Australian Government

Inspector-General of Taxation

Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution

A report to the Assistant Treasurer

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May 2012

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25 May 2012

The Hon. David Bradbury MP
Assistant Treasurer and Minister Assisting for Deregulation
Parliament House
Canberra ACT 2600

Dear Minister

Review into the ATO's use of Early and Alternative Dispute Resolution

I am pleased to present you with my report of the review into the Australian Taxation Office's (ATO's) use of early and alternative dispute resolution (ADR). This review arose following stakeholder concerns that the ATO was not making sufficient use of dispute resolution opportunities. The Commissioner also requested that I undertake this review.

Given the complexities inherent in the tax system, some level of disputation may be unavoidable on tax technical matters. In the 2010-11 financial year, the ATO reported 434,000 active compliance activities with liability adjustments and some 17,400 objections in relation to income tax. In viewing these statistics, it is important to appreciate that a significant portion of the 434,000 may be small adjustments resulting from data matching activities which do not often lead to dispute.

While stakeholders accept that there will be occasions where disputes arise, they contend that the vast majority of disputes should be capable of resolution without resort to formal channels such as the objection and litigation processes. Indeed, statistics provided by the Administrative Appeals Tribunal show that approximately 90 per cent of applications for review in tax matters are resolved prior to hearing. This suggests significant opportunity for greater engagement to resolve disputes and reduce unnecessary costs for taxpayers and the ATO alike.

The review attracted strong interest with submissions received from a broad range of stakeholders including taxpayers, tax practitioners and their representative bodies, dispute resolution experts and members of the judiciary. Additionally, having regard to the Federal Government's broader strategic framework for access to justice, the relevant staff at the Attorney-General's Department and members of the National Alternative Dispute Resolution Advisory Council (NADRAC) have been consulted.

During the investigation I observed that, at a high level, the ATO is committed to engaging with taxpayers to resolve disputes earlier. I have noted some examples in which the ATO's early engagement and appropriate use of ADR has assisted to resolve matters in dispute either wholly or partly without the need for litigation.

However, and notwithstanding the ATO's high level commitment, a number of the cases raised in submissions, and which were examined in this review, indicate a variance in the taxpayer experience when seeking to engage with the ATO to resolve disputes.

Some concerns raised in earlier reviews were again brought to my attention in this review. A common theme seems to be a perceived lack of independence in the objection process, particularly in relation to larger more complex matters. I have sought to address this, in line with my submission to the 2011 Federal Government's Tax Forum, by proposing that the ATO pilot a separation of its objection and litigation functions from its audit function in the management of its most complex disputes.

I have identified a number of other opportunities for improvement aimed at encouraging and empowering earlier engagement to reach a common understanding of the issues in dispute and the most appropriate means of resolving any such dispute. A key aspect is ensuring that all parties possess the necessary information to understand the issues in dispute and the different techniques and practitioners available to assist in resolving those issues.

In total, twenty-two recommendations have been made. The ATO has agreed in full with fourteen, agreed in part with four, agreed in principle with two and disagreed with one. The remaining recommendation (recommendation 5.5) is directed at government.

The effective implementation of the agreed recommendations should result in significant improvements in the way the ATO seeks to resolve tax disputes. However, given the disagreement on one major recommendation and the partial or qualified response to a number of other recommendations, the impact of this report and its recommendations may not be fully realised.

I offer my thanks for the support and contribution of professional bodies, industry associations, taxation practitioners, dispute resolution experts, members of the judiciary and individuals to this review. The willingness of many to provide their time, expertise and experience 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 as well as officers of other Government agencies such as the Attorney-General's Department and NADRAC.

Yours faithfully

Ali Noroozi
Inspector-General of Taxation

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EXECUTIVE SUMMARY

The Inspector-General of Taxation's (IGT) review into the Australian Taxation Office's (ATO) use of early and alternative dispute resolution (ADR) was prompted by a number of concerns raised by stakeholders that, notwithstanding the ATO's high level commitment to earlier engagement with taxpayers to resolve disputes, at a practical level, the ATO was not making sufficient use of dispute resolution opportunities, instead preferring taxpayers to progress disputes through formal channels such as those outlined in Part IVC of the *Taxation Administration Act 1953*.

The Commissioner of Taxation also requested that the IGT undertake this review.

The review received a high level of interest and the IGT received over forty written and oral submissions from a broad range of stakeholders including taxpayers, tax practitioners and their representative bodies, dispute resolution experts and members of the judiciary. During the conduct of the review, the IGT was mindful of the Federal Government's strategic framework for access to justice which, amongst other things, seeks to encourage a shift in the community and federal agencies towards a resolution culture.

The IGT recognises the ATO's current work program to enhance its dispute resolution framework. These include its Integrated Approach to Dispute Resolution and the Transforming Tax Technical Decision Making project which seek to engage ATO senior staff earlier in the compliance process to enhance the robustness of ATO technical decisions in the first instance and to resolve any disputes which may arise as close to the original decision as possible. These together with discussion of other ATO initiatives are outlined in Chapter 2.

The report notes that a large portion of matters brought to litigation, particularly in the Administrative Appeals Tribunal (AAT), are resolved prior to hearing. Statistics provided by the AAT show that approximately 90 per cent of matters are resolved without hearing and further statistics from the ATO show that many of these are resolved as a result of new or additional information being identified. Such statistics suggest a significant opportunity for earlier resolution of tax disputes through better information exchange and engagement including the use of ADR.

The report found that in some instances, the ATO's dispute resolution processes worked well, with senior staff appropriately engaged, issues identified and ADR processes employed to address and resolve specific cases. However, in other cases, some taxpayers' experiences appeared to be varied with officers appearing uncertain of their ability or authority to engage in discussions with taxpayers to address concerns and resolve disputes early in the process.

The IGT has made twenty-two recommendations, all but one (Recommendation 6.1) of which are broadly aimed at:

- Ensuring the ATO and the taxpayer engage earlier to ascertain and agree on those matters that are agreed and those that remain in contention;
- Streamlining of information exchange between the parties to ensure that the matters in dispute are understood;
- Ensuring clear escalation channels to appropriate ATO personnel to engage in dispute resolution processes;

- Bringing early engagement and ADR to the forefront of ATO dispute resolution efforts and only litigating cases which turn on genuine and fundamental disputes as to law and where there is a public benefit in having the matters judicially determined;

- Enhancing the skills and understanding of both ATO staff and taxpayers of the different types of engagement available in ADR and the circumstances in which these may be appropriate through increased training and publication of information respectively; and

- Identifying opportunities for continuous improvement through implementing processes to enable feedback to be provided regarding the use of ADR in the tax dispute context.

The final recommendation (Recommendation 6.1) is aimed at addressing the perceived lack of independence in the objection process and empowering the ATO's in-house legal services function to assess matters independently of the audit arm and determine, on the facts and evidence, whether a matter should be abandoned, otherwise settled or proceed through to litigation. These concerns were raised in the course of this review as well as in earlier reviews and the IGT's submission to the 2011 Federal Government's Tax Forum (the 'Tax Forum Submission').

The IGT notes in the report that while the ATO still enjoys higher rates of success than taxpayers in the AAT, this was not as pronounced in the Federal Court where there was a clear downward trend. In the High Court, statistics gathered and analysed by the IGT showed that since its last favourable outcome in a tax technical dispute in July of 2008, the ATO has been involved in ten other tax technical matters, with only one judgment delivered in its favour.

The IGT seeks to address these concerns, amongst others, in Recommendation 6.1, as a prelude to the relevant recommendation in the Tax Forum Submission. Broadly, Recommendation 6.1 proposes that the ATO undertake a pilot separation of its objection and litigation functions from its audit function in the management of its most complex disputes.

The ATO has disagreed with the above recommendation. However of the twenty-two recommendations made in this report, the ATO has agreed in full with fourteen recommendations, agreed in part with four, agreed in principle with two and disagreed with one. The remaining recommendation was directed at government.

CHAPTER 1 — INTRODUCTION

CONDUCT OF THE REVIEW

1.1 This is the Inspector-General of Taxation's (IGT) report of his review into the Australian Taxation Office's (ATO) use of early and alternative dispute resolution (ADR). The report is produced pursuant to section 10 of the *Inspector-General of Taxation Act 2003* (IGT Act 2003).

1.2 This review was commenced, pursuant to subsection 8(1) of the IGT Act 2003, following concerns expressed during consultation on the IGT's forward work program which was announced in April 2011. Notwithstanding the ATO's high level commitment to enhancing its dispute resolution framework to resolve tax disputes at an earlier point in time, it was asserted that in practice ATO officers were still reluctant to engage with taxpayers to resolve tax disputes instead preferring taxpayers to challenge decisions through formal channels such as those set out in Part IVC of the *Taxation Administration Act 1953* (TAA 1953).

1.3 Stakeholder submissions to the IGT noted that a lack of understanding of dispute resolution techniques on the part of officers at various levels within the ATO, the inability to depart from established procedures and policies in appropriate cases and senior officers not being involved until late in the dispute process all contributed to foregone opportunities for the ATO and taxpayers to address issues in a timely and cost-effective manner without resort to litigation.

1.4 The Commissioner of Taxation (the Commissioner) also requested that the IGT consider undertaking this review pursuant to paragraph 8(3)(b) of the IGT Act 2003.

1.5 Terms of reference for this review were announced on 26 July 2011. Appendix 1 reproduces a copy of the terms of reference and submission guidelines for this review.

1.6 The IGT received a wide range of submissions from a very diverse stakeholder group. The IGT met with interested taxpayers, tax practitioners and their respective representatives bodies as well as legal experts and practitioners across the dispute resolution spectrum.

1.7 The IGT review team spoke with ATO staff involved in litigation to obtain a qualitative understanding of the factors which assist to resolve matters without resort to litigation. In addition, the IGT examined case documents from the ATO's enterprise case management system — Siebel — as well as those specifically requested and provided by ATO staff.

1.8 The IGT also worked progressively with ATO senior management to distil the areas for improvement and to agree on specific actions. The IGT discussed these matters with interested external stakeholders, including members of the National Alternative Dispute Resolution Advisory Council (NADRAC) and the Attorney-General's Department.

1.9 In accordance with section 25 of the IGT Act 2003, the Commissioner was provided with an opportunity to make submissions on any implied or actual criticisms contained in this report.

STRUCTURE OF THE REPORT

1.10 The remainder of hapter 1 defines ADR, considers the current federal government framework and initiatives driving ADR as well as international approaches to dispute resolution.

1.11 The rest of the report is structured as follows:

- Chapter 2 outlines the ATO's current work program in relation to dispute resolution and a number of initiatives which have been implemented or will be implemented in the coming months;
- Chapter 3 examines ways in which the ATO may enhance its early engagement capability with the aim of identifying and addressing issues as and when they arise during the compliance process;
- Chapter 4 discusses when ADR may be appropriate and how it should be initiated;
- Chapter 5 looks at different types of ADR and different types of ADR practitioners and considers when each may be appropriate in a given taxation dispute. This chapter will also outline the need for establishing clear rules of engagement between the ATO and taxpayers when participating in ADR; and
- Chapter 6 examines stakeholder concerns regarding the independence of the ATO's management of objections, its conduct of litigation and the merits of establishing a structural and procedural separation between the ATO's audit and objection/litigation functions.

WHAT IS ADR AND EARLY DISPUTE RESOLUTION?

1.12 ADR is a broad term. It may be used to describe a process involving an impartial person (the ADR practitioner) who assists the parties to resolve issues between them through means other than litigation. On the other hand it can encompass techniques and approaches to prevent and manage disputes without a third party's intervention.[1]

1.13 Throughout this report, where 'ADR' is used the IGT is referring to those processes in which an ADR practitioner is retained to assist the parties to arrive at a negotiated outcome, unless the specific context suggests otherwise or the where the IGT expressly expands the definition.

---

1 National Alternative Dispute Resolution Advisory Council (NADRAC), *National Principles for Resolving Disputes and Supporting Guide*, Canberra, April 2011, viewed on 1 February 2012, <www.nadrac.gov.au>, p. 65.

1.14 Early dispute resolution 'is the concept and process of intervention in the formal dispute process to resolve that dispute early, effectively and legitimately.'[2] It aims to:[3]

- prevent unnecessary disputes;
- reduce the frequency and severity of disputes; and
- ensure that early effective and legitimate resolution of disputes takes place.

1.15 Early dispute resolution is sometimes abbreviated to 'EDR'. However, as the use of the acronym 'EDR' may cause some confusion with External Dispute Resolution processes,[4] the IGT has not used this acronym in the report, other than where it is a direct quote from a reference document.

FEDERAL GOVERNMENT INITIATIVES

1.16 In 2009, the Federal Government released the Access to Justice Taskforce's report, *A Strategic Framework for Access to Justice in the Federal Civil Justice System*,[5] and adopted its central recommendations for a strategic framework to 'guide consideration of future justice reforms and decisions about resourcing to ensure that the justice system is accessible and appropriate.'[6]

1.17 The strategic framework comprises five principles for access to justice policy-making and methodology to translate the principles into practice.[7] One of the methodologies is to ensure that there are clear pathways to fair and equitable outcomes through, amongst other things, a culture change to focus on dispute prevention and resolution and greater use of ADR.[8]

1.18 In line with the strategic framework, the government has sought to drive a cultural change towards earlier and more effective use of dispute resolution techniques other than litigation. The former Commonwealth Attorney-General, the Honourable Robert McClelland MP, in particular voiced his desire for 'ADR to be seen as built into the fabric of our system of justice' and his encouragement of 'government agencies to move to a "resolution culture".'[9]

1.19 To facilitate this desired cultural shift towards more active and earlier resolution of disputes on the part of government agencies, the federal government has undertaken a number of initiatives including amendments to the Legal Services Directions 2005 (LSD

---

2 Law Society of New South Wales, *Early Dispute Resolution (EDR) Task Force Report*, Sydney, 1998, viewed 27 June 2011, <www.lawsociety.com.au>, p. 4.
3 ibid., p. 5.
4 See for example: Financial Service Ombudsman Limited <http://fos.org.au> and Credit Ombudsman Service Limited <www.cosl.com.au>.
5 Attorney-General's Department, *A Strategic Framework for Access to Justice in the Federal Civil Justice System*, Canberra, 2009, viewed 10 November 2011, <www.ag.gov.au>.
6 ibid., p. 61.
7 ibid., p. 62.
8 ibid., p. 64.
9 R. McClelland MP, Attorney-General, Speech delivered at the ADR in Government Forum, 4 June 2008, Canberra, viewed on 21 June 2011, <www.attorneygeneral.gov.au>.

