taxpayer should have an opportunity to attend an ATO workshop.

The LBTC booklet requires that our teams prepare an audit plan; discuss it with the taxpayer; and provide regular progress updates. The planned timeframes also need to allow, where relevant, for other processes, such as the General Anti-Avoidance Rules panel, including an opportunity for the taxpayer to present their views. There is an expectation that teams will actively manage cases in line with the plan and adopt a purposeful approach to ensure matters progress in a timely manner. This is reinforced and assured through our monthly review and callover processes.

Audit plans are designed having regard to the circumstances of the case, which are widely differentiated in the large market. We believe that the imposition of these internal benchmarks will not encourage or support teams in developing a more considered plan. It could also have unintended effects if teams become focused on meeting benchmarks to the detriment of relationships and case outcomes.

Our commitment to open, ongoing and frank dialogue in the LBTC booklet includes discussions with the taxpayer at the position paper stage. Where appropriate, specialists assisting the audit team will attend and actively participate in these discussions. We believe it is not necessary to convene a separate ATO-taxpayer workshop for this purpose.

However, to the extent that this recommendation is about ensuring that processes are monitored as tightly as possible, then we agree in principle with that intent.

RECOMMENDATION 8.4

The ATO should review the escalation processes embodied in publicly available guidance (including the LBTC booklet) through a process of consultation with the Large Market, to specifically consider improvements that may be made in enhancing stakeholder understanding and access for addressing concerns in audit and risk reviews.

ATO Response

Agree.

This will be achieved through consultations with the Large Business Advisory Group in developing the next revision of the LBTC booklet.

RECOMMENDATION 8.5

If the ATO wishes to expand the scope of an audit, to encompass issues that were not listed in the original audit notification letter, then it should only do so after subjecting the issues to an appropriate approval process such as business case approval or risk review. This is designed to ensure that the audit is warranted and that overall compliance costs are minimised.

ATO Response

Agree.

Where our compliance teams recommend that an issue should proceed to audit, they must seek approval from an independent panel of Senior Executive Officers. We will update our directions to teams to clarify that this also applies to situations where the scope of an existing audit may be expanded.

RECOMMENDATION 8.6

An ATO framework should be developed that provides a formal process for determining whether an ATO extension of time request made upon a taxpayer is appropriate in their particular circumstances. Such a framework should ensure that a request is not made where the need for the extension has arisen from undue delay on the ATO's part.

ATO Response

Agree in part.

We agree that the decision to seek an extension of time to amend a taxpayer's assessment is an important one and should not be made without due consideration.

We do not agree that this decision requires a separate formal process. It should be made by our team leaders, in discussion and consultation with their senior executive officer as appropriate, and this itself constitutes a formal process for that decision. We will clarify this in the LB&I Compliance Manual, consistent with your Recommendation 6.2.

Where taxpayers have concerns about any aspect of an audit, including a request for extension of time to amend assessments, they are encouraged to discuss it with the audit team leader and/or the officer who has been identified as the escalation point at the start of the case. This reflects what we expect in current practice and the roles and responsibilities of our senior officers as outlined in your Recommendation 6.1.

In response to Recommendations 4.2, 4.3, and 6.1 we have noted that we are in the process of revising and updating our instructional materials (including the LB&I Compliance Manual). We will ensure the changes made also reflect the roles and

responsibilities of our senior officers having specific regard to making a decision to seek an extension of time to amend an assessment.

We do not agree that an ATO delay should be an over-riding factor in deciding whether to seek an extension of time. In the large market, there are times when significant risks from prior years need to be investigated on behalf of the community. Unnecessary delays should be avoided as far as possible through careful planning and should be taken into account when deciding whether to request an extension for time. However, even if a case has been delayed, there will be times when we need to seek the extension of time to fulfil our duty to the community in protecting the integrity of Australia's tax system.

RECOMMENDATION 8.7

The ATO should develop an "Aged Case Report" showing all audits that have not been finalised within two years and providing reasons, and supply this report to the Deputy Commissioner LB&I on at least a monthly basis. The Deputy Commissioner LB&I should review this report and determine any action required to expedite these audits.

ATO Response

Agree.

RECOMMENDATION 8.8

The ATO should enhance the IQF process to ensure that the Facts and Evidence Worksheets are completed effectively and progressively throughout the audit process, in accordance with policy and to provide a continuous and accurate repository of operational work activities.

ATO Response

Agree.

CHAPTER 9: POSITION PAPERS

9.1 This chapter addresses the ATO's issuance of position papers in an audit context. It considers both the process by which a position paper is developed and also the form and content of the position paper itself.

9.2 The position paper process review considers, amongst other things, the level of engagement and exchange expected between the ATO and taxpayers in the presentation of ATO views or positions and related taxpayer responses. The details of the position paper's form, content and approach are explored to consider opportunities for improvement for both the taxpayer and ATO.

9.3 Taxpayer concerns raised in submissions and consultations regarding the position paper process are also canvassed. Briefly, issues raised included the length of time taken for the ATO to issue a position paper, the timeframe for taxpayers to respond and the quality of position papers.

9.4 The chapter makes recommendations to improve the position paper process by further promoting transparency, engagement and dialogue and also the quality of position papers form and content. These combined recommendations, if implemented effectively, should assist in improving the ATO's end-to-end management of audit disputes along with taxpayer understanding and satisfaction in that process.

BACKGROUND

Purpose

9.5 The position paper process is an important aspect of fair decision making in ATO audits of taxpayers. It is one of the ways in which the ATO explains and communicates its position for particular matters in dispute to taxpayers. More specifically the position paper provides taxpayers with:

- information about the ATO's view of the facts and the law applicable to the matter;
- an opportunity prior to the audit's finalisation to provide further facts and legal argument that may be relevant to formulation of the ATO's position; and
- an opportunity to discuss contentious issues so as to better understand the merits of each other's position in reaching agreement about how the matter may be finalised.¹

9.6 The Compliance Manual requires that position papers be transparent in process and that taxpayers have an opportunity to respond to them. If a taxpayer

1 ATO Position paper procedures.

responds to a position paper then this should be taken into account in deciding the final ATO view of the position.²

9.7 A position paper is not a 'decision', but rather the presentation of the ATO's preliminary view of the facts and the law applying to them. The ATO's position paper procedures state that:

... the ATO provides a position paper on a co-operative basis to provide information relevant to decisions that it is about to make. The position paper represents the ATO's considered view after consultation as appropriate with technical specialists and forums, Tax Counsel Network, external legal advisers and the taxpayer. As such, it demonstrates that the ATO has identified appropriate issues and has given the taxpayer opportunity to discuss and explain any issue before the ATO makes any adjustments.³

Process and content

9.8 The Large Business & International (LB&I) Compliance Manual sets out a number of key points that auditors should consider in relation to position papers:

- it is advisable to start to develop the position paper as early as possible in the audit;
- if it will assist to obtain further information, clarify the facts or resolve the issues then the auditor may provide a draft position paper to the taxpayer early in the audit and ask for their views;
- whilst the position paper is a more formal way of setting out the ATO's views on the issues, the auditor should also arrange a conversation with the taxpayer to discuss the contents of the position paper; and
- the ATO must provide taxpayers with sufficient time to respond to the position paper, which would normally be 28 days, although this will ultimately depend on the complexity and significance of the issues.⁴

9.9 The Manual also provides that the position paper may contain the following:

- the material facts and evidence upon which the ATO view is based;
- the ATO view that is relevant to the audit and the application of the ATO view to the facts; and
- the taxpayer's view or contentions.⁵

2 LB&I Compliance Manual, Chapter 12, p 24.

3 ATO Position Paper Procedures.

4 LB&I Compliance Manual, Chapter 12, p 24.

5 LB&I Compliance Manual, Chapter 12, p 25.

Engagement with taxpayers

9.10 The LB&I Compliance Manual also sets out a number of mandated steps that must be conducted in the course of determining the ATO position. Two of these steps involve presenting the ATO findings to the taxpayer and managing the position paper process.⁶

Managing the position paper process

9.11 The Compliance Manual mandates that in managing the development of an ATO position paper a case officer will:

- present the initial ATO view to the taxpayer;
- hold an interview (where possible) with the taxpayer to discuss the initial ATO view and give the taxpayer the opportunity to provide feedback;
- provide the taxpayer with the opportunity to provide written feedback on the initial Tax Office view; and
- consider the taxpayer's feedback and provide them with a written response.⁷