2005)[10] and the enactment of the *Access to Justice (Civil Litigation Reforms) Amendment Act 2009* (AJCLRA Act 2009) and the *Civil Dispute Resolution Act 2011* (CDRA 2011) to direct the Commonwealth and private litigants to consider options, including ADR, to resolve disputes prior to commencing litigation.

1.20 Another initiative is the proposed amendment of the *Administrative Appeals Tribunal Act 1975* (the AAT Act 1975) in the form of the Access to Justice (Federal Jurisdiction) Amendment Bill 2011 to 'enable regulations to be made to empower the Administrative Appeals Tribunal (the AAT) to impose fees on government agencies that unsuccessfully appeal or defend decisions in proceedings in the AAT.'[11]

Access to Justice (Civil Litigation Reforms) Amendment Act 2009 (AJCLRA Act 2009)

1.21 The enactment of the AJCLRA Act 2009 demonstrates a concerted effort on the part of government to effect a cultural change in the conduct of litigation so that, at the same time as resolving disputes justly, the following considerations are at the forefront:[12]

- focussing the Court, parties and their lawyers' attention on resolving disputes as quickly and cheaply as possible;
- reducing the costs of litigation;
- allocating resources in proportion to the complexity of the issues in dispute;
- avoiding unnecessary delays; and
- management of the Court's judicial and administrative resources as efficiently as possible.

1.22 Central to the reforms is the addition of sections 37M (the overarching purpose) and 37N into the *Federal Court of Australia Act 1976* (FCA Act 1976).

1.23 Relevantly, subsection 37M(1) of the FCA Act 1976 states:

> 37M (1) The overarching purpose of the civil practice and procedure provisions is to facilitate the just resolution of disputes:
>
> (a) according to law; and
>
> (b) as quickly, inexpensively and efficiently as possible.

1.24 Subsections 37N(1) and 37N(2) of the FCA Act 1976 provide:

> 37N (1) The parties to a civil proceeding before the Court must conduct the proceeding (including negotiations for settlement of the dispute to which the proceeding relates) in a way that is consistent with the overarching purpose.
>
> 37N (2) A party's lawyer must, in the conduct of a civil proceeding before the Court (including negotiations for settlement) on the party's behalf:
>
> (a) take account of the duty imposed on the party by subsection (1); and
>
> (b) assist the party to comply with the duty.

---

10 Justice M. Kellam, Welcome Address to the ADR in Government Forum, 4 June 2008, Canberra, viewed on 21 June 2011, <www.nadrac.gov.au>, p. 2.

11 Explanatory memorandum, Access to Justice (Federal Jurisdiction) Amendment Bill 2011, p. 66.

12 Explanatory Memorandum, Access to Justice (Civil Litigation Reforms) Amendment Bill 2009, p. 3.

1.25 The Court may impose adverse costs orders against a litigating party or their lawyer, personally, pursuant to section 43 of the FCA Act 1976, for a failure to conduct matters in a way which is timely, efficient, economical and in line with the overarching purpose.[13]

1.26 These reforms impact on all users of the Federal Court of Australia (Federal Court), including the ATO as one of the largest users of the Federal Court system. In particular, while the provisions do not prescribe what the parties and their representatives must do to ensure they act consistently with the overarching purpose, the explanatory memorandum to the Access to Justice (Civil Litigation Reforms) Bill 2009 provides examples of conduct which may be inconsistent and therefore in breach of the duty imposed by section 37N. These include:[14]

- unreasonably refusing to participate in conciliation, mediation, arbitration or other alternative dispute resolution opportunities, because alternative dispute resolution provides a mechanism for the parties to resolve their dispute early, quickly and cheaply;
- failing to act in good faith in attempting to resolve or narrow issues in the proceedings;
- unreasonably rejecting an offer of settlement of part or whole of the proceeding; or
- pursuing issues in the proceeding that had no reasonable prospect of success. This might include issues that were vexatious or frivolous.

Civil Dispute Resolution Act 2011 (CDRA 2011)

1.27 In 2011, the government enacted the CDRA 2011 which came into operation on 1 August 2011. The CDRA 2011 gives effect to a number of recommendations made by NADRAC in its 2009 report, *The Resolve to Resolve – Embracing ADR to improve access to justice in the federal jurisdiction* (NADRAC's 2009 report).[15]

1.28 Specifically, the overall aims of the CDRA 2011 are to:[16]

- change the adversarial culture often associated with disputes;
- have people turn their minds to resolution before becoming entrenched in a litigation position; and
- ensure that if a matter does progress to court, the issues are properly identified, ultimately reducing the time required for a court to determine the matter.

1.29 The CDRA 2011 applies to all proceedings instituted in either the Federal Court or Federal Magistrates Court, except those which have expressly been excluded.[17] Sections 6 and 7 require:

> **6** An applicant who institutes civil proceedings in an eligible court must file a genuine steps statement at the time of filing the application.

---

13 *Modra v State of Victoria* [2012] FCA 240.
14 ibid., para. 30.
15 NADRAC, *The Resolve to Resolve – Embracing ADR to improve access to justice in the federal jurisdiction,* 2009, Canberra, September 2009, viewed on 27 June 2011, <www.nadrac.gov.au>.
16 ibid., p. 4.
17 Part 4 of the *Civil Dispute Resolution Act 2011* (CDRA 2011).

> **7** A respondent in proceedings who is given a copy of a genuine steps statement filed by an applicant in the proceedings must file a genuine steps statement before the hearing date specified in the application.

1.30 Subsection 4(1A) of the CDRA 2011 provides that a person takes a genuine step to resolve a dispute 'if the steps taken by the person in relation to the dispute constitute a sincere and genuine attempt to resolve the dispute, having regard to the person's circumstances and the nature and circumstances of the dispute.'

1.31 Without limiting the scope of 'genuine steps', the CDRA 2011 relevantly provides by way of example that such steps may include 'considering whether the dispute could be resolved by a process facilitated by another person, including an alternative dispute resolution process'. Further, '[i]f such a process is conducted but does not result in resolution of the dispute [then] consider … a different process', such as 'attempting to negotiate with the other person, with a view to resolving some or all the issues in dispute, or authorising a representative to do so.'[18]

1.32 Taxation disputes are generally conducted under Part IVC of the TAA 1953, which provides taxpayers with rights of review to certain ATO decisions. As the Act empowers taxpayers to initiate the exercise of these rights, at first instance, the Commissioner will be the respondent in either the AAT or the Federal Court. Notwithstanding this, as a participant in the litigation, the ATO's conduct will nonetheless be governed by the requirements of both the AJCLRA Act 2009 and the CDRA 2011.

1.33 The CDRA 2011, together with the AJCLRA Act 2009, further supports the desired 'cultural change in civil dispute resolution from adversarial litigation.'[19]

Legal Services Directions 2005 (LSD 2005)

1.34 As an agency under the *Financial Management and Accountability Act 1997*, the ATO is bound by the LSD 2005 and the Commonwealth's obligation to act as a model litigant (outlined in appendix B to the LSD 2005).[20]

1.35 Specifically, the obligation to act as a model litigant in the handling of claims and litigation requires Commonwealth agencies to act fairly and honestly by, *inter alia*:

> 2(d) endeavouring to avoid, prevent and limit the scope of legal proceedings wherever possible, including by giving consideration in all cases to alternative dispute resolution before initiating legal proceedings and by participating in alternative dispute resolution processes where appropriate.
>
> 2(e) where it is not possible to avoid litigation, keeping the costs of litigation to a minimum, including by:
>
> (i) not requiring the other party to prove a matter which the Commonwealth or the agency knows to be true;
>
> (ii) not contesting liability if the Commonwealth or the agency knows that the dispute is really about quantum;

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18 See paragraphs 4(1)(d), (f) and (g) of the CDRA 2011, respectively.
19 Explanatory Memorandum, Civil Dispute Resolution Bill 2010, p. 3.
20 Attorney-General's Department, *Legal Services Directions 2005*, Canberra, 2005, viewed on 20 June 2011, <www.ag.gov.au>.

(iii) monitoring the progress of the litigation and using methods that it considers appropriate to resolve the litigation, including settlement offers, payments into court or alternative dispute resolution; and

(iv) ensuring that arrangements are made so that a person participating in any settlement negotiations on behalf of the Commonwealth or an agency can enter into a settlement of the claim or legal proceedings in the course of the negotiations.[21]

1.36 Additionally, paragraphs 5.1 and 5.2 of the model litigant obligation require:[22]

5.1 The Commonwealth or an agency is only to start court proceedings if it has considered other methods of dispute resolution (for example, alternative dispute resolution or settlement negotiations).

5.2 When participating in alternative dispute resolution, the Commonwealth and its agencies are to ensure that their representatives:

(a) participate fully and effectively; and

(b) subject to paragraph 2 (e) (iv), have authority to settle the matter so as to facilitate appropriate and timely resolution of a dispute.

1.37 In line with recommendation 8.4 of NADRAC's 2009 report,[23] the former Attorney-General also indicated his intention to amend the LSD 2005 'to require agencies, unless an exemption is obtained, to develop and regularly review dispute management plans requiring appropriate use of ADR.'[24]

Access to Justice (Federal Jurisdiction) Amendment Bill 2011

1.38 As mentioned earlier, the government recently proposed a new sub-section to be added to section 70 of the AAT Act 1975 which would empower the AAT to impose fees on government agencies that unsuccessfully appeal or defend proceedings in the AAT.

1.39 The explanatory memorandum notes that:[25]

The purpose of this fee is to provide a financial incentive to promote better primary decision making and early resolution of issues where possible. It is envisaged that, under the regulations, the Tribunal will have the discretion not to impose the fee where a government agency had compelling reasons to proceed to a hearing. Examples of such situations include where new information is provided at the hearing that was not available to the primary decision maker.

1.40 The bill further reinforces the government's commitment to instilling a dispute resolution culture and reaffirms the obligation of all federal agencies to seek alternate means of resolving disputes before initiating or progressing litigation.[26]

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21 ibid.
22 ibid., p. 25.
23 NADRAC, above n. 15, p. 120; Australian Law Reform Commission, *Managing Justice*, ALRC Report 89 (2000) Recommendation 69, p. 478.
24 R. McClelland MP, Attorney-General, *Model Dispute Management Plan for Agencies*, Terms of Reference, Canberra, 1 December 2009, viewed on 1 February 2012, <www.nadrac.gov.au>.
25 Above n. 11.
26 On 29 March 2012, the Senate Legal and Constitutional Affairs Legislation Committee recommended that the Senate pass the Bill. See: Senate Legal and Constitutional Affairs Legislation Committee, *Access to Justice (Federal Jurisdiction) Amendment Bill 2012 [Provisions]*, March 2012, Canberra, viewed on 20 April 2012, <www.aph.gov.au>, p. vii.

INTERNATIONAL APPROACHES TO DISPUTE RESOLUTION

1.41 The federal government's initiatives generally accord with international efforts to embed a culture of dispute resolution rather than litigation in the public service.[27] 'With companies and government increasingly seeking to reduce costs and streamline processes, tax litigation holds less and less appeal; there is a growing recognition on both sides that an alternative approach to resolving disputes is needed.'[28]

1.42 Moreover, the need to maintain working relationships after a dispute is resolved has led to revenue authorities implementing initiatives to address tax disputes outside of litigation.[29]

1.43 Internationally, a number of different initiatives to resolve tax disputes without litigation have been identified. For example, in 2001, the US Internal Revenue Service (IRS) launched the Fast Track Settlement (FTS) process for large corporate taxpayers. Briefly, the FTS involves negotiations between the IRS and large taxpayers which are facilitated by an officer from the Office of Appeals, an independent dispute resolution unit within the IRS. The program has seen significant success with 86 per cent of cases being resolved and the appeal timeframes being reduced from 684 days to 84.[30] The IRS also has a number of other initiatives aimed at resolving disputes early including Fast Track Mediation, Early Referral and Post Appeals Mediation.[31]

1.44 Similarly, the New Zealand Inland Revenue Department's (IRD) structured approach mandates a conference between the IRD and the taxpayer where the IRD does not accept the taxpayer's contentions in response to a Notice of Proposed Adjustment. The purpose of the conference is to enable the parties to 'identify and clarify facts and issues and allow any disputed facts to be resolved. A conference provides an opportunity for the parties to state the facts and define the issues clearly and concisely.'[32]

1.45 As will be discussed in Chapter 3, the United Kingdom's Her Majesty's Revenue and Customs (HMRC) agency recently launched two dispute resolution pilots aimed at resolving large and complex cases and disputes involving small and medium enterprises through facilitated discussions (and ADR, if necessary) without resort to litigation.

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27 See, for example, Ministry of Justice and Attorney General's Office, *The Dispute Resolution Commitment*, London, May 2011, viewed on 20 July 2011, <www.justice.gov.uk>.

28 Ernst & Young, *Tax Dispute Resolution: A New Chapter Emerges*, 2010, viewed on 12 July 2011, <www.ey.com>, p. 4.

29 Organisation for Economic Cooperation and Development (OECD), *Study into the role of tax intermediaries*, 2008, viewed on 13 July 2011, <www.oecd.org>, p. 74.

30 ibid., p. 75.

31 S. Thomas, 'Overview of ADR Options at the IRS', *Journal of Consumer and Commercial Law*, Vol. 10, No. 3, pp. 126 – 129.