9.12 The Manual notes that the above can happen either within the position paper process or separate to it depending on the circumstances of the case. If the case officer has moved directly to a position paper process then the ATO view would most likely be presented to the taxpayer in the form of a draft position paper.⁸

Dealing with taxpayer responses to position papers

9.13 The position paper procedures provide guidance to case officers on what to do if there are delays in receiving a taxpayer's response to the position paper.⁹

6 LB&I Compliance Manual, Chapter 12.

7 LB&I Compliance Manual, Chapter 12, pp 36-37.

8 LB&I Compliance Manual, Chapter 12, p 37.

9 ATO position paper pProcedures.

Table 9.1: Guidance to case officers in dealing with responses to position papers¹⁰

Event	Action
If case officer receives no response within the date set in the covering letter	Contact the taxpayer or their agent to determine why there has not been a response and whether one is coming.
If the taxpayer has not responded by the requested time, and plans to respond to the position paper	<p>Determine whether it is appropriate to grant an extension of time. Consider any relevant business practice and such factors as:</p> <ul style="list-style-type: none"> • complexity of the issue(s); • the need for the taxpayer to get a legal opinion or other specialist advice; • whether the statutory time limits for making adjustments are getting close to expiry; • the taxpayer's position on the compliance model or the co-operative compliance model and their behaviour to date (for example, whether they have provided information and documentation in a timely manner); • whether the expectation that the taxpayer will respond is realistic and the taxpayer's response is likely to materially alter the ATO position; • the progress the taxpayer has made to date in responding to the position paper; and • other special circumstances. <p>If the case officer agrees to an extension, confirm the new date for a response in writing to the taxpayer.</p> <p>If the case officer does not agree to an extension, discuss the matter with the Team Leader to determine what course of action to take next.</p>
It is not clear whether or not the client will send a response	It may be suitable in some circumstances for the case officer to send a reminder letter advising that if the ATO does not receive a response within 14 days the ATO will finalise its view in accordance with the position paper.

9.14 The position paper procedures also provide instructions to ATO staff on how to deal with taxpayers that respond to position papers with questions or requests for clarification. The procedures state that where a taxpayer's questions are reasonable, then an auditor must ensure that their actions are consistent with the Taxpayers' Charter and provide an appropriate response to the taxpayer's queries. The procedures note that a taxpayer question will be considered reasonable if:

- it seeks to clarify a fact stated by the ATO in the position paper;
- if the ATO considers that time spent answering the questions is a reasonable allocation of resources; and
- the questions are asked in good faith.¹¹

9.15 The position paper procedures state that where further questions from a taxpayer are unreasonable, then it is appropriate for an auditor to refuse to reply to them. The procedures list situations in which taxpayer questions about a position paper are considered unreasonable, and these are:

- the taxpayer has been uncooperative and obstructive;
- they pose an unreasonable administrative burden;

¹⁰ ATO position paper procedures.

¹¹ ATO position paper procedures.

- they are outside of the scope of furnishing responses to the taxpayer to enable them to respond to the position paper;
- they are in the nature of seeking further and better particulars, as if part of a 'quasi-litigation' process;
- they are submitted in order to delay the finalisation of the case; or
- they are frivolous or vexatious.¹²

9.16 The position paper procedures also note that it is better to provide the taxpayer with only one position paper on the issue. However, it is recognised that in exceptional circumstances an amended paper may be necessary, for example where there are material changes to the ATO position as a result of the taxpayer's response.¹³

9.17 For quality assurance purposes an auditor is required to provide the position paper to all necessary internal stakeholders (including their team or technical leader) for examination and clearance before sending it out to the taxpayer. The clearance process is about ensuring that the position paper meets all technical and procedural quality standards, including that it:

- is consistent with the principles of the corporate approach to interpretative work, Taxpayers' Charter, ATO Judgement Model and Compliance Model;
- is adequately researched and appropriate and relevant information gathered;
- reviews and applies appropriate legislation, case law and ATO views and appropriately manages precedential issues and procedural requirements in accordance with relevant ATO practice statements;
- conformed with any ATO business line instructions concerning escalation; and
- used appropriate spelling, grammar, layout and tone.¹⁴

SUBMISSIONS AND CONSULTATIONS

Process

9.18 A considerable number of stakeholder submissions and consultations with the IGT expressed strong concerns on key aspects of the ATO's position paper process. The ATO were a little surprised by this representation as it seems inconsistent with the Client Feedback Questionnaire results over the last few years. There were also some good examples of ATO improvement in this process that certain taxpayers and advisers had experienced and shared with the IGT – these also tended to be more recent examples.

¹² ATO position paper procedures.

¹³ ATO position paper procedures.

¹⁴ ATO position paper procedures.

9.19 A number of taxpayers and advisers commented that position papers were still being issued after little or no contact from the ATO for many months, creating real surprises for them regarding the facts and issues identified as presented by the ATO.

9.20 They also asserted that given the lack of prior engagement, the facts set out in position papers are not agreed or tested prior to the ATO forming a technical view. This means that the ATO's technical specialists are providing views based on incorrect facts in those circumstances. Taxpayers also remarked that by this stage it is often too difficult to change the ATO's view of the facts and evidence.

9.21 By way of example, one taxpayer submitted that it received a position paper where the ATO relied on an external market valuation to support its position where there was no prior opportunity to respond to the methodology or the basis of the valuation. In addition, there was no opportunity for the respective valuers to meet to discuss the differences in methodology and valuations.

9.22 The taxpayers and advisers believed that the efficiency and effectiveness of audits would be greatly improved if there were opportunities to meet with the ATO to discuss the facts, issues and legal basis before the ATO issues a position paper. Taxpayers would also like to see the ATO's technical specialists involved as early as possible in the audit, including in discussions with taxpayers, so as to assist with development of technical arguments contained in position papers and to review taxpayer responses.

9.23 The taxpayers and advisers submitted that, in their experience, the ATO does not adequately consider their responses to position papers. For example, they do not see their views and positions being formally addressed in any revised position paper. Others remarked that there was often no opportunity to meet and discuss the taxpayer's response or be given an explanation as to why their response had been accepted or not. They said that this has contributed to the perception that the ATO has already formed their view on the facts, issues and law and is unwilling to depart from its stated position. Some taxpayers suggested that in their view the ATO does not readily consider a taxpayer's response during the audit stage and so they are left trying to try and escalate the issues during the objection stage.

9.24 The ATO expressed certain views in this context with the IGT. The ATO believes that this may also be a question of misaligned expectations. The ATO suggested that some arguments or views as put by taxpayers will have a potentially more significant bearing on the case than others. The ATO view is that it is not necessary to weigh down a position paper with an extensive analysis of arguments or comments that have no significant impact on the outcome. Discussion at the time when the ATO's final position paper is prepared enables teams to explain their views on what the taxpayer has said and why some matters, if any, have not been given more weight.

9.25 A number of taxpayers and advisers also raised concerns with the considerable time and money they have spent in responding to position papers or information requests but which have not resulted in any discussion or change to the ATO's position paper. Taxpayers referred to instances where position papers were issued shortly after they responded to an information request (in one case less than two

weeks), raising doubts about whether the ATO had properly considered the information and documents provided by taxpayers.

9.26 In another case, a taxpayer received a broad information request (with a 28-day response time) which was very shortly followed by the ATO's position paper. The taxpayer said that it was unclear how the ATO could issue a position paper prior to the taxpayer responding to the information request. The taxpayer asserted that if the information was not required by the ATO in its analysis, then it was unclear why the information had been requested and its relevance. The taxpayer indicated that due to the short timeframes in having to respond to both the position paper and information requests, it had to incur considerable costs on external advisers, counsel and lawyers as well as significant internal staff costs.

Timeframes

9.27 A common theme in nearly all submissions was that the ATO did not provide a reasonable opportunity for taxpayers to adequately respond to position papers. A number of taxpayers and advisers asserted that it was rare to obtain a position paper without an accompanying time pressure, with many instances of position papers being issued late in the audit process leading to increasing costs and tension in finalising audits.

9.28 Taxpayers have also complained of unreasonable timeframes to respond to position papers or have a meaningful discussion, especially where there has been little engagement leading up to the provision of the position paper. Some taxpayers have indicated that they have had to respond to a position paper and at the same time deal with a large number of other ATO compliance activities such as risk reviews, other information requests and compliance obligations (for example, business activity statements and various return obligations).