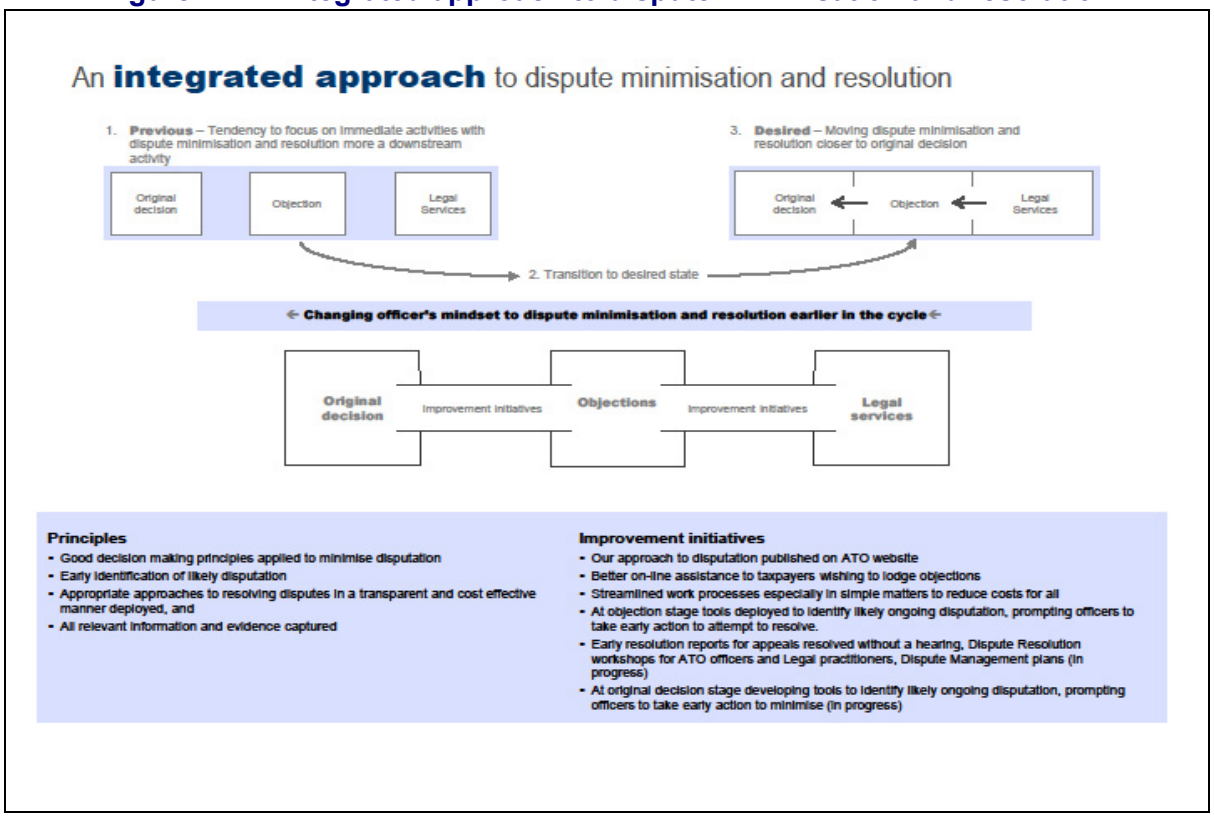
32 Inland Revenue Department, *Disputing a Notice of Proposed Adjustment*, Wellington, January 2011, viewed 2 February 2012, <www.ird.govt.nz>, p. 7.

CHAPTER 2 — THE ATO'S CURRENT WORK PROGRAM IN RELATION TO ADR

2.1 The ATO has recognised that ADR has generally been employed during litigation[33] rather than being addressed earlier during the audit or objection stages. In other forums, the ATO has noted that 'in the past, the ATO had tended to focus on immediate activities, and therefore dispute resolution was seen as more of a downstream process.'[34]

2.2 Following a number of the IGT reviews, for example the *Review into the underlying causes and management of objections to Tax Office decisions*[35] (the Objections review), which called for an end-to-end approach to resolution of disputes, the ATO has embarked on a program of work to implement such an integrated system, seeking to avoid litigation and resolve disputes as close to the original decision as possible (see the figure below).

Figure 1: An integrated approach to dispute minimisation and resolution



33 M. D'Ascenzo, *In Search of Solutions,* speech delivered to the Administrative Appeals Tribunal and the ACT Bar Association seminar: 'The obligation to assist: model litigants in Administrative Appeals Tribunal Proceedings', 26 August 2009, viewed on 1 October 2011, <www.ato.gov.au>.

34 Australian Taxation Office, *Micro Business Partnership Minutes*, 3 August 2011, viewed on 1 February 2012, <www.ato.gov.au>.

35 Inspector-General of Taxation, *Review into the Underlying Causes and Management of Objections to Tax Office Decisions*, 11 August 2009, <www.igt.gov.au>.

2.3 The driving principles underlying the ATO's integrated approach are:[36]

- good decision making principles applied to minimise disputation;
- early identification of likely disputation;
- appropriate approaches to resolving disputes in a transparent and cost effective manner deployed; and
- all relevant information and evidence captured.

2.4 As part of its work to implement the integrated approach, the ATO is looking to implement the following initiatives:[37]

- our approach to disputation published on the ATO website;
- better on-line assistance to taxpayers wishing to lodge objections;
- streamlined work processes especially in simple matters to reduce costs for all;
- at objection stage tools deployed to identify likely ongoing disputation, prompting officers to take early action to attempt to resolve;
- early resolution reports for appeals resolved without a hearing, Dispute Resolution workshops for ATO officers and Legal practitioners, Dispute Management Plan (in progress); and
- at original decision stage developing tools to identify ongoing disputation, prompting officers to take early action to minimise (in progress).

2.5 The ATO has also developed and is implementing a number of improvements and initiatives to encourage and enhance the use of dispute resolution techniques throughout its compliance process. These are discussed below.

ATO POLICIES AND PUBLICATIONS

Practice Statement *PS LA 2007/23*

2.6 Practice Statements are issued by the ATO to 'provide direction and assistance to staff on the approaches to be taken in performing duties involving the application of the laws administered by the Commissioner.'[38] It is mandatory for ATO staff to search for, and follow, any practice statements which may be relevant for their work. A failure to do so may result in disciplinary action under the *Public Service Act 1999*.[39]

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36 Australian Taxation Office, *An integrated approach to dispute minimisation and resolution*, copy provided by the ATO to the IGT. This is generally reflected in the ATO approach to dispute resolution webpage which appears on www.ato.gov.au.

37 ibid.

38 Australian Taxation Office, *Practice Statement PS LA 1998/1 Law Administration Practice Statements*, Canberra, 21 May 2009, viewed on 5 April 2012, <www.ato.gov.au>, para. 1.

39 ibid., para. 6.

2.7 Practice Statement PS LA 2007/23 *Alternative Dispute Resolution in ATO Disputes and Litigation* (PS LA 2007/23)[40] contains the ATO's published view on its approach to ADR (including direct negotiation between the ATO and the taxpayer).

2.8 PS LA 2007/23 states that 'the ATO recognises and supports the use of Alternative Dispute Resolution (ADR) in appropriate cases as a cost effective, informal, consensual and speedy means of resolving disputes.'[41] It further states that while 'not all cases are suitable for ADR … for those that are, it is essential that parties make an informed consideration and select a process which is suited to the circumstances and nature of the dispute.'[42]

2.9 Specifically, the practice statement instructs ATO officers that:

> Officers playing a role in the management of ATO disputes particularly those in litigation must consider whether it would be appropriate to participate in some form of ADR to attempt to resolve the dispute. In doing so officers must have regard to the circumstances of the case, applicable law and relevant ATO policies, the attitude of the other party to ADR and the attitude of the relevant court or tribunal if in litigation.[43]

2.10 The practice statement generally observes that the hallmarks of when ADR may be appropriate are as follows:[44]

- there must be issues that are able to be negotiated;
- the ATO has something to give;
- the taxpayer/other party has something to give;
- the dispute is capable of being settled within existing settlement policies and practices; and
- settlement must be preferable to judicial determination.

2.11 PS LA 2007/23 also outlines the instances in which the ATO considers that ADR is not appropriate. This will be further discussed in Chapter 4.

2.12 Other matters addressed by the practice statement include the use of ADR in different forums such as the AAT, the Federal Court, Federal Magistrates Court and the State courts.

The ATO Code of Settlement Practice

2.13 The ATO's Code of Settlement Practice 'provides guidelines on the settlement of taxation disputes in relation to all taxpayers. It provides guidance as to the situations in which settlement could be considered and outlines the processes which should be followed.'[45] It also assists in ensuring that 'settlements of taxation disputes occur only in appropriate cases and in accordance with established practices that provide the necessary checks and balances, and there is transparency and accountability in the settlement

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40 Australian Taxation Office, *Practice Statement PS LA 2007/23 Alternative Dispute Resolution in ATO Disputes and Litigation*, Canberra, 26 October 2010, viewed on 20 June 2011, <www.ato.gov.au>
41 ibid., para. 1.
42 ibid., para. 3.
43 ibid., para. 8.
44 ibid., para. 9.
45 Australian Taxation Office, *Code of Settlement Practice*, Canberra, 23 December 2011, viewed on 23 May 2012, <www.ato.gov.au>, para. 1.

process.'[46] Practice Statement 2007/5 mandates that 'tax officers who make settlement decisions must follow the Code.'[47]

2.14 The Code, like PS LA 2007/23, generally outlines the circumstances in which the ATO considers that settlement of taxation disputes may be appropriate and those in which it may be inappropriate.[48]

2.15 Specifically, paragraphs 25 and 26 of the Code state:

> **25.** Circumstances where it would be generally inappropriate to settle include where:
>
> - the outcome of the settlement would be contrary to an articulated policy reflected in the law;
> - the matter is subject to escalation to settle the ATO view;
> - the matter is clear-cut or there is a clearly established and articulated ATO view on the issue, and there are no special circumstances such as those described in paragraph 26;
> - the settlement would involve inconsistency of treatment for taxpayers in comparable circumstances;
> - it is in the public interest to have judicial clarification of the issue and the case is suitable for this purpose — in such cases, it may be appropriate to fund the litigation under the test case funding program;
> - litigation of the matter through the courts could have a significant flow-on compliance effect and the case is suitable for this purpose;
> - a similar matter is being litigated and awaiting outcome;
> - the taxpayer's case is poor and unlikely to be pursued through the Administrative Appeal Tribunal (AAT) or court. Care is necessary to ensure the settlement practice does not encourage frivolous objections and appeals; and
> - inability to pay a tax debt as it falls due has been deliberately created and it would be inappropriate to consider settlement without first escalating the matter (see paragraph 35).
>
> ***26.*** As a general guide, settlement may be an appropriate way to resolve a matter if:
>
> - the cost of litigating (including internal ATO costs) is out of proportion to the possible benefits, having regard to the prospects of success (including collection of the tax), and likely award of costs, assessed as objectively as possible;
> - there are complex factual or quantum issues in contention, or evidentiary difficulties, or there is genuine uncertainty as to the proper application of the law to the facts, sufficient to make the case problematic in outcome or unsuitable for resolution through the AAT or courts, (for example, where the issue is peculiar to the particular taxpayer, and the opposing positions are each considered reasonably arguable.) This is particularly so where the settlement includes an agreed approach for future income years;
> - a participant or group of participants in a tax avoidance or other arrangement has come to accept the Commissioner's position and settlement is around the steps necessary to unwind existing structures and arrangements;
> - the settlement will achieve compliance by the taxpayer, group of taxpayers, or section of the public, for current and future years, in a cost-effective way; and

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46 ibid., para. 3.
47 Australian Taxation Office, *Law Administration Practice Statement 2007/5 Settlements*, Canberra, 8 February 2012, viewed on 23 May 2012, <www.ato.gov.au>, para. 5.
48 ibid., paras. 25 and 26.

- unique or special features exist which make it unsuitable for resolution through litigation, for example, a dispute about the valuation of a unique asset.

2.16 Specifically, the Code notes that 'there are a range of alternative dispute resolution approaches, including mediation, which could be used, depending on the circumstances, to assist in reaching settlement'[49] and refers back to PS LA 2007/23 for further guidance on the use of ADR in the settlement of taxation disputes.

Other ATO documents

2.17 The ATO has also published certain documents which outline its approach to compliance in relation to certain sectors of the taxpayer market, namely, the Large Business and International sector and High Wealth Individuals.

2.18 In the booklet *Wealthy and Wise: A Tax Guide for Australia's Wealthiest People* (the Wealthy and Wise booklet), the ATO notes that 'unless there is an immediate risk to the revenue, such as where funds are leaving the country or a business is being liquidated, we will normally discuss the case with the taxpayer before making an adjustment, including making a full and frank disclosure of our position, and attempt to resolve any disputes that arise.'[50]

2.19 The *Large Business and Tax Compliance* (LBTC) booklet is more specific on the use of ADR. It notes 'although we [the ATO] always attempt to resolve disputes directly with you and your representative in the first instance, where a direct negotiation has not resolved the issue we will consider whether an alternative dispute resolution (ADR) process may assist.'[51]

2.20 The LBTC booklet also notes that when in litigation, the ATO will continually review whether ADR may assist to resolve some or all of the issues in dispute though, like PS 2007/23, it notes those instances it considers where ADR may be inappropriate, including where 'it would be in the public interest to have judicial clarification of the issues in dispute and the dispute is a suitable vehicle to test the issues.'[52]

ATO website information

2.21 The ATO's website also contains general information in relation to dispute resolution and ADR.

2.22 The 'ATO approach to dispute resolution' webpage encourages taxpayers to speak directly with the ATO early where it is identified that there is, or may be, a disagreement in relation to a view or a decision. It notes:[53]

> By working together, we may be able to resolve a dispute quickly without the need for more formal review processes. Ongoing dialogue is essential in gaining a complete understanding

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49 ibid., para. 37.
50 Australian Taxation Office, *Wealthy and Wise: A Tax Guide for Australia's Wealthiest People*, Canberra, 1 March 2010, viewed on 27 June 2011, <www.ato.gov.au>, p. 18.
51 Australian Taxation Office, *Large Business and Tax Compliance*, Canberra, 28 March 2012, viewed on 23 May 2012, <www.ato.gov.au>, p. 34
52 ibid., p. 34.
53 Australian Taxation Office, *ATO approach to dispute resolution,* Canberra, 30 June 2011, viewed on 2 December 2011, <http://www.ato.gov.au/content/00284692.htm>.

> of your circumstances. It also gives us an opportunity to explain our understanding of your situation and our likely answer. This will allow you to consider our view and respond, including providing any further information to assist us in reaching a decision.

2.23 The ATO's webpage further outlines what it expects of taxpayers, and what taxpayers can expect, to ensure that ATO officers apply the law correctly. Specifically, the webpage states that taxpayers should:[54]

- provide all relevant information so that we can make correct, timely decisions regarding your circumstances. It is not necessary to wait for us to ask for it;
- respond promptly, fully and accurately if we ask for information or clarification about something you've told us;
- if you consider it would help us, say in complex matters, provide us with your view on how the relevant laws apply to you, taking account of your circumstances; and
- let us know as soon as possible if you think we've misunderstood something or made a mistake.

2.24 The webpage also states that the ATO will, where appropriate:[55]

- talk with you to ensure we have a shared understanding of the issues and relevant facts in the matter;
- ask for any additional information we think we need to make our decision and explain to you why we need it;
- explain our position to you and listen to, and fully consider, any issues or alternative positions you put forward; and
- ensure we are clear on where we agree and work to identify and, if possible, resolve any issues in dispute.

2.25 Another ATO webpage, headed 'Alternative dispute resolution', it refers to PS LA 2007/23 and notes that:[56]

> We recognise and support the use of alternative dispute resolution (ADR) as a cost-effective, informal, consensual and speedy means of resolving disputes. This extends to using ADR to deal with only part of a dispute or to deal with procedural or interlocutory matters in relation to a dispute.
>
> All tax officers handling disputes are required to consider whether ADR processes, which include direct engagement and negotiation with taxpayers and their representatives, might assist in the resolution of the dispute or limit the scope of the dispute in some material way.

ATO DISPUTE RESOLUTION NETWORK

2.26 Towards the end of the 2007 calendar year the ATO's Law and Practice business line established a Dispute Resolution Network (DRN) to facilitate the increased use of ADR across the ATO.[57] The DRN was one element of a broader project to reduce the escalating costs of disputes involving taxpayers and the ATO through the use of different dispute resolution processes (including ADR) to resolve or narrow the scope of disputes.

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54 ibid.
55 ibid.
56 Australian Taxation Office, *Alternative Dispute Resolution*, Canberra, 1 March 2010, viewed on 2 December 2011, <http://www.ato.gov.au/content/00231563.htm>.
57 Internal ATO Minute issued by First Assistant Commissioner (Law & Practice), dated 18 December 2007.

2.27 The ATO has advised the IGT that the DRN comprises relatively senior staff within the ATO who possess a good understanding of relevant ATO policies and procedures for settling of disputes, a high degree of judgment and a willingness to work with other business lines across the ATO to 'identify and resolve the entirety of any dispute.'[58]

2.28 The DRN is required to 'provide an internal support structure for staff considering the use of alternative dispute resolution methodologies or processes.'[59] In addition, it was noted that names of the network's members are published on the ATO's intranet and that the network would assist in encouraging development in negotiation and dispute resolution skills and to consolidate these through the updating of relevant information, policies and procedures and training products within the ATO.[60]

ATO Litigation Risk Indicator

2.29 Since 2009, the ATO has employed a Litigation Risk Indicator (LRI) at the objection stage to better inform and assist decision makers identify matters with a risk of ongoing disputation. The LRI comprises fourteen risk indicators.[61]

2.30 An ATO objection officer is required to assess the particular case against each of the fourteen risk factors and determine the risk of ongoing dispute and litigation, which are categorised as follows:

- not applicable — where an objection is allowed in full, is invalid, settled or withdrawn by the taxpayer;
- unlikely;
- likely (interim);
- likely (AAT); or
- likely (Federal Court).

2.31 Where the LRI identifies a matter as 'likely' to proceed to litigation the objection officer is required to escalate the matter through their team leader for review and engagement of relevant ATO officers to see if the matter can be resolved before it crystallises into a formal dispute. Broadly, the officers which may be engaged include those from the Tax Counsel Network (TCN), Centre of Expertise (COE), Legal Services Branch (LSB) and the DRN.[62]

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58 ibid.
59 ibid.
60 ibid.
61 Australian Taxation Office, Online Resource Centre for Law Administration (ORCLA) intranet page, document entitled 'Risk of Litigation – Overview'.
62 Australian Taxation Office, ORCLA intranet page, document entitled 'Risk of Litigation – Escalation'.

2.32 The ATO has noted the importance of utilising the LRI to assist in identifying cases likely to be litigated. The ATO has noted that the use of the LRI assists in ensuring that the ATO:[63]

> … can engage the right people in a more timely way, ensuring that we have all facts and evidence by the time we have the first conference in the AAT or the scheduling conference in the Federal Court. So, if litigation is likely, we can proceed to litigation more quickly, which also helps to cut down time and costs for both parties. The LRI also works in reverse. It highlights to us the cases that aren't likely to proceed to litigation, which may be appropriate for dispute resolution.

2.33 The ATO has recently completed a pilot at the audit stage with the Dispute Risk Indicator (DRI) which is aimed at early identification of cases at risk of dispute.

2.34 Like the LRI, the ATO seeks to use the DRI to engage appropriate personnel early in the process where there is a risk of ongoing dispute. The ATO expects to introduce the DRI later this year.[64]

ATO NTLG Dispute Resolution Sub-committee

2.35 In June 2011 the ATO established the National Tax Liaison Group (NTLG) Dispute Resolution Sub-committee with a membership comprising 'representatives of major tax, law and accounting professional associations, senior members of the ATO, the Attorney General's Department, NADRAC, the Federal Court, the AAT, individual practitioners and prominent academics.'[65]

2.36 The sub-committee was 'established to drive the Attorney-General's Strategic Framework for Access to Justice in the Federal Civil Justice System, with respect to taxation disputes'[66] and to 'provide stakeholders and senior ATO leaders with a forum for consultation to develop dispute resolution strategies which encourage disputing parties to focus on prompt resolution to avoid or minimise the scope of litigation.'[67]

2.37 The sub-committee is an advisory and consultative forum and does not play a role in the resolution of specific taxation disputes.

ATO Dispute Management Advisory Panel

2.38 In 2011, the ATO commenced a pilot Dispute Management Advisory Panel (the Panel) for cases in its Large Business and International (LB&I) business line to 'provide advice around the strategic management of key disputes, including consideration of the most

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63 J. Granger, *ATO Law Expertise: Evolution or Revolution*, speech delivered to the 24th Australasian Tax Teacher's Association Conference 2012, Canberra, 20 January 2012, viewed on 20 January 2012, <www.ato.gov.au>.

64 ibid.

65 Australian Taxation Office, *NTLG Minutes, September 2011*, Canberra, 9 December 2011, viewed on 15 December 2011, <www.ato.gov.au>, item 15.4.

66 Australian Taxation Office, *Dispute Resolution Charter*, Canberra, 29 February 2012, viewed on 15 March 2012 <www.ato.gov.au>.

67 ibid.

appropriate cases to take forward to litigation and cases that should be resolved through, or benefit from, alternate dispute approaches.'[68]

2.39 Specifically, the Panel will seek to assist LB&I to effectively and holistically manage its disputes through:[69]

- Early identification of the right cases for litigation to address ATO strategic risks and clarify the law.
- Internal processes that are aligned with the principles of EDR/ADR.[70]
- Processes supporting the early engagement of Legal Services, TCN and external counsel in potential litigation.
- Ensuring where litigation occurs, the ATO position is well supported by the right arguments and evidence.
- Working with Risk Owners to strategically manage risk through the inclusion of appropriate dispute management strategy in their broader risk mitigation strategies.

2.40 The Panel will also avail itself to assist in the implementation of Recommendation 9.3 of the IGT's *Report into the Australian Taxation Office's large business risk review, audit policies, procedures and practices* (the Large Business review).[71]

2.41 The IGT's recommendation 9.3 stated:[72]

> 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.

2.42 In particular, where the reviewing officer is unable to agree with the audit team's position, the matter may be referred to the Panel for advice.[73]

2.43 As the Panel is currently in its early stages of operation, it is not yet possible for the IGT to assess the utility and effectiveness of the Panel in identifying and resolving disputes.

ATO Strategic Internal Litigation Committee and case management plans

2.44 When litigating tax matters, or complex debt matters, the ATO utilises Strategic Internal Litigation Committee (SILC) meetings to ensure that all ATO stakeholders are properly apprised of issues and developments in the case. A separate SILC is convened for

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68 Australian Taxation Office, *LB&I Dispute Management Advisory Panel Draft Charter*, document provided to the IGT.
69 ibid.
70 The Panel uses the acronym EDR to denote 'early dispute resolution'. The IGT does not otherwise use the EDR acronym in this report.
71 Inspector-General of Taxation, *Report into the Australian Taxation Office's large business risk review, audit policies, procedures and practices*, 7 September 2011, <www.igt.gov.au>.
72 ibid., p. 149.
73 Australian Taxation Office, above n. 69.

each tax technical litigation matter, regardless of the forum in which the matter is litigated, and meetings are held at all critical stages of the proceeding.[74]

2.45 The composition of a particular SILC will vary from case to case but will always include an officer from the ATO's LSB and the business line officer. It may also include a member from the TCN or a COE.[75]

2.46 Relevantly, during the SILC process, the ATO litigation team is to:[76]

> … consider whether the matter is suitable for ADR. If suitable, it is essential that parties carefully consider and select a process which is suited to the circumstances and nature of the dispute.

2.47 As part of the ATO's general case management process for matters in litigation, the ATO's LSB officer is required to complete and maintain a SILC Case Management Plan (CMP) which 'is a document setting out the details and status of a litigation matter, including the litigation strategy and any milestones … and include all critical information such as a summary of the issues, the ATO view, the significance of the matter, the litigation risk rating and the ongoing costs related to the matter.'[77]

2.48 The ATO considers that the active use of SILC CMPs will ensure that there is:[78]

- proactive management and regular monitoring of costs, for example, by obtaining cost estimates. The SILC Case Management Plan provides for estimates of costs and actual costs to date;
- strategic management of litigation by monitoring the timely progress of cases;
- collaborative partnerships between all relevant stakeholders;
- limitation of interlocutory disputes where appropriate; and
- increased consideration and use of ADR.

2.49 A CMP must also be completed by external solicitors representing the ATO when litigated matters are not managed in-house.

ATO TRANSFORMING TAX TECHNICAL DECISION MAKING PROJECT

2.50 For some time there have been concerns about the ATO's tax technical decision making and taxpayer access to ATO technical experts. The IGT raised such concerns from as early as 2005 in both review and annual reports.[79] In line with these concerns, the ATO has embarked on a number of initiatives to deliver more effective and efficient use of tax technical resources through earlier engagement of tax technical expertise.

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74 Australian Taxation Office, *Practice Statement PS LA 2009/9 Conduct of Tax Office Litigation*, Canberra, 6 September 2010, viewed on 20 June 2011, <www.ato.gov.au>, para. 114.
75 ibid., para. 115.
76 ibid., para. 116.
77 ibid., para. 118.
78 ibid., para. 120.
79 See for example: Inspector-General of Taxation, *Work Program 2011-12*, Sydney, 4 April 2011, <www.igt.gov.au>; Inspector-General of Taxation, *Annual Report 2009-10*, Sydney, 2011, <www.igt.gov.au>, pp. 11 and 12; Inspector-General of Taxation, *Review into Delayed or Changed Australian Taxation Office views on Significant Issues*, Sydney, 17 March 2010, <www.igt.gov.au>, pp. 42 and 43.

2.51 The ATO is seeking to do this mainly through its Transforming Tax Technical Decision Making project (the T-project) which aims to improve outcomes for the community. The T-project flows directly from five key recommendations of the ATO's Law Improvement Project to:[80]

- Bolster technical networks within the business/service lines — Work with Compliance and Operations to provide early engagement for Active Compliance, Interpretative Advice and Operations staff dealing with technical matters.
- Investigate and establish early engagement mechanisms — including Tax Counsel Network/Centres of Expertise Consultants, tax clinics etc, to help deliver timely, quality decisions for the community and build technical capability in the business/service lines, and ensure less difficult or risky cases are not escalated to Law.
- Change the basis of escalation to Centres of Expertise and Tax Counsel Network to one based on a formal risk assessment, with 'precedential' one of several criteria to be considered.
- Design and implement a practice management function in Law, to manage the activities of our highest level experts and best meet the expectations of the community and ATO business/service lines.
- Design and implement a review process at sub-plan level to align law interpretative advice priorities with corporate and sub-plan priorities. This should be a two way process, with Law advising on emerging issues and risks the sub-plans should consider and where further risk assessment is required.

2.52 The ATO is currently conducting a number of pilots as part of the T-project and expects to implement these more broadly this year.

2.53 The IGT considers that enhancements in technical decision making and the effective employment of ATO technical expertise should go some way to ensuring that matters at risk of ongoing dispute and litigation are identified and addressed by the most appropriate ATO personnel.

2.54 The improvements should also align the ATO's efforts with the then Joint Committee of Public Accounts' (JCPA) recommendation that the ATO 'commit itself to providing decisions to taxpayers which are final and supportable in the first instance.'[81]

ATO COMPLIANCE CAPABILITY

2.55 As mentioned above, the IGT raised concerns regarding the ATO's technical capabilities as early as 2005. In addition, stakeholder concerns regarding the capability of ATO compliance staff were previously considered in the IGT's Large Business review[82] and the *Review into the ATO's small and medium enterprise audit and risk review policies, procedures and practices*.[83]

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80 Australian Taxation Office, above n. 65, item 11.
81 Joint Committee of Public Accounts, *Report 326: An Assessment of Tax*, Commonwealth of Australia, Canberra, November 1993, p. 270.
82 Inspector-General of Taxation, above n. 71.
83 Inspector-General of Taxation, *Review into the ATO's small and medium enterprise audit and risk review policies, procedures and practices*, Sydney, 24 April 2012, <www.igt.gov.au>.

2.56 During the course of this review, the ATO advised the IGT directly that:

> The ATO has invested significant resources in its active compliance activities in 2011-12 aimed at instilling a stronger focus on active case management to reinforce principles such as improved on-going communications and early engagement with taxpayers, obtaining relevant information early during audit activities, and explaining why that information is required during audits. This active case management focus is across all Compliance business lines and is intended to touch close to 5,000 officers before 30 June 2012.
>
> Furthermore, the ATO is planning a revamped learning and development activity for Compliance staff around good technical decision making in 2011-12. Part of this activity will focus on key intervention points aiming to make good quality technical decisions during audits and disputes.

2.57 The ATO further advised that these are two of a number of measures underway to improve ATO technical decision making and they were initiated, in part, as a result of the ATO's 2011-12 internal audit and objections review which is discussed below at paragraphs 2.69 to 2.72.

BUILDING INTERNAL ATO CAPABILITY ON DISPUTE MANAGEMENT AND RESOLUTION

2.58 The ATO has a centralised learning and development section, on which it spends about $70 million per year, which seeks to build staff knowledge and capability through a range of published training guides, in-house development programs, external programs and conferences.[84]

2.59 As part of its learning and development, the ATO has run a number of different conferences and workshops in relation to dispute management and ADR to assist it implement strategies to more effectively resolve disputes. In 2011 the ATO, in partnership with the Law Council of Australia, ran a series of workshops around the country to highlight its commitment to dispute resolution and to discuss its approach generally. Participants at these workshops included practitioners, ATO officers, ADR experts, NADRAC, registrars of the Federal Court and AAT and former members of the judiciary.

2.60 The ATO also advised the IGT that it is committed to a series of training seminars to be run nationally between April and June 2012 by a leading dispute resolution expert. The training is targeted towards staff at the APS6 level and above whose current roles require the application of negotiation and influencing skills.

2.61 The need to enhance skills and develop knowledge in conflict management and dispute resolution[85] and the ATO's learning and development initiatives in this area will be explored further in Chapter 3.

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84 J. Granger, above n. 63.

85 F. Dixon SC, speech delivered at the ADR in Government Forum, Canberra, 4 June 2008, viewed on 21 June 2011, <www.nadrac.gov.au>, p. 3.

ATO HOSTING ADR INTER-AGENCY GROUP

2.62 Since 2009, the ATO has hosted and chaired an ADR Inter-Agency Group which is attended by senior officers from a number of Commonwealth government agencies including the Department of Defence, the Attorney-General's Department, the Federal Court and the AAT.