9.29 Some advisers indicated that they had received amended assessments shortly before the expiration of the ATO's two-year timeframe even though they had little time to respond to the position paper or discuss the merits of the competing positions.

9.30 Taxpayers submitted that in a large market audit context it was inappropriate for the ATO to take 12 or more months to prepare and issue a position paper (with often little or no prior engagement around the risk hypothesis, facts and evidence) and then only provide the taxpayer with 28 days to respond. One taxpayer said that they were provided with a period of 28 days to respond to a position paper and told that no extension of time would be granted. This approach caused the taxpayer to incur considerable external fees to respond in such a short timeframe.

9.31 Other taxpayers submitted that it was often not possible, in the short time provided by the ATO, to prepare a detailed response to the position paper, especially where there has been little engagement leading up to the position paper. This was often because such a response would require the taxpayer to undertake further inquiries in order to be able to fully respond.

9.32 Other taxpayers have complained of delays in the ATO issuing a position paper and not meeting milestone dates. On one occasion the ATO initially indicated it

would provide the position paper in March 2007 – and on 15 subsequent occasions the ATO has set dates for the delivery of the position paper and on each occasion the ATO has failed to meet its self-imposed deadline.

Quality of position papers

9.33 Taxpayers and advisers observed a significant variation in length and quality of position papers in submission and consultation with the IGT. The good examples exhibited high quality in all aspects while those of lesser-quality were considered to be too long in parts, not clear in analysis or structure and often with incorrect, misstated or omitted facts with no explanation of the relevance of evidence. They believe that this arises because there has been no prior discussion between the ATO and taxpayers about key documents or transactions, leading to uninformed opinions, poor analysis and incorrect conclusions.

9.34 Taxpayers and advisers also strongly submitted that there should be greater guidance on the content of a position paper.

9.35 Taxpayers have raised concerns regarding the purpose of position papers, suggesting that the ATO use them to:

- present facts and technical arguments in a way that best supports an assessment being issued;
- omit or marginalise key facts that do not support the ATO's technical position; and
- ignore or otherwise not provide a fair representation of the taxpayer's technical position.

9.36 In consultations with the IGT, taxpayers and their advisers raised concerns that the ATO tends to rely heavily on the fact that the taxpayer bears the onus of proof. This results in either the taxpayer having to unnecessarily incur significant costs to prove immaterial facts or forcing taxpayers to lodge objections.

IGT OBSERVATIONS

9.37 The IGT believes that the position paper is a key part of the ATO's end-to-end dispute resolution process and that the audit process could be enhanced so as to encourage a more cooperative approach to developing and finalising a position paper.

9.38 It is important that the processes leading up to the issuing of a position paper encourages discussion and engagement, especially in relation to the facts and evidence, so as to minimise the perception of surprise relating to the facts and issues identified by the ATO. Greater engagement will also assist in identifying potential issues and points of disagreement earlier and provide taxpayers with an opportunity to discuss and explain any issue before the ATO makes any adjustments.

9.39 Likewise, the content of a position paper must best support any further disputation (objections and litigation). At the end of an audit, taxpayers should have a

clear understanding of the issues in dispute, the material facts that are agreed and any that are disputed and the evidence on which the ATO is relying to support its view and amended assessments. This is not only beneficial to the taxpayer but also to an ATO objections officer should the audit go on to dispute. In addition, these practices align with the requirements of the Federal Court Practice Note TAX 1 should the objection decision proceed to litigation.

9.40 The IGT found that often the receipt of a position paper was the first time taxpayers became clearly aware of the ATO's understanding of the facts, evidence and the issues subject to audit. However, by this stage the ATO has devoted considerable time and effort in the conduct of internal workshops, research and in forming an ATO position on the facts and evidence as identified by them.

9.41 Taxpayers have suggested that the position paper process should be enhanced by requiring the ATO to discuss and clarify the facts before preparing a position paper. Some suggested that this could be achieved by the ATO issuing a separate 'statement of facts' document setting out the ATO's understanding of the facts and the particular transaction. Taxpayers would then be provided with an opportunity to clarify and agree the facts as set out in the document. If the taxpayer disputes the facts, then they should provide the relevant areas of disagreement together with supporting documentation. Taxpayers could be given a reasonable period to respond, which could be extended by negotiation if further documentation is required to support the facts. For more detail on the Statement of Facts issues, reference should be made to Chapter 8 of this report.

9.42 An enhanced consultative approach would save a substantial amount of time on both sides by avoiding the need to develop, or respond to, technical arguments based on an incorrect understanding of the facts, or having to reconsider technical arguments based on a revised set of facts. It would also allow both the ATO and taxpayer to better appreciate the likely facts that are in agreement and the facts in dispute.

9.43 In addition, this would provide more time to discuss the technical merits of an issue before the completion of the audit and alleviate the current concern that an assessment often follows the issue of a position paper without taxpayers having had an appropriate opportunity to respond.

9.44 It would also reduce the potential need for the further clarification of the facts at the objection stage and ensure that there is a more comprehensive dialogue and testing of the technical merits of the ATO and taxpayer positions before the finalisation of the audit.

9.45 For certain issues, such as valuations, the ATO should also look to bring together external experts to discuss any differences in methodology and valuations before an amended assessment is issued. Only after this process has been exhausted and there are still differences in the market valuation should the ATO resort to issuing amended assessments.

9.46 The IGT also believes that the ATO should try and avoid circumstances where a taxpayer is issued with a position paper with a follow-up assessment shortly thereafter because the ATO's two-year audit timeframe is due to expire. The ATO

should not be influenced by the shorter self-imposed two year timeframe and should afford a taxpayer the opportunity to respond within a reasonably agreed timeframe. Where the statutory limitation period for amendment is due to expire, rather than issuing an amended assessment that may not be based on a final ATO view, the ATO should seek the taxpayer's agreement to extend the amendment period.

RECOMMENDATION 9.1

The ATO should develop and publish enhanced written guidance on the purpose, content and drafting of position papers in an appropriate publicly available publication.

ATO Response

Agree.

This will be achieved through the publication of the revised and updated LB&I Compliance Manual, in line with our response to Recommendation 4.2, 4.3 and 6.2.

RECOMMENDATION 9.2

The ATO should enhance its quality assurance processes to ensure position papers issued by the ATO clearly set out and address the following:

- issues subject to audit;
- material facts relevant to each issue that are agreed (including appropriate references to supporting evidence);
- material facts upon which the taxpayer or the ATO rely that are in contention (or expected to be in contention);
- the legal position or view the ATO has adopted and the reasons why (including appropriate legal and factual analysis); and
- the taxpayer's legal position or views and their contentions as to the ATO's legal position.

ATO Response

Agree.

As noted in our response to Recommendations 5.2 and 8.8, we are currently in the process of updating and enhancing our guidance to IQF assessors. This will include further points directing our assessors to consider the manner in which position papers set out these matters.

RECOMMENDATION 9.3

Where a taxpayer does not agree with the content of the ATO position paper (whether on fact or law) a senior technical specialist should review the taxpayer's response, form a view and sign-off on the final position paper. The senior technical specialist should have sufficient technical expertise and should not have been directly involved in the audit.

ATO Response

Agree.

It should be understood and emphasised that such a review is not a full internal review of all matters or issues in the audit, unless this is warranted. The review will examine the areas of disagreement as identified by the taxpayer in their response to the position paper.

CHAPTER 10: INTEREST AND PENALTIES

10.1 This chapter considers the issues and concerns raised by stakeholders about aspects of the ATO's approach to interest and penalties in the context of this IGT review. It makes recommendation to improve the level of transparency and engagement and promote greater certainty in determination and application of penalties.

10.2 In a practical sense it is difficult to de-couple penalties and interest issues, as these are often paired in a discussion context. The IGT has for the purpose of clarity sought to deal with these as discrete issues where it is more appropriate for the purposes of the report.

10.3 Penalty and interest concerns mainly arise in the context of a disputed taxpayer position, although concerns may also arise in voluntary disclosure situations.

10.4 The main stakeholder issues of concern were directed at both the level of, and process for, determining penalties and interest levied by the ATO against taxpayers. For penalties and interest to be considered, there is usually a dispute of some kind on foot that will require some form of negotiated or formal resolution.

Submissions and consultation

10.5 Taxpayers submitted that the tax system is now incredibly complex both in an everyday sense and for more significant transactions resulting in very high overall compliance costs. In the event that there is ultimately a dispute between the ATO and taxpayers in interpreting through this complexity, both parties naturally look to understand each other's view of a particular matter and assess the relative strengths and weaknesses of their positions against that of the other party.