2.63 The Group meets on a quarterly basis and discusses topical issues in ADR and dispute resolution relevant to government agencies. It also provides a collaborative forum for government agencies to share knowledge, best practices and initiatives in ADR.[86]

THE ATO'S INTERNAL ADR REGISTER

2.64 To assist it to monitor the use of ADR, for a number of years, the ATO has maintained an ADR Register in which staff are required to record details of all matters in which an externally facilitated ADR process is undertaken. As part of this review, the ATO has provided data from the ADR Register for the period 1 July 2008 to 30 June 2011 which comprises 250 tax dispute cases in which some form of ADR involving a third party practitioner was used.

2.65 Some of the data requested by the IGT, such as which party initiated the ADR, was not previously captured in the Register and was compiled by the ATO specifically for the purposes of the IGT's review.

2.66 The ATO has advised that the level of confidence in the accuracy of the data which has been captured by the ADR Register is much lower than it would like. Some of the reasons for this were the scope for human error and some perceived ambiguity in the information required to be entered.

2.67 The IGT notes that data from the ADR Register does not fully capture the ATO's dispute resolution efforts as, in particular, its participation in AAT case conferences is not recorded. Accordingly, data from the Register is used by the IGT in this report as indicative only and should not be considered to be definitive.

ATO DISPUTE MANAGEMENT PLAN

2.68 An important development that was brought to the IGT's attention during the conduct of this review was the ATO's commitment to develop a Dispute Management Plan (DMP). The ATO is currently in the process of developing its DMP in line with NADRAC's recommendation and strong encouragement from the former Attorney-General.[87] The ATO anticipates that a draft of the plan will be available by the middle of 2012 for internal circulation and discussion.

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86 Attorney-General's Department, *Dispute Management in Australian Government Agencies,* Canberra, viewed on 2 December 2011, <http://www.ag.gov.au/disputemanagement>.

87 Australian Taxation Office, *NTLG Dispute Resolution Sub-Committee Minutes, August 2011*, Canberra, 9 December 2011, viewed on 15 December 2011, <www.ato.gov.au>, item 5.

ATO Objection Review Report

2.69 In July 2011, the ATO commenced internal review of objections across three business lines — Micro Enterprise and Individuals (ME&I), Small & Medium Enterprise (SME) and Indirect Tax (ITX). A draft copy of the report of this review — the Objection Review Report (ORR) — and related briefing documents have been provided to the IGT.

2.70 Through sampling and analysing 145 cases, the ATO review sought to better understand current processes in Compliance and to identify opportunities for continuous improvement. Overall, the ORR seems satisfied with the quality of the technical decisions in the majority of audit and objection cases. The number of objections from active compliance activities also seems relatively small.[88]

2.71 However, the ORR has identified that there were opportunities for improvement particularly in relation to early engagement with taxpayers and obtaining the 'right information at the right time.'[89]

2.72 Where relevant, the IGT will outline further findings and statistics in the ORR in later chapters. As the ORR was provided to the IGT in draft form, the IGT acknowledges that conclusions drawn or agreed improvements arising out of that report may change before the final version is presented to the Commissioner.

Stakeholder concerns regarding ATO use of ADR

2.73 The IGT acknowledges and is aware that the ATO's efforts in relation to ADR have been recognised publicly.[90] Indeed, during consultations on this review, stakeholders recognised the ATO's commitment to ADR in more recent years and welcomed it.

2.74 However, concerns raised in submissions to the IGT suggest that there is significant room for improvement. These concerns include:

- ATO officers at the audit stage of the compliance process are too inexperienced, do not appreciate and understand the nature of the taxpayer's business and transactions and seem unwilling or uncertain about engaging with taxpayers to address issues of concern;
- the ATO's approach to information gathering and information sharing is increasing costs for taxpayers and is not conducive to early resolution of disputes;
- a lack of awareness, authority and skills on the part of ATO staff generally to identify opportunities for, and to engage in, ADR to resolve disputes at an earlier point in time thereby prolonging the dispute and increasing costs;
- senior technical experts are only engaged in matters late in the compliance process, resulting in matters not being able to be settled earlier;

88 Australian Taxation Office, *Objection Review Report* (Draft dated 21 February 2012), p. 3.
89 ibid.
90 F. Dixon SC, above n. 85.

- when attempting to engage the ATO in ADR, taxpayers (especially smaller taxpayers) face difficulties in identifying appropriate ATO escalation channels or personnel;

- the ATO has not always been upfront about matters being progressed for law clarification purposes and which purportedly cannot be settled;

- when participating in ADR, the ATO is not properly managing expectations about the overall purpose of the ADR, the matters that may or may not be set for discussion and the authority of ATO officers attending; and

- general concerns regarding the independence of the objections process and the ATO's management of litigation, particularly in large complex matters.

2.75 These are considered further through the remainder of this report.

CHAPTER 3 — EARLY ENGAGEMENT AND AVOIDING UNNECESSARY DISPUTES

3.1 Whilst a strong dispute resolution framework and capability is essential, the overarching aim for both the ATO and taxpayers should be the prevention of unnecessary disputes.

3.2 The IGT considers that the ATO and taxpayers should work towards building and maintaining a kind of engagement which minimises the occurrence of disputes by developing a clear understanding of each other's position on the facts, evidence and findings of fact. An outcome of such a process may be the development of clear points of agreement or disagreement (as the case may be) and, in the latter case, an understanding of the reasons for such disagreement.

3.3 In the Large Business review the IGT noted that 'agreeing facts assists in maximising understanding of issues and minimising dispute-related costs and better directs evidentiary needs.'[91] The report recommended, amongst other things that:[92]

> … 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.

3.4 The ATO disagreed with the IGT's recommendation, noting:[93]

> …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.

3.5 The ATO further noted, *inter alia*:[94]

> 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

91 Inspector-General of Taxation, above n. 71, p. 134.
92 ibid.
93 ibid.
94 ibid.

relevance is determined by the legal issues in dispute. 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.

3.6 The ATO has stated that it adopts a risk-based approach to audits. Relevantly, this approach should ensure that at the earliest interaction between the ATO and the taxpayer, the parties would have a general appreciation of the broad tax law issues that are in contemplation, albeit that this may require more detailed consideration at a later stage depending upon the specific nature of the inquiry or dispute.

3.7 The IGT's recommendation 8.2 in the Large Business review, and his recommendation 3.1 here, are predicated on the understanding that armed with an appropriately risk-differentiated approach to reviews and audits, ATO officers should be able to engage with taxpayers in working together to identify facts and evidence which would either prove or disprove the risks currently the subject of audit or review.

3.8 The ATO has also reported that a significant portion of its active compliance activities are high-volume data-matching exercises in which information received from third parties is matched against individual income tax returns and other income statements with adjustments made in relation to omitted income (for example, bank interest) or over-claimed entitlements.[95] Further, the ATO states in a recent publication that, in the 2010-11 year, there were 434,000 audits and reviews which resulted in a liability adjustment, and 17,400 were disputed through objections.[96]

3.9 Acknowledging that market segments differ, requiring different approaches by the ATO in its active compliance activities, the IGT considers that other than in situations such as the high volume data-matching cases identified above, there is nothing which would prevent the ATO and the taxpayer from achieving a shared understanding of each other's respective positions in cases where detailed legal analysis and application of the law to the facts is required. Such an understanding must stem from the facts and evidence, an identification of any gaps in those facts and evidence and what further information may facilitate a better or clearer understanding of the matter in dispute.

3.10 The IGT is not suggesting that the parties should agree to facts and evidence divorced from the legal context. On the contrary, the ATO's risk-differentiated approach to risk reviews and audits should provide some underlying legal basis or question needing to be tested.

3.11 Furthermore, the IGT does not suggest that the parties should seek to agree on all facts and evidence in all cases prior to undertaking detailed legal analysis. As in the Large Business review, the IGT and stakeholders recognise that from time to time, agreeing on facts

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95 In 2010-11, the ATO reported that it took action in over 416,000 cases as a result of data matching. See: Commissioner of Taxation, *Annual Report 2010-11*, Canberra, 2011, p. 100.

96 Australian Taxation Office, *Your Case Matters 2012*, Canberra, 30 April 2012, viewed on 1 May 2012, <www.ato.gov.au>, p. 4.

may not always be clear cut or possible. 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 reach agreement on the facts.[97] In other words, the parties may agree to disagree but appreciate what is required to reach agreement on facts.

3.12 It should be noted that information on the ATO's website, as referred to in the previous chapter, and on its intranet suggests that the ATO also shares this view.[98] For example, the ATO's intranet page entitled 'Engaging with the Taxpayer' instructs its staff that interaction with taxpayers 'provides an opportunity to reach a common understanding or agreement, as early as possible on the facts and issues of the case, especially those that may form the basis of an ongoing dispute.'[99] The ATO's dispute risk procedures also make the same point to its staff.[100]

3.13 Accordingly, the IGT remains of the view that agreeing, or agreeing to disagree, on the facts as early as possible is crucial to achieving early resolution or at the very least narrowing points of dispute. This shared understanding, properly communicated and recorded, is likely to:

- assure taxpayers that their position has been fully considered, even if the parties cannot ultimately agree;
- assist the parties to determine what matters are in contention;
- assist in determining whether these may be addressed by direct discussions or the provision of further information; and
- assist in determining whether engagement in early dispute resolution or ADR may assist to resolve any contentious matters. This should optimally be done at the earliest point in the compliance process.

RECOMMENDATION 3.1:

To foster and encourage an open and continuous dialogue between the ATO and taxpayers during risk reviews and audits, the IGT recommends that, where legal analysis and application of the law to the facts is required, the ATO should, before undertaking detailed analysis and application of the law:

- *ensure the taxpayer understands the nature of the ATO's concerns;*
- *afford the taxpayer an opportunity to present their own understanding of the facts, whether in writing or in conference with relevant ATO officers, or a combination of the two as the case may be;*

97 Inspector-General of Taxation, above n. 71, p. 133.
98 Australian Taxation Office, above n. 53.
99 Australian Taxation Office, ORCLA intranet page, document entitled 'Engaging with the taxpayer'.
100 Australian Taxation Office, ORCLA intranet page, document entitled 'Dispute Risk Procedures'.

RECOMMENDATION 3.1 (CONTINUED):

- *at the earliest practicable point in time during the compliance process, clearly communicate its understanding of the facts of a case to the taxpayer; and*
- *ensure that the taxpayer's view of the facts is concisely summarised in any correspondence, interim audit reports, position papers or other relevant document and, where possible, communicate the reasons why it has disagreed with the taxpayer's understanding of the facts.*

ATO Response

Agree in principle.

We agree with the underlying premise that there should be clear and ongoing communication with the taxpayer on both the facts and issues as our thinking develops during a case. We also encourage taxpayers and their advisers to engage in open and continuous dialogue with the ATO at all stages of a matter.

We note that the facts are not at large, particularly in large and complex cases and the relevance of facts is often determined by the legal issues in dispute.[1]

Nevertheless, we think there is merit in settling the facts as early as possible in any process and we would welcome a draft statement of facts from the taxpayer — given that they are best placed to provide the full facts. Where the taxpayer is willing to work co-operatively with us, we encourage an iterative process both in relation to facts and in the application of the law to those facts.

We note that paragraph 3.9 of the report recognises that, from a practical perspective, a different approach is necessary for higher volume cases. In such cases, we do provide taxpayers with a contact point and the opportunity to talk to us about their case.

[1] Gordon, J (2007) Speech to ATO staff on information and evidence gathering.

INFORMATION REQUESTS

3.14 In order to ensure that the parties are able to achieve a shared understanding of the facts (in agreement or disagreement as the case may be) at the earliest possible point, it is critical that there is sufficient and appropriate information exchange between the ATO and the taxpayer.

3.15 Submissions to the IGT have noted that where the parties possess sufficient information, this assists them to identify the matters in dispute, agree to those facts which are objectively ascertainable and to more effectively engage in early resolution of disputes or ADR. It was also noted in some submissions that where all relevant information was not available to either of the parties, engagement and discussions (whether directly or through ADR) may serve only to increase the number of interactions without any real outcomes, resulting in additional time and costs to the parties.

3.16 Unlike commercial litigants, the ATO is not a direct contracting party to the underlying transaction which may give rise to tax consequences and is sometimes required to investigate the transaction many years after the fact. As a result, the ATO relies on information obtained from taxpayers or third parties in its audit and review processes to assist it in arriving at a decision, assessment or determination.

3.17 Where the necessary information is not obtained, this can lead to technical decisions at the audit stage which are unsustainable. The ORR's sample of 145 objections cases revealed that in 72 of these, the appropriate information had been obtained at audit, 60 in which the ATO review team considered that the appropriate information was not obtained and 13 in which judgment was made regarding the information being obtained.[101]

3.18 The ATO's ORR examined 58 cases in which taxpayer objections were allowed in full and 50 cases in which the objection was allowed in part. The ORR found that in cases where objections were allowed in full, the assessor was of the view that in 31 cases the appropriate information was not obtained at audit and in 38 cases further evidence was provided by the taxpayer.[102]

3.19 In relation to cases where the objection was allowed in part, the assessors formed the view that in 23 cases the appropriate information was not obtained at audit and in 35 cases further evidence was provided which led to the objection being allowed in part.[103]

3.20 Importantly, the ORR noted that in almost all cases in which the appropriate information was obtained at audit, there was evidence of ongoing communication between the ATO and the taxpayer[104] which potentially presents more opportunities for achieving a shared understanding.

3.21 Another source which may shed more light on information exchange between taxpayers and the ATO is the Early Resolution Reports (ERR).

3.22 The ATO has, for a number of years, maintained and analysed ERR which seek to capture information as to why the Commissioner conceded a case, why the taxpayer withdrew a case or why the matter settled prior to a court or tribunal hearing.[105] The ATO considers that analysis of the ERRs will assist in identifying systemic issues and relevant insights which may be applied to improve, amongst other things, 'focus on ensuring that tax officers endeavour to resolve disputes at the earliest opportunity with the aim of minimising future litigation.'[106]

3.23 An ATO analysis of the ERRs for the 2010 financial year noted that taxpayers providing evidence late (after lodging an appeal) remains a significant reason for finalising litigation cases prior to hearings. The analysis found that, as a result of more evidence being provided, the ATO settled or conceded approximately 40 per cent of all non-scheme[107] cases before a decision from a court or tribunal was handed down. In 63 per cent of these cases, the

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101 Australian Taxation Office, above n. 88, p. 14.
102 ibid.
103 ibid.
104 ibid.
105 Australian Taxation Office, ORCLA intranet page, document entitled 'Early Resolution Report'.
106 ibid.
107 A case which did not arise out of the ATO's investigation of a scheme or arrangement which is designed to avoid or defer tax.

evidence had been previously requested before the litigation stage and in a further 29 per cent of cases, the taxpayer provided totally new, unexpected evidence.[108]

3.24 Statistics provided to the IGT by the ATO for the 2011 year showed that 77 non-scheme litigation cases were finalised prior to hearing as a result of further information being provided by the taxpayer to the ATO. This represents 43 per cent of all matters finalised prior to hearing. Of these, 42 cases (or 55 per cent) involved the taxpayer providing additional facts or evidence previously requested by the ATO and the remainder (45 per cent) were instances where the taxpayer provided new or unexpected information to the ATO.

3.25 At the IGT's request, the ATO also made available the text of the ERRs in relation to a random sample of cases which were conceded or otherwise settled prior to hearing in the AAT. A review of these provides some greater insight to some of the reasons why new information is provided, or requested, at the litigation stage. In a number of cases, it was clear that at the litigation stage, the opportunities created by the AAT case conferences enabled the parties to better understand the matters in dispute and to focus efforts on obtaining the appropriate information.

3.26 In one example, the taxpayer disputed a decision to disallow input tax credits due to the taxpayer being unable to produce tax invoices to substantiate the claims. At the litigation stage, consideration was given to alternate documentation which may be used to substantiate the claim. Through discussions between the ATO litigation and objections officers with the taxpayer and his tax agent, a settlement was reached to allow credits which could be substantiated with other information.

3.27 Submissions to the IGT also note that many matters settle following the filing of the taxpayer's evidence and prior to the hearing. Generally, it is agreed that dispute resolution processes will only work if the ATO and taxpayers communicate and exchange information about the facts and matters in dispute earlier so as to address misunderstandings and misconceptions. The same principle applies to situations in which the parties seek to achieve a negotiated outcome without resort to litigation.

3.28 However, often the taxpayer is uncertain as to why information is being sought, as the ATO does not tend to communicate its technical views until the position paper is issued.

3.29 In one case reviewed by the IGT, the taxpayer in question approached the ATO to engage in ADR prior to issuing an amended assessment to enable the taxpayer to provide the ATO with more facts to correct matters which the taxpayer considered the ATO had misunderstood. The IGT's review of the ATO officer's file note in this case revealed that the taxpayer felt the interaction had been one-way, that the ATO had not communicated its thinking or reasoning which resulted in the taxpayer being unable to appreciate the ATO's position.

3.30 This uncertainty may result in less focused, and a greater volume of, information being provided and is likely to reduce the opportunities for early resolution. Stakeholders consider that a better understanding of the ATO's thinking and reasons for the requested information will better assist both the taxpayers and their representatives to provide the ATO with information that is necessary in the circumstances.

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108 Commissioner of Taxation, *Annual Report 2009-10*, Canberra, 2010, p. 29.

3.31 From the ATO's perspective, especially in large complex matters, it is sometimes understandable that the technical position to be finally adopted is in formulation and remains so until it has an opportunity to review the available information. However, where this is the case, the IGT is of the view that earlier and more extensive engagement with taxpayers will provide greater clarity regarding what information is available to assist the ATO to better direct and focus its information gathering efforts.

3.32 The ATO's LBTC booklet provides LB&I taxpayers with a commitment of engagement and ongoing dialogue where information is requested as part of active compliance activities.[109] A similar commitment to continuous dialogue and engagement is made to High Wealth Individual (HWI) taxpayers.[110] This level of interaction provides a valuable opportunity for the ATO and taxpayers to better focus the scope of inquiry. The IGT considers this commitment should be made to all taxpayers, not just HWIs and those within LB&I.

3.33 The IGT recognises that in more extreme cases, especially those which concern criminal activity such as serious fraud or evasion, it may not be appropriate for the ATO to disclose its reasons for requesting certain information. In the IGT's view, those cases should be rare and where such cases are identified, they should be dealt with by the ATO's specialist Serious Non-Compliance business line.

3.34 In general, the IGT considers that the ATO should provide taxpayers with reasons as to why certain information is being sought. In the IGT's view, this would serve two purposes, being to:

- ensure taxpayers and their representatives have a greater understanding of the ATO's technical thinking and the reasons for requesting information; and
- enable taxpayers to more effectively engage with the ATO in delivering information which satisfies the ATO inquiry and minimises delay and expense.

3.35 Where meetings are conducted at the commencement of audits or other compliance activities, such as in the LB&I, ITX and Tax Practitioner and Lodgment Strategy (TPALS) business lines, the IGT is of the view that such meetings provide a valuable opportunity for the taxpayer and the ATO to come to a shared understanding of the scope of the compliance activity and information which may need to be provided.

3.36 Submissions to the IGT have expressed concern that where information is sought by way of correspondence, some taxpayers have expressed concern that such information may be misunderstood or otherwise not fully appreciated by the reviewing ATO officer. In these instances, it has been suggested that opportunities should be afforded to taxpayers and their representatives to both provide information and concurrently speak with the ATO officer about the information and explain the context in which they believe it should be considered and understood.

3.37 However, stakeholders have noted that such an approach is not always available as ATO officers seemed uncertain as to their ability to engage in this manner, perceive that they lack authority to do so or would be unduly influenced by the taxpayer's view of the facts.

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109 Australian Taxation Office, above n. 51, p. 29.
110 Australian Taxation Office, above n. 50, p. 36.

3.38 In one example, representatives for the taxpayer who were responding to a risk review questionnaire sought to contact the ATO officer to engage him in discussions to explain the nature of the taxpayer's business and why a particular response may appear unusual in the general case but was fully understandable within the context of that industry. These representatives reported that it was difficult to engage with the relevant officer, and it was not until after the intervention of a more senior officer in the ATO that a meeting was arranged which resulted in the situation being understood.

3.39 The IGT has made a number of recommendations regarding information gathering requests in his Large Business review. Many of the issues above may be overcome or alleviated if these recommendations were adopted across all ATO business lines with appropriate modifications.

3.40 The IGT appreciates that the approach recommended below may not be able to be applied in cases where, for example, the ATO:

- is necessarily engaged in covert evidence gathering;
- is reliant on another government agency gathering and providing the evidence; or
- is necessarily exercising its powers of access without notice (for example, pursuant to section 263 of the *Income Tax Assessment Act 1936* (ITAA 1936)).

3.41 Such cases, where they exist, should be in the minority and should not operate to prevent the ATO implementing the recommendation made below more broadly.

RECOMMENDATION 3.2:

In line with the theme of recommendations made by the IGT in the Large Business review, the IGT recommends that the ATO should, when requesting necessary information from taxpayers:

- *provide the taxpayer with an opportunity to discuss the scope, appropriateness and relevance of the information request and, to the extent possible, provide the reasons for the request;*
- *work with the taxpayer to identify alternative documents, to the extent possible, where there are significant difficulties in providing the requested documents; and*
- *provide the taxpayer with an opportunity to discuss the contents of the information provided.*

ATO Response

Agree as tailored to each market segment.

We believe that this recommendation is more applicable to large, complex cases in the large business and small & medium enterprises markets. In relation to such cases we have implemented substantial further improvements to our processes in response to the Inspector-

General's previous concerns as expressed in recommendation 7.2 in the Large Business review.

In the context of large audits or disputes the ATO has procedures to explain why we require requested information and we provide the taxpayer with an opportunity to discuss the contents of the information provided. The majority of taxpayers are willing to engage openly with us to progress issues in this way and we encourage such a reciprocal approach.

We remain committed to working with taxpayers to identify the most efficient way to respond to our information requirements. As part of this, we consider whether alternative information sources could assist in minimising compliance costs. However, there are times when we require specific documents and cannot always accept alternatives or substitutes.

For those more routine matters in other markets, including high volume requests, information requests are often made through correspondence. It is our practice to provide a contact point so that taxpayers can seek advice or discuss the request if they have questions. We think this opportunity substantially meets the broader thrust of this recommendation.

SHARING INFORMATION

3.42 The ATO has extensive investigative powers which enable it to compel disclosure by taxpayers and their associates, as well as third parties, of required information and documentation.[111] This power enables the ATO to gather information from third parties upon which it may seek to rely.

3.43 Stakeholders have expressed concern that this is sometimes done without the taxpayer being afforded an opportunity to inspect or comment on the additional information. This may hinder a taxpayer's ability to fully understand the putative case that may be in development against them or to address particular issues which may arise. Such an approach can seriously diminish the effectiveness of early engagement and increase the likelihood of protracted disputes, resulting in additional time and increased cost.

3.44 Stakeholders have advised the IGT that where this information is not provided by the ATO following an informal request, taxpayers have little option but to formally request documents under the *Freedom of Information Act 1982*, which adds time and cost for both the taxpayers and the ATO. Alternatively, where that FOI request does not yield necessary information, taxpayers are more inclined to commence litigation as this may enliven discovery processes under relevant Court rules.

3.45 Stakeholders have noted that this is undesirable and may be avoided where the ATO takes a more practical approach to information sharing. Indeed, this is the very same approach the ATO suggests that it would like taxpayers to adopt when responding to its information requests.

3.46 The ATO does not currently maintain a record of whether FOI requests relate to matters under compliance action (for example, audit or objection). As such, it is not currently

111 See for example section 264 of the ITAA 1936 and section 353-10 of Schedule 1 to the *Taxation Administration Act 1953.*

possible for either the ATO or the IGT to ascertain the extent to which taxpayers need to rely on FOI to obtain information which would better enable them to understand the ATO's technical thinking during the end-to-end compliance process.

RECOMMENDATION 3.3:

In order to assess the extent to which taxpayers are relying on the FOI process to ascertain relevant information from the ATO during compliance processes, the IGT recommends that the ATO:

- *update its internal FOI record-keeping system to record whether FOI requests are made in relation to compliance cases; and*
- *publish the outcome annually thereafter to establish the extent to which taxpayers are using the FOI process during compliance activities in gaining access to relevant information.*

ATO Response

Agree in part.

We agree to analyse this but we question whether all relevant taxpayers are relying on FOI to obtain information from the ATO during compliance processes. For example there were about 434,000 compliance activities including a significant number of high volume cases resulting in adjustments in 2010-2011 and in the same year about 850 FOI requests were received. In the vast majority of compliance activities taxpayers are not making FOI requests.

The analysis recommended will be included in work already underway aimed at expanding our analysis of FOI applications.

In relation to compliance activities the ATO has received FOI requests relating to long-running, complex cases which required consideration of hundreds of thousands of pages of information. Each of these requests can cost up to $500,000 or more in out-sourcing the work to a law firm to prepare documents for release to the applicants. Our early analysis of 2011-12 data shows we have spent about $1.3 million (45% of our FOI legal costs to date), dealing with FOI requests relating to 13 taxpayers, of which 5 related to Project Wickenby.

For publishing purposes, given the relatively small numbers of applications involved, we will need to balance public interest against the need to ensure taxpayers' right to secrecy is not infringed.

3.47 The IGT, in keeping with earlier comment, considers the ATO should generally adopt a policy that favours the release of information to assist taxpayers and their representatives to better appreciate the ATO's position.

3.48 Such a process is already in place for liquidators and trustees in bankruptcy where information is requested outside the FOI regime to assist in their work,[112] and for unfair

112 Australian Taxation Office, *Release of taxpayer information*, Australian Taxation Office, Canberra, 23 September 2010, viewed on 1 November 2011, <www.ato.gov.au>.

preference claims against the Commissioner. The IGT understands that this approach to information sharing has assisted both the insolvency practitioners and the Commissioner to settle a large number of disputes without resort to litigation, while also maintaining both sides' competing statutory obligations – the Commissioner's obligation to protect the revenue and the insolvency practitioner's obligation to act in the best interest of all creditors in maximising returns.

3.49 The ATO advises the IGT that it already encourages officers at the audit and objection stage to share information with taxpayers informally where such information, if disclosed, would not prejudice the ATO's ongoing investigation.

3.50 The IGT has found an example in which this has occurred through reviewing active compliance cases on the ATO's Siebel case management system. In that case, the taxpayer sought access to information held by the ATO in relation to the audit. The audit officer escalated through relevant senior officers within the business line and the FOI section and released the requested information without the need for formal application.

3.51 The IGT recognises that in some instances, it may be necessary for the ATO to maintain the confidentiality and anonymity of third parties who provide information to it as part of an ongoing investigation. Sometimes, the maintaining of anonymity of informants is necessary to protect their safety.

3.52 The IGT appreciates that in these sensitive cases, not all information may be able to be provided. However, a large amount of corroboration is needed when the ATO acts on information anonymously provided. The IGT considers that such considerations must necessarily be balanced against the right of taxpayers to examine and respond to any information on which the ATO may rely in formulating its position.

3.53 To an extent, the ATO seems to share the same view. An internal instruction to ATO staff provides:[113]

> The tax officer must contact the taxpayer when an objection is expected to be disallowed in full or, in part due to acquiring information that the taxpayer is unaware of, which:
>
> - concerns material facts, evidence or a technical view, or
> - provides a very persuasive explanation of the basis of the audit position.
>
> Additional information can be obtained from any source such as the audit decision maker, or subject or industry experts from either within or outside the ATO.
>
> The tax officer must explain to the taxpayer how the additional information influences the ATO position and what information if any, would alter the ATO position.

3.54 This approach may go some way to assisting the taxpayer to better understand the ATO's decision but the IGT does not see any reason why it should only be limited to the objection phase of an end-to-end process as the ATO's information gathering powers are able to be utilised at other stages such as during an audit. Furthermore, while apprising the taxpayer of the impact of third party information on an ATO decision may be useful, unless the information is provided to the taxpayer they are deprived of an opportunity to directly address the accuracy, credibility and relevance of the information relied upon by the ATO.

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113 Australian Taxation Office, above n. 99.

3.55 The IGT considers that where the ATO seeks to rely on third party information in formulating its position or in rendering a decision, such information should first be provided to the taxpayer for comment. The instances in which the provision of such information would prejudice an ongoing investigation or jeopardise the safety and anonymity of informants should be rare.

3.56 The IGT is of the view that where such situations exist, the ATO should communicate to the taxpayer both why the totality of the information cannot be provided to them, and to provide the information in redacted form to the extent that this does not seriously prejudice an ongoing investigation or situations where confidentiality of individuals may need to be preserved for safet reasons. Ultimately, the taxpayer has a right to understand the case against them and the evidence used in that case.

RECOMMENDATION 3.4:

Save where disclosure of requested information would seriously prejudice an ongoing investigation, the IGT recommends that the ATO:

- *adopt and promote a policy of open and informal information sharing with taxpayers; and*
- *where information is not to be disclosed on an informal basis, that decision should be signed off by a senior officer with information access expertise and the reasons for this are communicated to the taxpayer.*

ATO Response

Agree.