10.6 It is not an uncommon experience to find that the ATO and taxpayer may have a differing technical view or interpretation on how the law operates with respect to the same matter. It may also be that prima facie both views have considerable merit. This difference of opinion may ultimately escalate to the point of formal dispute. The outcomes of formal dispute resolution by way of litigation also gives rise to polarised win or lose outcomes – a risk on outcome that may not suit either party for various reasons. Decided cases in the Large Business & International (LB&I) taxpayer segment also provide some context in relation to formal outcomes risk for both taxpayers and the ATO.

10.7 A number of stakeholders expressed the view that the penalties and interest regime in its current design or application does not adequately take account of these difficulties that are experienced by taxpayers due to the complexity of the overall self-assessment regime which taxpayers must navigate within. Taxpayers expressed a desire to have greater flexibility and latitude in situations where they have adopted a reasonable position that may be disputed at a later time. Stakeholders also raised

various specific concerns about the application of penalty mitigations such as reasonably arguable positions (RAP), amongst others.

10.8 The level of both penalties and interest was suggested by stakeholders to be too high in many instances, particularly where taxpayers were contemplating a settlement, making it difficult for them to avoid formal resolution processes as any other accommodation made no commercial sense for them.

10.9 Stakeholders also expressed a view that penalties and interest were often used as a negotiation device by the ATO. While a level of engagement that seeks to ensure penalties are carefully considered was supported, the particular concern raised by some taxpayers was that they believed the process was used in a more punitive or coercive manner.

10.10 A few stakeholders felt that where the ATO took an approach of asking the taxpayer to make a submission on penalties and interest, the process was one that was vague and uncertain as to both conduct and outcome. After a period these taxpayers complained that a raw determination would simply issue without any explanation of the ATO's reasons, reinforcing a lack of due process.

10.11 A specific concern raised by a number of stakeholders in relation to due process was taxpayer penalty reductions. A view expressed by some taxpayers was that the ATO had unduly restrictive or unreasonable approaches in relation to voluntary disclosures in determining penalty reductions. These taxpayers considered that they had provided information in good faith believing that they had done so on a voluntary basis and that it was not reflected appropriately in determinations provided. In certain instances this acknowledgement may have been provided by the ATO at a later time after taxpayer agitation, but typically only as part of a negotiated position in settlement.

PENALTIES AND INTEREST — ATO ADMINISTRATION

10.12 The ATO's approach to penalties and interest is outlined in broad terms on its website.¹

10.13 The ATO document has links to a range of administrative documents that provided guidance and direction to staff on the application and mitigation or reduction of penalty and interest amounts levied on taxpayers in various circumstances.

10.14 The ATO has expressed certain views to the IGT in relation to the application of penalties and interest set out in the LB&I context.

10.15 The ATO appreciates that penalties and interest are understandably an area of concern and that they wish to ensure these are applied in a consistent and transparent manner across all taxpayers. This has implications for all taxpayers and not just the LB&I market segment.

1 Refer to <http://www.ato.gov.au/print.asp?doc=/content/82390.htm>.

10.16 The consideration of penalties typically does not arise until later in the process of dispute. The ATO believes that it is usually of assistance from both parties' perspectives for the taxpayer to provide a submission in relation to the process at that time, although it will give consideration to submission at an earlier time should taxpayers wish. The ATO considers that a separate penalties submission provides an opportunity for the taxpayer to raise issues that may not have been the subject of ATO focus or otherwise appreciated.

IGT OBSERVATIONS

10.17 It is generally understood by the ATO and Large Market taxpayers that the issue of dealing with penalties does not warrant consideration if no primary tax liability is in dispute. However, there is an exception with the recent passing of the *Taxation Laws Amendment (2010 Measures No 1) 2010 Act*. Under Schedule 6 of this Act penalties may be imposed without a shortfall amount existing. The IGT has had a range of concerns raised by various stakeholders recently about these provisions and how the ATO might apply them in practice. The IGT understands that the ATO is considering its position in this regard.

10.18 The issue of penalties and interest centres on the resolution of a genuine dispute between the taxpayer and ATO. In this report the focus is solely directed toward ATO LB&I risk review and audit processes and it is difficult to make broad ranging recommendations for penalty and interest matters solely in relation to the LB&I segment (as classified by the ATO).

10.19 The potential application of any recommendation is likely to have much broader relevance across the entire taxpayer population. For this reason, the IGT considers that the issue of penalties and interest and their application (including mitigation or reductions) by the ATO is more appropriately addressed in a separate dedicated review.

10.20 In addition, the IGT has reviewed the application of penalties and interest in a compliance context previously. The report, entitled *Review into the Tax Office's Administration of Penalties and Interest Arising from Active Compliance Activities*, was publicly released on 28 September 2005². The nature and specific issues raised by stakeholders in the context of this report, appear to have important differences to those investigated previously and deserve dedicated attention at a later date.

10.21 There are, however, more general comments in relation to observations made during the conduct of this particular review that can be made.

10.22 It will not always be the case that both the taxpayer and ATO agree on the appropriate application or levying of penalties. A brief review of reported cases on this issue shows that there may at times be considerable variation from the original Commissioner's determination to that of the tribunal or court decisions. On the other

2 The full report may be located at http://www.igt.gov.au/content/reports/penalties_review/default.asp.

hand, there are also cases in the tribunal or courts that reaffirm the Commissioner's original determination.

10.23 There are, however, some important areas that need to be considered in ensuring there is appropriate confidence in the system with respect to penalty and interest matters.

10.24 The four areas that the IGT considers give cause for reflection are:

- effective ATO communication with taxpayers;
- consistency in the ATO's assessment of taxpayer behaviour;
- penalty administration approaches including reasonably arguable position (RAP) and voluntary disclosure; and
- the application of due process.

10.25 The IGT has observed situations where the ATO's communication with taxpayers around penalty and interest matters could be improved. A particular area of concern for taxpayers was the communication between the time the original amended assessments were issued and the internal ATO determination of the penalty and interest were issued. While there were examples of effective engagement in this area, there were other situations where communication could have been more effective in terms of timeliness and in explanation of the analysis and calculation methodology.

10.26 The issue of greater consistency in the ATO's assessment of taxpayer behaviour in a penalties and interest context is a challenging area. The IGT has not had the opportunity to investigate this matter in detail, but preliminary indications are that this is a continuing area of taxpayer and adviser concern.

10.27 The application of a level playing field approach is critical to the prompt resolution of disputed matters by settlement or alternative dispute resolution approaches. From an efficiency perspective, it is necessary to engender trust and confidence in the process such that one party does not get a better outcome over another in relation to the same or a very similar matter, by simply taking a different approach.

10.28 The issue of reasonably arguable position or RAP also presents challenges. The ATO has advised the IGT that it has conducted an internal review in the area of RAP for the LB&I market segment. The IGT has not had the opportunity to review these findings but some are set out below for completeness.

10.29 The ATO conducted a review of penalties in all large business audits that were completed between 1 July 2007 and 18 May 2010. During this period LB&I completed 93 audits, 49 of which resulted in tax shortfall adjustments. Of these 49 cases, 31 had penalties remitted including 18 where penalties were remitted in full. The ATO found that of the 31 cases where penalties were remitted, there were 14 where it was relevant to consider whether the taxpayer had a RAP. Of these cases there were only 3 where the ATO decided that the taxpayer did not have a RAP. The ATO considers that, based on this internal review, it has considered and applied RAP penalty mitigation fairly

and appropriately. The experiences that some stakeholders related to the IGT suggested a different take on this outcome.

10.30 The IGT is mindful that there may be differing opinions about how the issue of RAP should be tackled in a practical and interpretive sense. It may also be that new attitudes are emerging, suggesting that the broader taxpaying community is recognising the difficulties that arise from a very complex tax system in a self-assessment environment where taxpayer responsibility for voluntary compliance is extremely difficult and costly to manage.

10.31 The application of penalties may be considered or perceived to be increasingly unfair or unreasonable where taxpayers believe they have been making genuine and reasonable efforts to comply with highly complex law. If correct this presents a growing tension for taxpayer and administrator alike, and raises potential policy considerations.