Our approach is to share information with taxpayers in the spirit of this recommendation. This is outlined in the Large business and tax compliance booklet where we set out mutual expectations during compliance activities, including that both parties should provide relevant information in a timely manner.

In responding to disclosure requests, we do take account of our previous disclosures during audits, the time required to respond and administrative costs of such requests. It is our practice to provide clear and complete reasons where information is not to be disclosed on an informal basis.

We also encourage taxpayers and their advisors to take an open and informal approach to information sharing with us.

CASE CONFERENCES WITH TAXPAYERS

3.57 Submissions to the IGT have noted that where tax officers have sought to appreciate the commercial and factual nature of a taxpayer's business, there has been a better working relationship, leading to a common understanding of issues and concerns which were able to

be addressed more efficiently. Conversely, where this does not occur, there was a tendency for issues to escalate to disputes requiring formal intervention.

3.58 In one case, the effectiveness of early engagement avoided what may otherwise be a dispute. In this case the ATO officer engaged with the taxpayers and their representatives to discuss responses to a risk review questionnaire which may be misconstrued but which were otherwise acceptable within the specific industry context.

3.59 In another case, the IGT was advised by a taxpayer that throughout the course of an audit, the ATO auditor failed to appreciate the nature of the taxpayer's business and refused to accept information presented to them to assist in their understanding both of the taxpayer's industry generally and the taxpayer's business specifically. This crystallised a dispute which the taxpayer challenged in an objection and subsequently in the AAT. The submission to the IGT suggested that had there been greater engagement by the ATO auditor with the taxpayer to inspect the business premises, the infrastructure and the books and records of the taxpayers, then the matter may have resolved rather than progressing through litigation.

3.60 As the ATO aspires to identify and resolve disputes early and as close to the original decision maker as possible, the IGT considers that a consistent and systematic approach to open engagement and communication between the parties is critical.

3.61 The ATO's internal repository of procedures, the Online Resource Centre for Law Administration (ORCLA), contains a number of documents which outline procedures for staff aimed at providing guidance and support for ATO officers who interact with taxpayers in the course of their duties. The 'Engaging with the taxpayer' page in ORCLA mentioned earlier directs that:[114]

> During the life cycle of a dispute, there will be instances when the tax officer either identifies issues of concern or senses the taxpayer is likely to dispute the outcome. In these instances the tax officer must engage with the taxpayer as soon as possible.

3.62 The document goes on to further explain that:[115]

> Interaction with the taxpayer includes phone and face-to-face discussions and provides an opportunity to:
>
> - show the audit or objection is being conducted fairly and impartially;
> - create a collaborative environment;
> - request information necessary to reach a decision;
> - communicate the ATO view of the relevant facts, evidence, application of the law and penalties;
> - give the taxpayer an opportunity to respond to the ATO view, in particular where the view is based on information the taxpayer may not be aware of;
> - actively listen to the taxpayer's arguments about facts and issues;

114 Australian Taxation Office, above n. 99.
115 ibid.

- reach a common understanding or agreement, as early as possible on:
  - many aspects of the audit or objection; and
  - the facts and issues of the case, especially those that may form the basis of an ongoing dispute;
- explore options for resolving the issues in dispute;
- discuss the future management of the issues that remain in dispute; and
- reach finality sooner.

3.63 The IGT considers that these new processes, properly implemented should provide taxpayers with greater opportunity and access to ATO officers to ventilate and discuss issues of concern with a view to resolving any disputes which may arise.

3.64 However, the instruction appears to presuppose the existence of a dispute before engagement should take place. The IGT is of the view that there is room to improve these communication opportunities both to enable the parties to better understand each other's positions and to identify facts and evidence which may assist to resolve any disagreement. In effect, communication and engagement opportunities between the ATO officer and taxpayers should be broadened and occur throughout the different stages of the compliance process and prior to disputes arising.

Case Conferences in the AAT

3.65 The AAT makes extensive use of case conferences in which an AAT Conference Registrar acts as an independent third party who brings the parties together to discuss the dispute, determine whether it can be settled at the conference, whether a formal ADR process may assist or if the matter cannot be settled, and how the matter can best be expedited for hearing and determination by a Tribunal Member.[116] Case conferences are mandatory prior to a matter being listed for hearing.

3.66 Some submissions to the IGT have noted that the use of AAT case conferences has been particularly useful in tax disputes to bring to the ATO's attention information which is pertinent to the issues in contention and to be able to explain and clarify the information presented.

3.67 Indeed, in discussions with a number of ATO litigation officers who participate in the AAT case conferences, it has emerged that the intervention of the conference registrar, as a neutral third party, often assists the parties to better appreciate each other's respective positions, the evidentiary burden in proceeding to hearing and the opportunities which exist for resolution of the matter.

3.68 The high success rate of the AAT case conferences is illustrated by statistics which have been provided to the IGT. These show that of the 3400 tax matters finalised in the AAT during the three year period from 1 July 2008 to 30 June 2011, only 15 per cent were finalised by way of a decision on the merits following a hearing, with the remaining being resolved by

116 Administrative Appeals Tribunal, *Conferences*, Sydney, November 2010, viewed on 21 September 2011, <www.aat.gov.au>, p. 3.; Administrative Appeals Tribunal, *Conference Process Model*, Sydney, 16 May 2012, viewed on 23 May 2012, <www.aat.gov.au>.

way of agreement between the parties or the matter being withdrawn. During the same period, the statistics show that the AAT held 2866 conferences, 245 conciliations, 26 mediations and 26 early neutral evaluations or case appraisals. There were only 284 matters which progressed to substantive hearings.

3.69 In summary, the above AAT statistics show that over 90 per cent of AAT cases in the three years ending 30 June 2011, were resolved without progressing to hearing. This suggests that there is much room for improvement in settling issues earlier and not resorting to bringing matters to the AAT. The discussion that follows further explores these opportunities for improvement.

3.70 It should be noted that the AAT and the ATO adopt different methodologies when recording tax dispute matters. The ATO records one dispute for each taxpayer regardless of the number of tax years which that taxpayer is disputing. In contrast, the AAT records each disputed tax year as a separate matter.[117] As such, the statistics recorded here for the AAT are not directly reconcilable with statistics reported by the ATO, such as those contained in the annual reports.[118]

Direct conferencing with taxpayers prior to litigation

3.71 Stakeholders have suggested that if the AAT case conferences were replicated by the ATO prior to formal proceedings being commenced, this may assist to address issues earlier. Others, while generally supporting the idea have cautioned the IGT against imposing an additional burden on disputants with processes which may protract and add to the cost of disputes.

3.72 One of these documents, on the ORCLA intranet webpage, the 'Case Conferencing' Document (CCD), encourages ATO officers to identify opportunities to conference with taxpayers in resolving disputes at their earliest point in time and provides some guiding instructions regarding what conferencing with taxpayers involves. [119]

3.73 The CCD defines a case conference as a discussion, between taxpayers and their representatives on the one hand and the relevant ATO officers on the other, where there is an appointment, an agenda and a consideration of who will attend.[120] In particular, the CCD notes, 'conferences can discuss matters such as legal issues in dispute, the correction of any factual errors, the provision of additional facts, or the administration of the dispute.'[121]

3.74 These ATO direct conferences are intended to occur well before legal proceedings are commenced and thus fall outside of the case conferencing process mandated by the AAT. They are intended to provide a forum for facilitated discussions to occur directly between the taxpayer and the ATO officer.

3.75 The ATO considers that such conferences may be useful to discuss complex issues or information, a contentious position paper or the prospect of settlement. In particular, it

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117 For example, if Taxpayer A disputes his income tax for the 2007, 2008 and 2009 years, the ATO will record this as one dispute whereas the AAT will record it as three.
118 See for example, Commissioner of Taxation, above n. 108, p. 30; Commissioner of Taxation, above n. 95, p. 105.
119 Australian Taxation Office, ORCLA intranet page, document entitled 'Case Conferencing'.
120 ibid.
121 ibid.

urges its officers to consider case conferencing where there is a risk of litigation, the taxpayer is likely to receive an adverse decision on interpretative assistance work (for example, an adverse private ruling), the taxpayer has appealed an ATO decision or the taxpayer has requested a conference.[122]

3.76 The CCD goes on to say that where a taxpayer has requested a case conference, the ATO officer is to consider 'whether a case conference would be a productive forum to discuss matters with the taxpayer, remembering that this is an opportunity to attempt to resolve or limit the dispute.'[123]

3.77 From some of the examples which have been brought to light during consultation, the IGT considers that effective conferences between the ATO and the taxpayer would assist to improve the understanding of the parties' respective positions and aid in resolving some of these matters without resort to litigation.

3.78 In addition to this, the IGT has also been provided with copies of the ATO's pro-forma correspondence used during the audit process. As mentioned earlier, the IGT notes that business lines such as LB&I,[124] ITX and TPALS have incorporated into their audit processes an initial meeting at which audit and timeframe expectations are outlined so that the parties are better able to establish a common understanding of what will be involved.[125]

3.79 Further the TPALS business line correspondence also offers an additional meeting for the ATO officer and taxpayer to meet and discuss the ATO's interim report findings and provide an opportunity for the taxpayer to furnish any further relevant information for the ATO's consideration before the report and audit are finalised.[126]

3.80 As discussed in Chapter 2, the ATO currently utilises the LRI at objection stage to assess the risk of a matter proceeding to litigation following an adverse objection decision. If such a matter is identified, the objections officer is required to escalate the matter to engage, where appropriate, senior ATO officers from the TCN, COE and/or LSB to assist to resolve the matter earlier and without resort to litigation.

3.81 The IGT considers that greater direct engagement between the ATO and taxpayers may serve to develop a collaborative and cooperative relationship in which matters of concern may be expeditiously and informally addressed as they arise. The IGT encourages business lines, except in matters concerning serious criminal fraud or evasion and in which covert investigations may be necessary, to incorporate opportunities for face-to-face discussions as part of the compliance process and related correspondence with the objective of:

- outlining the ATO's areas of inquiry or focus;
- developing a shared understanding of the ATO's expectations of the taxpayers and also what the taxpayers may expect of the ATO officers undertaking the compliance activity; and

122 ibid.
123 ibid.
124 Australian Taxation Office, above n. 51, pp. 8 and 10.
125 Examples of ITX and TPALS standard correspondence provided by the ATO to the IGT.
126 Copy of TPALS template letter provided by the ATO to the IGT.

- setting other general expectations such as areas of inquiry and timeframes for completion of the compliance activity.

3.82 The IGT notes that while the ATO has promoted the use of case conferencing with its staff, the IGT was unable to find general references to this on its public website or in other published documents. The IGT is of the view that it would benefit both the ATO and taxpayers for the ATO to more publicly promote the engagement of tax officers with taxpayers through, for example, the use of direct conferences at specific points in the end-to-end compliance process. The ATO has advised the IGT that it will incorporate this as part of its current work to develop a DMP.

3.83 Additionally, the IGT considers that these ATO direct conferences should be built into existing end-to-end processes across all business lines to provide opportunities for the ATO and taxpayers to engage with each other to arrive at a common understanding of the matters of concern and how these may be addressed in an expeditious and efficient manner.

3.84 Indeed, as one piece of correspondence from a tax practitioner reviewed by the IGT pointed out, the ATO's commitment outlined in the LBTC booklet to engage with taxpayers to resolve disputes directly (that is, by direct negotiation between the taxpayer and their representatives and the ATO) or otherwise through ADR should be made to all taxpayers and not only those in the LB&I segment.

3.85 The IGT considers that there are different times at which these conferences between the ATO and taxpayers may occur. Specifically, with the aim of avoiding and limiting the scope of disputes, the IGT considers that opportunities to conference with taxpayers should be incorporated into the ATO's compliance processes at:

- commencement of an audit or review;
- prior to issuing a position paper or reasons for decision;[127] and
- following the lodgment of an objection.

3.86 Furthermore, the flexible use of direct conferences with taxpayers should be encouraged at other points during the compliance process where the parties consider that such conferences would assist to address any issues or concerns arising in the matter.

3.87 The IGT acknowledges that not all cases will lend themselves to such conferences at specified times. However, the IGT considers that the inclusion of direct conferences throughout the end-to-end process and in ATO compliance procedures will generally act as key milestones and triggers for both the ATO and taxpayers to turn their minds to matters of concern or contentious issues which may be addressed through direct contact and discussions.

127 See for example, Inspector-General of Taxation, above n. 71, para 9.38, p. 146.

RECOMMENDATION 3.5:

The IGT recommends that:

1. *The ATO update the Taxpayers' Charter to commit to a position which favours engagement with taxpayers for the purposes of dispute resolution and where direct negotiations fail to resolve the dispute, the ATO will consider other dispute resolution options, including ADR.*

2. *The IGT further recommends that the ATO amend its compliance procedures to require ATO officers to consider, and if appropriate engage in, direct conferences with taxpayers at each of the following points in time:*

   - *when the parties have reached agreement as to the facts, or agreement to disagree on contentious factual matters;*
   - *prior to issuing a position paper or reasons for decision;*
   - *following the lodgment of an objection; and*
   - *at any other point in time at which the parties agree that a case conference would be beneficial.*

ATO Response

Agree to 3.5.1, and agree in part to 3.5.2 in relation to large and complex cases in the large business and small & medium enterprises markets.

We agree to update the Taxpayers Charter to state that the ATO will consider avenues for dispute resolution, including ADR, in appropriate circumstances. In doing so, we note that the booklet entitled "If you're subject to review or audit" we state that we will:

….. work towards resolving disputes about the facts, or how the law applies to the facts, prior to finalising the audit.

We agree to on-going engagement with taxpayers during our large and more complex compliance activities and we have procedures and a focus on skilling to reinforce this requirement (see for example the Large business and tax compliance booklet). We encourage taxpayers and their advisors to take a similar approach.

We believe that a more iterative engagement throughout the audit process is beneficial to the efficient conduct of large and complex matters. It is often not until after we have developed our position paper in larger audits that we would have a more considered articulation of facts and law, which allows both parties to narrow ongoing discussions. However, there may be other points of time at which the parties agree that a case conference would be beneficial.

Use of trained ATO officers to guide the parties in direct case conferences

3.88 The ATO has considered the possibility of using an independent, in-house tax officer as a facilitator in case conferences, especially where there will likely be a number of

participants in the conference, where the issues to be discussed are complex or where previous discussions between the parties have not been successful.[128]

3.89 The ATO further notes that the facilitator in such a conference would 'guide the parties through their discussion ensuring the participants focus on the purpose of their work together.'[129]

3.90 Between February and July 2011, the HMRC conducted two dispute resolution pilots which focused on the use of in-house HMRC facilitators to assist in the resolution of disputes in the large and complex cases and those involving small and medium (SME) taxpayers.