10.32 It is important to consider voluntary disclosures in this context. Voluntary action by taxpayers is a modern tax administration foundation stone. The provision of information by voluntary disclosure by taxpayers to tax administrators is vital for efficiency. Reduction of penalties for voluntary disclosures are an important feature designed to assist this outcome. The effective management of penalty remissions by tax administrators is particularly important in reinforcing voluntary taxpayer behaviours. Any conduct by tax administrators must carefully consider this as a positive incentive in support of pro-active taxpayer assistance. To do otherwise may hinder taxpayer confidence in the important area of information disclosure to, and gathering by, tax administrators.

10.33 The IGT considers that voluntary disclosure actions by taxpayers should not be unclear or otherwise amalgamated with broader issues or settlement negotiations. The understanding should be one that is commonly held as between the parties at the earliest opportunity. To do otherwise provides for an environment of uncertainty at best and at worst bad faith perceptions by both parties. Other areas of penalty remission are important, but any aspect that relates directly to voluntary taxpayer action is particularly vital both in practice and perception.

10.34 The payment of interest on amounts owed to another party demonstrates the economic concept of opportunity cost that is both well understood and accepted by large business. The two main concerns raised by stakeholders in relation to the ATO's levying of interest were:

- the actual application of the interest charge be it General Interest Charge, Shortfall Interest Charge or a funding equivalent concept. The differences in application as to which charge was applied and how it was applied presented significantly different economic outcomes; and
- the credit margin or opportunity cost between the ATO (or more correctly the Commonwealth Government) and taxpayer has increased dramatically in more recent times due to the prevailing market situation where deposits with banks are earning historical highs over Government equivalent interest rates. This may occur where a taxpayer deposits 50 per cent of a disputed tax liability amount with the ATO and it is resolved in the taxpayer's favour and ultimately refunded.

10.35 The application of due process is an issue that is often raised by stakeholders with the IGT. The IGT will consider the concerns raised in this context along with others in determining and conducting future reviews.

RECOMMENDATION 10.1

To improve transparency and taxpayer understanding of the ATO's interest and penalty consideration and determination processes, the ATO should improve the quality and timeliness of its communication and engagement with taxpayers.

ATO Response

Agree.

The LBTC booklet commits our teams to ongoing dialogue and engagement with taxpayers in relation to all aspects of the risk review and audit. In response to other recommendations in this review, we have committed to update instructional materials to better reflect the LBTC commitments. This will include more specific guidance on the importance of communication around the penalty decision to support teams in improving the way they engage and communicate with taxpayers on this aspect of the case.

RECOMMENDATION 10.2

The ATO should enhance the voluntary disclosure process by ensuring that it clearly communicates to the taxpayer, at the time of the disclosure in question or promptly afterwards, whether it accepts that the disclosure is voluntary.

ATO Response

Agree.

**APPENDIX 1: LARGE BUSINESS AND INTERNATIONAL
STRUCTURE**

Deputy Commissioner Large Business and International

Mark Konza

Deputy Commissioner Case Leadership

Jim Killaly (NAT)

Assistant Deputy Commissioner LB&I and Operations

Annette Chooi
(from 28/4/11)

Assistant Deputy Commissioner Case Leaders

George Hitti (LAT)

Assistant Commissioner Manufacturing

Michael Tucker (BXH)

Assistant Deputy Commissioner International

Michael O'Neill (LAT)

Assistant Commissioner Operations - Latitude East

Greg Dick

Assistant Commissioner Operations - Parramatta

Peter O'Reilly

Assistant Commissioner Case Leader

Judy Morris (LAT)

Assistant Commissioner Case Leader

Kevin Hughes (CAS)

Assistant Commissioner Financial Services

Paul Suppree (CAS)

Assistant Commissioner Jurisdictional Income Practice

Michael Jenkins (CAS)

Assistant Commissioner Operations - HUR

Peter Dunne

Assistant Commissioner Operations - Moonee Ponds and Northbridge

Peter Bonett

Assistant Commissioner Case Leader

Scott Burrows (HUR)

Assistant Commissioner Case Leader

David White (CAS)

Assistant Commissioner Energy and Resources

Michael Smithson

Assistant Commissioner Economist Practice

David Honeybun (CAS)

Assistant Commissioner Operations - BNE

Brad Edwards

Assistant Commissioner Operations - Casselden

Anne Connon

Assistant Commissioner CGT, Consolidation, Losses and Innovation

David Allen (NAT)

Assistant Commissioner TOFA

Ross Brookes (LAT)

Assistant Commissioner Sales and Services

Stuart Hamilton (NAT)

Assistant Commissioner Transparency Practice

Malcolm Allen

Assistant Commissioner Interpretive Assistance

Lyndall Crompton

Assistant Commissioner Compliance Assurance

Ian Read

Assistant Commissioner New Measures & Government Relations

Mike Slattery (NAT)

Assistant Commissioner Papua New Guinea Project

Greg Topping (PNG)

Assistant Commissioner Business Management and Governance

Nick Antonacci (BXH)

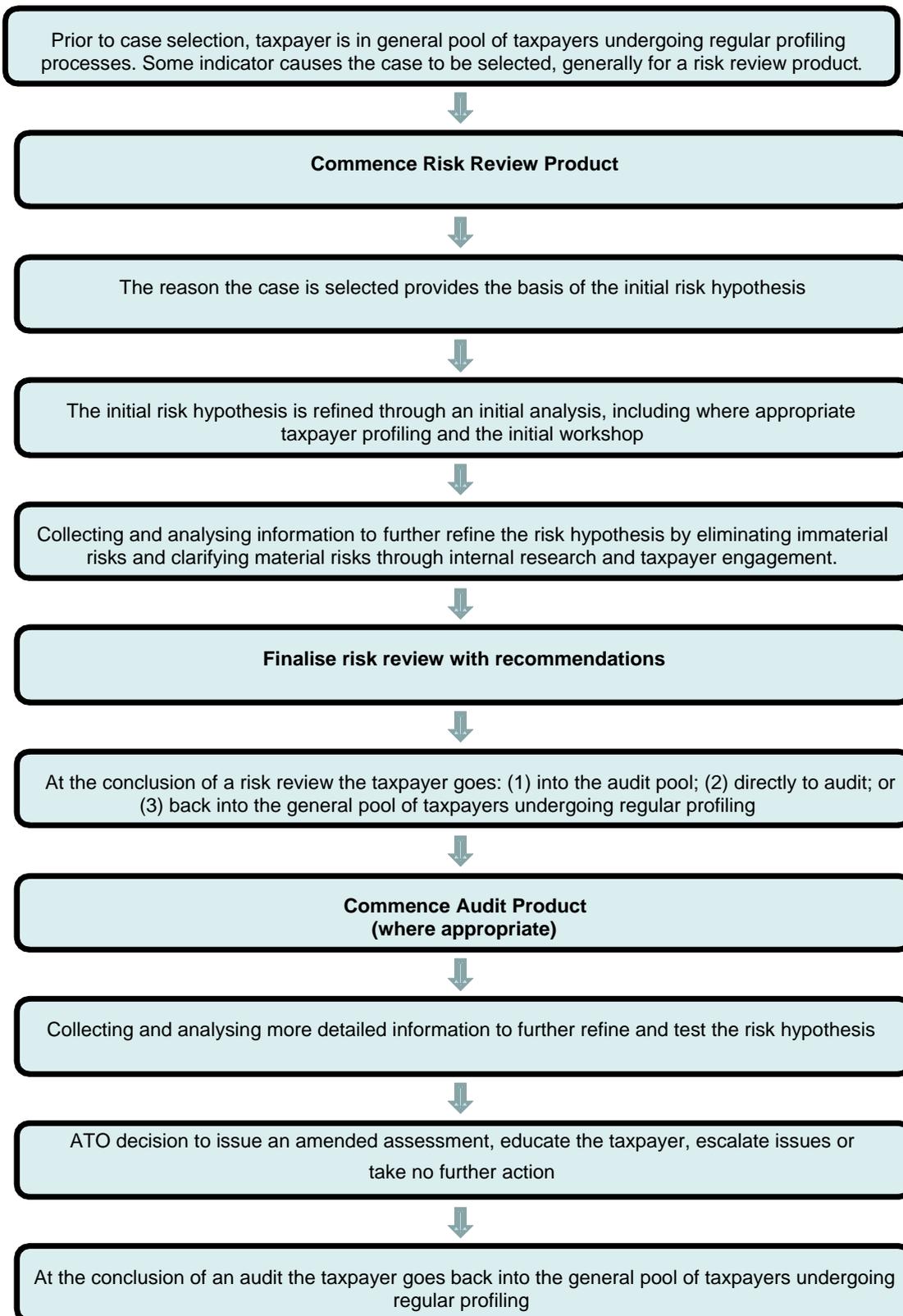
Assistant Commissioner Risk, Intelligence & Systems Support

Anthony Siouclis (BXH)

APPENDIX 2: ASPECTS OF ATO RISK REVIEW & AUDIT PROCESSES

Penalties and interest	Greater consistency in the: Assessment of taxpayer behaviour Reasonably arguable position
Position papers	Timeframes Greater transparency and engagement around position paper Purpose and quality
Information gathering	Clearer identification of the relevancy or information request Better engagement around information requests Clear guidance around nature and detail of documentation required at each stage Clearer process around issuing s264 notices Clearer process around LPP and accountants concession
Risk review and audit processes	Key milestone events – having to establish facts and evidence Better engagement around facts and evidence Better engagement around issues Clearer guidance and expectations around key milestone events Better access to technical specialists Clearer escalation points
Project management	End-to-end accountability of risk review and audit process Single point of contact for all aspects of review and audit
Risk hypothesis	Sharing of risk hypothesis Refinement of risk hypothesis as review or audit progresses
Risk review and audit products	Sharing of risk rating with taxpayers and discussion Uncertainty around scope, purpose and outcomes around various products Clear expectations around process, timeframes and outcomes Demonstrated alignment with Risk Differentiation Framework

APPENDIX 3: RISK REVIEW & AUDIT STAGES



*This diagram is adapted from the diagram in the LB&I Compliance Manual at Chapter 1, Appendix 2 (p17).

APPENDIX 4: TERMS OF REFERENCE & SUBMISSION GUIDELINES

Review into the ATO's large
business audit and risk review
policies, procedures and
practices

Terms of Reference &
Submission Guidelines

17 November 2009

BACKGROUND

1.1 The ATO's audit and risk review policies, procedures and practices have a significant impact on business, not only in terms of the cost of compliance but also the potential for further, and unnecessary, disputation.

1.2 The ATO states that its active compliance program for large business (involving risk assessment and audit) is aimed at encouraging voluntary compliance, identifying areas for law clarification and addressing failure to meet tax obligations. The ATO has designed a suite of audit and risk review products such as Forward Compliance Arrangements (FCAs), Annual Compliance Arrangements (ACAs), Client Risk Reviews (CRRs) and comprehensive and specific issue audits to assist in improving compliance behaviour and facilitating collaborative tax risk management practices.

1.3 In relation to large business comprehensive and specific issue audits, many including the Inspector-General of Taxation (IGT), welcomed the ATO's aspiration to resolve large business audits within two years and client risk reviews within six months.

1.4 However, during consultations on the IGT's work program, representatives of businesses and the tax profession repeatedly raised concerns that audits are often being finalised within the two years, but the way they are being handled is not achieving the aim of trying to resolve issues and disputes as early as possible. They submitted that delays in the early stages of these audits were resulting in important processes being truncated towards the end of the two years in order to achieve the targeted timeframe. Important processes allegedly being compromised include providing taxpayers with a reasonable opportunity to respond to ATO position papers, serious consideration by the ATO of taxpayer responses, and the extent of dialogue between taxpayers and the ATO in establishing agreed facts.

1.5 Stakeholders expressed concern with the ATO's exercise of its informal and formal information-gathering and access powers (section 263 and 264 of the *Income Tax Assessment Act 1936*) during risk reviews and audits. Some believed that the ATO was exercising these powers inappropriately, alleging that the ATO uses information-gathering requests to intimidate taxpayers. Others were of the view that the information gathered by the ATO was of limited or, indeed, no use in future proceedings although the associated taxpayer costs of compliance and stress can be enormous.

1.6 Taxpayers also raised concerns with the ATO's application and remission of penalties, in particular whether a reasonably arguable position exists. Some have suggested that the ATO will apply lack of reasonable care penalties whenever there is a disagreement notwithstanding the merits of the taxpayer's case. Others have also asserted that the ATO does not adequately consider the reputational risk associated with the ATO applying penalties, especially Part IVA penalties, and the financial duress caused where the disputed primary tax amounts are large.

1.7 This review will seek to establish whether taxpayer concerns such as the above are justified. It will examine the management of selected large business audit cases handled by the Large Business and Internationals (LB&I) business line with a focus on important milestone events and the underlying issues and behaviours. It will consider if ATO

behaviours and decision-making processes are leading to extended timeframes or unnecessary disputes. This will provide a basis for conclusions to be drawn and recommendations of best practice in the handling of comprehensive and specific issue audits in the large market segment.

1.8 The review will also consider other ATO audit and risk products, some of which are relatively recent developments, such as FCAs and ACAs. Whilst other products, for example, comprehensive and specific issue audits, have existed for a much longer period, even these have undergone some changes, particularly in relation to timeframes as stated above. There have been suggestions that the ATO's explanation and application of its various audit and risk review products is contributing to uncertainty and delaying the timely progress of audits and risk reviews. Equally, others have also suggested that the principles contained in the ATO's *Large business and tax compliance 2006* booklet are not being communicated or applied in practice. Both the ATO and taxpayers are likely to benefit from analysis of these products in order to determine whether each may be better employed.

1.9 A preliminary question also worth considering is how much information should be provided with the income tax return. Some have suggested that given that large business taxpayers are subject to ongoing CRRs then more information should be gathered upfront, rather than requested down-the-track during the audit. It has been submitted that the benefit of this could include better information capture for large business by knowing in advance what information the ATO is seeking, thereby leading to more timely and open dialogue and taxpayer certainty. The IGT is interested to hear from stakeholders on whether, and in what circumstances, it may make sense to have large businesses disclose more information as part of the income tax return process.

1.10 Given the IGT's relatively recent review of the ATO's administration of GST audits for large taxpayers, this review will focus primarily on income tax audits conducted by the LB&I business line.

TERMS OF REFERENCE

1.11 In accordance with subsection 8(1) of the *Inspector-General of Taxation Act 2003* (IGT Act), the IGT on his own initiative will conduct the following review:

The IGT will examine aspects of the ATO's large business audit and risk review policies, procedures and practices, with a focus on:

- *the ATO's comprehensive and specific issue audits, client risk reviews and related processes and behaviours, including:*
 - *whether audits and risk reviews are finalised within the appropriate timeframes without increasing the level of disputation;*
 - *the ATO's exercise of its information gathering powers (both formally and informally) and whether these powers are being used appropriately and effectively;*
 - *the ATO's application and remission of penalties and interest.*
- *the ATO's audit and risk review product framework and related management, including:*
 - *whether they are meeting taxpayer expectations;*

- *whether the ATO's application of the various risk products is promoting taxpayer certainty, collaboration and the timely resolution of issues and disputes; and*
- *whether certain products (such as client risk reviews) are being employed in a manner that is consistent with the ATO's design and taxpayer expectations and understanding.*
- *Large business' expectations around how audits and risk reviews should be handled so as to promote their timely, efficient and fair resolution.*

AIM OF THE REVIEW

1.12 The IGT will identify issues and make recommendations which, when addressed, should improve the use of ATO's audits and risk review products and framework, including its exercise of its information-gathering powers, and minimise potential adverse impacts on large business. This will include the identification of practices that promote the early resolution of disputes and minimise the costs of compliance.

CONSULTATION PROCESSES

1.13 The IGT will:

- publish a copy of the terms of reference for this review on his website;
- take submissions on this review from members of the public generally, or from particular people or organisations, within the time frame set out below; and
- request the Commissioner of Taxation to provide information and/or documents relevant to this review.

SUBMISSIONS

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

1.15 The closing date for submissions is 31 December 2009. Submissions can be sent by:

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

Fax to: 02 8239 2100

Email to: largebusiness@igt.gov.au

CONFIDENTIALITY

1.16 The IGT is seeking detailed accounts of large businesses experiences in dealing with ATO audits and risk review products. This would greatly assist the IGT in identifying potential systemic issues and allow for the more efficient and effective examination of these

issues. If necessary, submissions may be provided to the IGT in confidence, in which case the information contained in such submissions will not be made available to any other persons including the ATO.

SUBMISSION GUIDELINES

1.17 These guidelines envisage that, broadly, your submissions will be divided into a number of parts.

1.18 At the outset of your submission, it is important to provide a detailed account of specific ATO practices and behaviours that, in your view, impact upon the timely, efficient and effective resolution of an audit or risk review. In addition, the IGT is also seeking examples of positive ATO practices and behaviours that contributed to the timely resolution of an audit or risk review.

1.19 In investigating the ATO's audit and risk review practices and related behaviours, it may be useful to provide a time line of events outlining your key interactions with the ATO including information requests, key meetings, the issuing of position papers and ATO amended assessment (if relevant).

1.20 Any adverse or detrimental impacts of the ATO's audit and risk review practices and behaviours should then be set out and, if possible, quantified. These might include unanticipated tax liabilities raised in amended assessments (including tax, penalties and interest) for prior years, increased compliance costs in dealing with the ATO directly during the audit or increased ongoing compliance costs thereafter and potential restructuring of significant commercial arrangements.

1.21 The submission should list alternative actions, practices or behaviours which, in your view, could have minimised the adverse effects.

1.22 The following is provided to assist you in developing these parts of your submission. It includes a range of questions to assist you in considering issues that have been raised during community consultations.

ATO'S AUDIT AND RISK REVIEW PROCESSES AND BEHAVIOURS

1.23 This review will consider the following:

- how the ATO handles and completes comprehensive and specific issue audits and client risk reviews within the appropriate timeframes;
- how the ATO is exercising its informal and formal information-gathering and access powers during CRRs and audits; and
- the ATO's application and remission of penalties and interest.

ATO's timeframe for completing audits and risk reviews

1.24 Concerns were raised during the consultation process that the ATO does not provide sufficient time for taxpayers to test the factual and evidentiary basis for compliance decisions. It is alleged that the ATO spends a great deal of the two-year period gathering

facts and developing its view before issuing a position paper to the taxpayer. Taxpayers only become aware of the facts relied upon when the position paper is issued and it often relies on incorrect or irrelevant facts or omits important facts altogether. This is also pertinent to how the ATO applies penalties and the facts, evidence and assumptions upon which penalty decisions are based. It was also alleged that taxpayers are usually given no more than 60 days to consider and respond to the position paper.

1.25 Some believed that this practice arises because the ATO relies too heavily on taxpayer bearing the onus of proof. It has been suggested that rather than relying on the burden of proof, the ATO should be required to determine the correct basis for raising the assessment. Alternatively, others suggested that the ATO, during the initial stages of the audit, should determine which facts are relevant to the issues in question and ensure that the facts are tested before applying the law to the facts and developing its technical view with the taxpayer.

1.26 It has been suggested that audits involving multiple or complex issues have the same two-year timeframe but no additional ATO resources. This effectively reduces the time allowed for either the ATO or advisers to consider any one issue, leading to the issuing of a premature amended assessment based on untested facts and evidence. Others believe that the ATO issues lengthy position papers with the expectation that taxpayers respond to each issue. Some stakeholders have indicated that they cannot determine the primacy of issues and, given the limited timeframes for response, are often pressured to be selective about the issues they challenge without being able to assess the relative importance or significance of that issue.

1.27 It has also been suggested that the ATO does not seek to narrow the issues in contention during the audit or risk review process. Often all issues remain on the table until the ATO's final position paper and subsequent issuing of amend assessments. Taxpayers believe that such practices and behaviours do not contribute to the timely resolution of audits and increases the potential for further and more costly disputation.

1.28 One of the aims of this review is to investigate the above allegations and to determine whether the ATO is satisfactorily completing comprehensive and specific issue audits within two years and client risk reviews within six months without increasing the level of disputation.

1.29 The methodology for this review may include:

- selecting a sample of representative comprehensive and specific issue audit cases (those that went on to dispute and those that did not);
- examining the timeframes for critical milestone events (dialogue, the issuing of position papers and the time allowed for taxpayer response); and
- seeing whether these variables influence the likelihood of early resolution.

1.30 The review will consider whether there is any pattern in the type of audits going on to dispute. This will then provide a basis for conclusions to be drawn and recommendations of best practice in the handling of audits in the large market segment.

QUESTIONS FOR CONSIDERATION IN YOUR SUBMISSION

General

- What aspects of the current comprehensive and specific issue audit and risk review processes work well? Why do those processes work well and how have they contributed to the timely resolution of an audit or risk review?
- What aspects of the current audit processes do not work well? Why and how could these be improved?

The quality and timeliness of ATO position papers

- Do you believe that the ATO position papers accurately and succinctly set out the facts and evidence and issues in contention?
- Does the ATO adequately test the facts and evidence set out in its position papers with taxpayers?
- At what stage in the two year audit timeframe has the ATO issued you with a position paper? Has the ATO ever issued you with a position paper just prior to the end of the two-year timeframe? If so, what was the impact on your business?
- What is the usual period of time that the ATO has allowed for you to respond to its position paper? Do you believe that the ATO provides you with sufficient time to respond to its position papers?
- Do you believe that the ATO adequately considers your responses to its position papers? Has the ATO changed its view or approach after considering your responses to its position papers?
- How could position papers be improved?

Level of engagement and interaction

- Did you feel that there was an appropriate level of engagement during the audit or risk review?
- Did you encounter delays caused by a change in ATO personnel dealing with the audit or risk review?
- Did the ATO provide you with updates at key stages of the audit or risk review process?
- If problems arose in the course of an audit or risk review, did you have clear information on the escalation processes? Did you ever have to escalate concerns with the progress of an audit or risk review?
- Has the ATO ever issued you with a premature amended assessment just prior to the end of the two-year timeframe? If so, what were the impacts on your business?
- How could the level of engagement and interaction be improved to promote the more timely resolution of audits and risk reviews?
- It has been suggested by some tax practitioners that the top 50 company's receive disproportionately better ATO service and access to decision-makers than other large corporations. Have you found that the ATO's practices, behaviours and level of engagement differ dependent upon the size of the taxpayer? If so, do you believe that this difference was justified in the particular circumstances?

ATO's exercise of its information gathering and access powers (both formally and informally)

1.31 During the consultation process, it was asserted that the ATO is using its information gathering and access powers in a majority of client risk reviews and comprehensive and specific issue audits. Some argue that very little of this information is actually used in any subsequent litigation. A number of reasons have been suggested for this occurring including information requests that are not well prepared (thereby leading to inconclusive and non-probative answers) are due to the fact that the Commissioner does not have the burden of proof (which lies with the taxpayer).

1.32 It has been submitted that the ATO's information requests are often not well-targeted, with a prevailing culture of asking questions about everything, even on issues which are not under audit. Some stakeholders commented that the associated taxpayer costs of compliance and stress with information requests can be enormous, with nearly \$500,000 in costs in one case alone. Others have said that poorly targeted information requests can lead to taxpayers having to expend significant resources, in terms of staff time and management focus, beyond the associated external costs of compliance. Calls have been made for greater accountability around how the ATO exercises its information gathering and access powers, especially the relevancy and admissibility of the information obtained by the ATO in any subsequent dispute.

1.33 Some have also proposed that the ATO should request more information as part of the income tax return so as to allow for a more targeted audit or risk review focus.

1.34 The review will include an examination of whether the ATO is exercising its information-gathering powers in accordance with its Access and Information Gathering Principles of only using powers where informal requests fail and minimising taxpayer compliance costs. It will also examine the subsequent use of that information and how the ATO assesses the effectiveness of its information requests in finalising audits or client risk reviews.

QUESTIONS FOR CONSIDERATION IN YOUR SUBMISSION

- During an audit or risk review, has the ATO requested you provide information or documents? If so, was this requested first informally (by way of letter)? Was the information-gathering process explained to you?
- Was it made clear how the requested information or documents related to the risks and issues under audit or risk review?
- Did you believe that the ATO's information requests were well-targeted and relevant to the issues under consideration? Please explain your situation?
- Did you feel that the ATO properly explains how the information and documents it requested has been used and relied upon in forming its final view?
- Where an audit went to further dispute (objection or litigation) do you believe that the earlier requested information or documents were relevant or did the ATO make further requests for information or documents?
- Did the ATO seek to minimise compliance costs associated with information requests? What discussions did you have?
- In relation to information requests you have received, what were the associated compliance costs? What impact did it have on your business?
- What steps could the ATO take to minimise taxpayers' compliance costs associated with information requests yet still obtain the necessary information and documents it requires for its audits or risk reviews?
- Have you claimed legal professional privilege or the accountants' concession with respect to an information request? If so, what has been your experiences in terms of the process, interactions with the ATO and costs of maintaining legal professional privilege or the accountants' concession?
- Is the level of information capture as part of a company's income tax return appropriate? Should more information be gathered upfront, and if so, what would be an appropriate trade-off for the associated increased up-front compliance costs?

ATO's application and remission of penalties and interest

1.35 Concerns continue to be raised with the ATO's application of penalties and interest. Some suggest that penalties are still being used as a bargaining tool while others believe that the ATO will apply lack of reasonable care penalties whenever there is a disagreement notwithstanding the merits of the taxpayer's case. Particular disquiet has been noted with the ATO's assessment of whether a reasonably arguable position exists. Many believe that the ATO's administration of this mitigating factor has made it more and more difficult for taxpayers to successfully maintain a reasonable arguable position. Others believe that there is a need for a more independent and objective assessment of penalties and interest following an audit.

1.36 It has also been asserted that the ATO does not adequately consider the reputational risk associated with the ATO applying penalties, especially Part IVA penalties, and the financial duress caused where the disputed primary tax amounts are large.

QUESTIONS FOR CONSIDERATION IN YOUR SUBMISSION

- Has the ATO applied a penalty following the completion of an audit? If so, what was the level of that penalty?
- Did the ATO properly explain the basis for the imposition of the penalty? Did the ATO provide you with a draft penalty decision? If so, did the ATO provide you a reasonable opportunity to provide a response to its draft penalty decision?
- Do you believe that the ATO considered your response in finalising its penalty decision?
- What have been your experiences in seeking to maintain that a reasonably arguable position existed as a mitigating factor in the application of penalties? What type of evidence did the ATO require so as to satisfy it that a reasonably arguable position existed?
- In the event that you subsequently disputed the audit decision, or entered in settlement negotiations, was there a reduction in the level of penalty? If so, did the ATO indicate the basis for that reduction or was it wrapped up as part of settlement or negotiation?

ATO'S AUDIT AND RISK PRODUCTS

1.37 The review will consider other ATO audit and risk review products as part of the wider examination of the ATO's large business audit and risk review practices.

1.38 The ATO has designed a suite of audit and risk review products such as Forward Compliance Arrangements (FCAs), Annual Compliance Arrangements (ACAs), client risk reviews and audits (both comprehensive and specific issue) to assist in improving compliance behaviour and facilitate collaborative tax risk management practices. The content, explanation, orientation and application of these products will have an important bearing on the progress of an audit or risk review.

1.39 During consultations, it was suggested that there may be scope to change the ATO's audit and risk review approaches. Some proposed that the ATO's audit and risk review product framework, and how it is implemented, should be more tailored around the particular taxpayer by taking greater account of its internal risk governance arrangements.

1.40 The IGT is now seeking to better understand large businesses' experiences and their interactions with the ATO in relation to these audit and risk review products including the circumstances that one type of product should be employed over another and the effect this has on taxpayers. Accordingly, the consideration of the following in your submissions would be most useful.

QUESTIONS FOR CONSIDERATION

- Have you been subject to one or more ATO audit or risk review products? If so, which audit or risk review products?
- Did you feel that the nature of the audit or risk review product was explained to you carefully? Was there a clear picture of the key steps, milestone events and outcomes?
- Was there sufficient flexibility in the timetable design to accommodate business requirements?
- Did you feel that you understood the difference between the various ATO products and how the product applied in your circumstances?
- How was the Taxpayers' Charter, and its application in the audit or risk review context, explained to you?
- Were you adequately informed of the type of resources that would be required from you (information requests, access to premises) during the audit or review?
- What was your overall experience in relation to the particular risk product in terms of the ATO engagement, its responsiveness and the alignment of the ATO response with the identified risk?
- Did you feel that the particular audit or risk review product was properly managed by the ATO?
- Did you feel that any changes in the nature of the audit or risk product were adequately explained to you – for instance, moving from a risk review product to an audit product?
- Based on your experience, in what circumstances do you believe the ATO should conduct a comprehensive or specific issue audit and in what circumstances should it offer taxpayers the opportunity to employ one type of product over another? For example, when should a FCA be employed rather than an ACA?
- Are there any barriers to entering into either FCAs or ACAs?
- As ATO clients, what improvements could be made to the ATO's audit and risk review product framework?

APPENDIX 5: ATO RESPONSE



Mr Ali Noroozi
Inspector-General of Taxation
GPO BOX 551
SYDNEY NSW 2001

Dear Ali,

Review into the ATO's large business audit and risk review policies, procedures and practices.

Thank you for providing us with the opportunity to comment on your final draft report on the *Review into the ATO's large business audit and risk review policies, procedures and practices*.

Acknowledgements

At the outset I acknowledge and thank you for the collaborative manner in which you have conducted this review. Our involvement with the working group of key practitioners and taxpayer representatives which you established has helped to inform our understanding of taxpayer perceptions and ways to address these perceptions.

General observations

I am pleased to note that stakeholders generally acknowledged a significant improvement in ATO interactions with taxpayers, including greater professionalism and diligence amongst our officers. I also observe that you considered the procedures and practices we have put in place in recent years have had a positive impact on finalising cases in a timely manner.

The *Large business and tax compliance* (LBTC) booklet establishes a high standard of mutual expectations and behaviour for both the ATO and taxpayers and is the flagship document setting out our approach to large market compliance. I am encouraged by your comments that the underlying principles in the booklet are positive and aimed at making risk reviews and audits more efficient and co-operative.

We agree with your observations on the importance of living out the LBTC booklet expectations in our casework. I am passionate to ensure that this occurs. In this regard, we are continuing to enhance our internal policies and processes to reinforce those expectations. I observe that you also acknowledge the significant efforts we have made to introduce enhanced assurance processes. These are critical for us in understanding how we are performing against our commitments in the booklet and identifying areas for further improvement.

We do not always agree with the perceptions and views of stakeholders canvassed in your report, but acknowledge that these are the views as expressed in their

submissions. We appreciate that you have also included commentary that is intended to reflect our perspective on some of these matters. Many of the stakeholder assertions are not consistent with the generally very positive feedback we receive in our Client Feedback Questionnaires and other stakeholder forums.

This suggests that a number of single case examples in the report are, in our view, not representative of the experience the broader large market population can expect in an audit or risk review.

We acknowledge that there is always room for improvement. We understand that not every taxpayer's experience reflects the high standard and aspirations in the LBTC booklet and sometimes the approach of taxpayers and their advisers does not meet these standards and expectations. I note you have made a number of recommendations that will help us to make improvements, building on the achievements of recent years.

ATO Response to Inspector-General's recommendations

Our responses to your specific recommendations are at Attachment 1. I understand that you will include these under the relevant recommendation in your final report.

In summary, of your twenty-eight recommendations we agree with twenty-two in full and with two in principle, and one in part. There are three recommendations where we do not agree.

In keeping with the focus of this review, where we have agreed to a recommendation, we do so in respect of the policies, practices and processes for large market income tax compliance.

We also note your observations about the potential for future review of policy arrangements and law for active compliance work, including the statutory processes for use of the ATO's powers of access. These are matters for Government.

Thank you again for the opportunity to comment on your report on this review.

Yours sincerely,



Bruce Quigley
Second Commissioner, Compliance

21 April 2011

APPENDIX 6: ABBREVIATIONS

AAT	Administrative Appeals Tribunal
AGS	Australian Government Solicitor
ABS	Australian Bureau of Statistics
ANAO	Australian National Audit Office
ATO	Australian Taxation Office
BAS	Business Activity Statement
CoE	Centre of Expertise
Commissioner	Commissioner of Taxation
FBT	Fringe Benefits Tax
GIC	General Interest Charge
GST	Goods and Services Tax
IGT	Inspector-General of Taxation
IGT Act	<i>Inspector-General of Taxation Act 2003</i>
IQF	Integrated Quality Framework
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
LB&I	Large Business & International
LPP	Late Payment Penalty
MEI	Micro Enterprises & Individuals
NTLG	National Tax Liaison Group
PAYG	Pay As You Go
PS	Practice Statement
SES	Senior Executive Service
SGC	Superannuation Guarantee Charge

SIC	Shortfall Interest Charge
SME	Small to Medium Enterprises
SMSF	Self-Managed Superannuation Fund
SNC	Serious Non-Compliance
TAA 1953	<i>Taxation Administration Act 1953</i>
TCN	Tax Counsel Network
TFN	Tax File Number