3.91 Interim results issued by HMRC have suggested that the pilots have been successful, resulting in considerable savings as compared to costs which would have been expended had the matters proceeded to litigation.[130]

3.92 As of May 2011, eleven entities had participated in HMRC's large business pilot which used the facilitated discussions as a precursor to formal mediation to ensure that the parties fully appreciated each other's respective arguments. Of these, two cases were resolved at mediation, two were entering mediation, one case was resolved through the facilitated discussions and a further two were proceeding towards bilateral resolution. The remaining four were at different stages of the facilitated discussions.[131]

3.93 In relation to HMRC's SME pilot, preliminary results indicate that 97 per cent of taxpayers who were offered an opportunity to participate in the pilot accepted to do so. As at May 2011, one hundred and fifty taxpayers had entered the pilot, with twenty eight facilitated discussions having been completed and 64 per cent of these had resulted in resolution of issues either in whole or in part. The preliminary evaluation noted that the average timeframe for cases progressing through the pilot was 28 days.[132]

3.94 HMRC advised that its goal in establishing the pilots was to divert cases from the First Tier Tribunal, and to that end, selected cases in which it was foreseeable that HMRC would issue an unfavourable determination or assessment to the taxpayer. Engagement as part of the pilot, therefore, occurred before assessment.[133]

3.95 HMRC also advised the IGT that significant external consultation was undertaken in relation to the pilots and, importantly, in formulating the terms of reference of the pilots and the measures of success, they relied on private sector experts who were seconded from the largest accounting firms. This, they advised, assisted to garner taxpayer support for the initiative and helped to impress that this was a joint project rather than one wholly owned by HMRC.[134]

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128 Australian Taxation Office, above n. 119.
129 ibid.
130 'Mediating Tax disputes: HMRC's ADR pilots', *Tax Journal*, 14 July 2011, viewed on 21 September 2011, <tj.nitin.dev.lnukapps.co.uk/tj/print/28822>.
131 ibid.
132 ibid.
133 Information provided by HMRC to the IGT, 23 December 2011.
134 Information provided by HMRC to the IGT, 23 December 2011.

3.96 When inviting participation in the pilots, HMRC provided taxpayers with clear statements of agreement as to what would be expected of each party, and emphasised the rights of taxpayers to proceed to the Tribunal should the matter not otherwise resolve.

3.97 In canvassing the potential of a similar pilot with stakeholders, the IGT was advised that though it may not be appropriate in all cases (particularly, the larger more complex matters), it may be of some utility in smaller tax disputes, especially where the taxpayer is not able to afford their share of the cost associated with engaging in ADR with an ADR practitioner. Some concern was expressed by stakeholders as to perceptions of bias, lack of independence and a lack of confidence in the process if it was not properly managed by the ATO. It is imperative that if such a pilot was to be run in Australia, the ATO actively ensure the independence (actual and perceived) of its in-house facilitators.

3.98 The IGT notes that the ATO agreed, as part of the *Review of aspects of the Tax Office's settlement of active compliance activities* (the Settlements review),[135] to implement mechanisms to 'improve the taxpayer experience in relation to the settlement process and access to settlement by providing a 'circuit breaker' or 'reference point' for taxpayers with the aim of drawing on significant alternative dispute resolution and settlement experience; and providing a fresh set of eyes for decisions to access the settlement process or disputes arising in the settlement process.'[136]

3.99 Given the high rate of concession and settlement which occurs at the AAT case conferences, the IGT is of the view that there would be considerable benefit in the ATO undertaking a pilot similar to HMRC's to assess whether in-house ATO facilitators could be utilised to act as circuit breakers in certain disputes and to assist in the resolution of these disputes without resorting to litigation under Part IVC.

RECOMMENDATION 3.6:

The IGT recommends that, in consultation and collaboration with external stakeholders, the ATO undertake a pilot to assess the utility and effectiveness of using trained in-house ATO officers to act as facilitators to assist in resolving smaller, less complex disputes.

ATO Response

Agree.

A sample of smaller, less complex indirect tax objection cases will be in scope for such a pilot, with the NTLG Dispute Resolution Sub-Committee to be involved in the evaluation.

Objection cases sampled for the pilot may include features such as:

- valuation or apportionment issues; and

135 Inspector-General of Taxation, *Review into Aspects of the Tax Office's Settlement of Active Compliance Activities*, Sydney, 1 December 2009, <www.igt.gov.au>.
136 ibid., p.23.

- smaller dollar objections involving disputes over the facts, or disputes over the application of penalty provisions.

ENHANCE SKILLING OF ATO STAFF TO BETTER MANAGE POTENTIAL CONFLICT

3.100 NADRAC has recommended, amongst other things, that a primary strategy in ensuring that government agencies are well placed to address issues before they become 'disputes' is the building of 'communication, negotiation and conflict resolution skills of people across the agency.'[137]

3.101 Submissions to the IGT have noted that enhanced education and training of staff is key to ensure that they are properly skilled to be able to both identify issues and to address them as and when these issues arise. It was perceived that one of the reasons for a lack of early engagement on the part of the ATO is that officers involved earlier in the compliance process were relatively inexperienced, lacking the skills and authority to engage with taxpayers.

3.102 The ATO also recognises the importance of enhancing skills to enable staff to better engage earlier with taxpayers to manage issues before they escalate to more formal disputes. Encouragingly, the ATO has committed publicly that, 'at a broad level [it has] invested in negotiation skills training and [it is] encouraging earlier direct contact with taxpayers, by phone, or meeting personally with taxpayers.'[138]

3.103 As discussed in Chapter 2, the ATO's centralised training section provides and coordinates internal training, as well as external conferences and forums to ensure staff gain a greater appreciation of dispute resolution options and resources available to equip them with practical skills in resolving potential conflict when interacting with taxpayers. The ATO's learning management system (LMS) enables ATO staff to register for training sessions relevant to their work.

3.104 The ATO has provided the IGT with a number of dispute resolution training modules which are listed on LMS. Some of these include:

- negotiation skills, a foundational session targeted at debt operations staff;
- negotiation in the field, which looks at negotiation, settlement and conflict resolution skills for active compliance field staff;
- negotiating and Influencing for IA, a foundational session targeted at tax technical officers at the audit stage;
- negotiating and influencing for LAC, a foundational session targeted at tax technical officers at the audit stage;
- negotiating and influencing for SE, a foundational session targeted at tax technical officers at the audit stage; and
- negotiating and influencing for SME, a foundational session targeted at tax technical officers at the audit stage.

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137 NADRAC, *Submission by NADRAC in response to the Issues Paper on the Review of the Legal Services Directions*, Canberra, April 2004, viewed on 1 November 2011, <www.nadrac.gov.au>, p. 2.

138 J. Granger, above n. 63.

3.105 Each of the above modules are presented in classroom sessions, with material provided to participants prior to, or on the day of, the training. The IGT understands that the sessions are not mandatory and are run on a needs and interest basis. That is, the LMS system permits ATO staff to 'pre-book' or express interest in a session with sessions being run once sufficient numbers are reached.

3.106 For each of the above modules, the IGT notes that there were no current planned sessions, and a one year projection did not reveal any future planned sessions which had been uploaded to LMS. Notwithstanding this, the modules allowed staff members to download copies of PowerPoint slides and workbooks which may be reviewed and worked through at that staff member's pace.

3.107 The IGT notes that the training modules are not formally assessed. A number of the modules provided state that:[139]

> There is no assessment for this course. By attending the classroom training, you successfully complete this course.

3.108 In addition, the IGT was advised during the course of this review that the ATO is currently in the development phase of a foundational negotiation skills training package, and is procuring an intermediate negotiation skills program to be rolled out to staff later in 2012.

3.109 While the IGT generally supports ongoing training, whether facilitated in-house or externally, it is important that the impact of such training is assessed at a practical level to ensure its relevance and effectiveness and that skills obtained are correctly and consistently applied. In particular, as negotiation and dispute resolution are complex areas requiring the application of different skills in different contexts, it is critical that any training provided is tailored to the needs of the organisation and of the individual staff member.

3.110 The IGT considers that it is imperative that all officers who interact with taxpayers and their representatives, at any stage of the compliance process, have strong communication and practical conflict management skills and be sufficiently confident and authorised to apply these skills to actively manage disputes which may arise. As the former Attorney-General has noted, if a resolution culture is to be achieved, there is a 'greater need for trained, experienced officers, to have the confidence' to exercise their own judgment in the resolution of disputes.[140]

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139 Australian Taxation Office, internal learning management system.
140 R. McClelland MP, above n. 9.

RECOMMENDATION 3.7:

1. *To ensure that ATO compliance and technical staff are well-equipped to prevent or resolve disputes, the IGT recommends that the ATO develop a targeted suite of training products which focuses on:*
    - *early identification of potential issues in dispute; and*
    - *negotiation and conflict management resolution skills.*
2. *The IGT further recommends that, based on the skilling needs of individual staff, the ATO compliance and technical staff who interact with taxpayers complete the above targeted training as a requirement of their performance development agreements, with reviews to be conducted periodically to ensure these skills are current and effective.*

ATO Response

Agree.

The ATO has existing training products that focus on negotiation and conflict management skills and processes that assist in the early identification of potential issues in dispute. Nevertheless we agree to review these products and processes to assess their fit for purpose.

The ATO also agrees to assess the need for compliance and technical staff who interact with taxpayers to complete training in relation to these matters.

As is currently the case, staff and managers will continue to review their training needs and the effectiveness of training received through the bi-annual performance management process.

The ATO has in place a number of programs and support mechanisms in relation to the matters identified in the recommendation. ATO training in these skills has included externally provided programs. The further roll out of these types of products and processes to compliance staff will depend on a range of factors including the assessment of the training needs of individual officers, case profiles and other skilling priorities.

CHAPTER 4 — INITIATING ADR

4.1 The Commissioner in his 2010–11 Annual Report[141] indicated a willingness to engage in ADR and through directions to ATO staff, such as PS LA 2007/23, the ATO has set out how and when ADR should be conducted. It should be appreciated that the ATO defines ADR broadly and includes within the definition 'direct negotiation of disputes by the parties without outside assistance.'[142]

4.2 To ensure consistency in this report the narrower definition of ADR is intended as outlined earlier. That is, it will be used to refer to processes in which an ADR practitioner assists the parties.

4.3 The ATO has indicated that its preference in relation to resolving disputes is to first engage and negotiate directly with taxpayers. Such an approach is sensible and should operate to reduce some of the costs associated with resolving the dispute for both parties. Where direct negotiations fail to resolve disputes the parties must turn their minds to other methods or processes which may assist in resolving the matter, including engaging in processes assisted by an ADR practitioner.

4.4 Having addressed early engagement in the chapter 3, this chapter will consider different aspects of ADR and the initiation of ADR where early direct engagement between the parties has failed to resolve the dispute.

WHEN IS ADR APPROPRIATE?

4.5 The AAT and NADRAC have acknowledged that, generally, all matters are potentially suitable for ADR.[143] While NADRAC identifies some factors which may render ADR inappropriate, such as lack of time, unmanageable imbalance of power or entrenched conflict, it cautions that factors such as these should not automatically dismiss the possibility of ADR.[144] Submissions generally supported this approach.

4.6 As previously noted, while the ATO generally supports the use of ADR, it has stated that 'not all cases are suitable for ADR' and that ADR may not be appropriate where:[145]

- it would be in the public interest to have judicial clarification of the issues in dispute and the dispute is a suitable vehicle to test the issues;
- resolution can only be achieved by departure from an established 'ATO view' on a technical issue; and

141 Commissioner of Taxation, above n. 95, p. 105.
142 Australian Taxation Office, above n. 40, para. 21.
143 Administrative Appeals Tribunal, *Alternative Dispute Resolution (ADR) guidelines*, Sydney, June 2006, viewed on 21 September 2011, <www.aat.gov.au>, p. 3; NADRAC, above n. 138, p. 3.
144 NADRAC, above n. 137, p. 4.
145 Australian Taxation Office, above n. 38, paras 4 and 11; see also Australian Taxation Office, above n. 51, p. 34.

- the dispute is of a kind where the state of the relationship between the parties is such that any proposed ADR is unlikely to be successful.

4.7 In relation to the third dot point, the practice statement does not provide any further guidance or examples of the kind of dispute which is envisaged. It is unclear whether the determination that ADR is 'unlikely to be successful' is made by the ATO, the taxpayer or both. Absent further clarity, the IGT is concerned that such a statement may be relied upon by either ATO officers or taxpayers as justification to avoid engagement.

4.8 Where it is accepted that ADR (including direct negotiation) is a useful vehicle for narrowing issues in dispute, clarifying evidence and fostering ongoing relationships as well as resolving disputes,[146] ADR (including direct negotiation) may be employed in a much wider context. Furthermore, where the ATO is seeking to drive a cultural shift towards an earlier and better resolution culture, it should work to remove impediments such as that mentioned in the preceding paragraph.

4.9 The IGT considers that the position the ATO should adopt is one which would bring ADR (including direct negotiation) to the forefront as the primary dispute resolution mechanism, rather than as an alternative. To this end, the ATO's starting position should be that it is appropriate to engage in ADR (whether through direct negotiations or otherwise) unless there are clear reasons to the contrary.

4.10 Such clear reasons should be limited to cases where associated costs and delays are disproportionate to the issues in contention or where a public benefit would be served by having matters judicially determined and ambiguous areas of the law clarified (as discussed below). Even where it is desirable to have a matter judicially determined, the IGT does not consider that there should be any barriers to the parties engaging in ADR to ensure a more streamlined approach in taking the matter to Court.

RECOMMENDATION 4.1:

The IGT recommends that the ATO adopt the principles espoused by the AAT and NADRAC, that all disputes are suitable for ADR (including direct negotiation) except where it would be clearly inappropriate. For example, where:

- *the cost and delay involved in ADR is disproportionate to the benefits to be derived, such as where the parties are in agreement as to the facts and the dispute turns on genuine and fundamental issues of law;*
- *there is a clearly identified public benefit in having the matter judicially determined; or*
- *there is a genuinely held concern that it is not appropriate to engage in dispute resolution, such as in cases of serious criminal fraud or evasion.*

The IGT further recommends that the implementation of this principle should be the subject of consultation with stakeholders as part of Recommendation 5.1.

146 ibid., paras 10.

ATO Response

Agree.

The ATO is committed to minimising and resolving disputes as early as possible and actively participates with the AAT and NADRAC in dispute resolution. As noted by the Inspector General at paragraph 4.1, the Commissioner indicated in his 2011 Annual Report a willingness to engage in ADR. As is recognised in the recommendation, there are cases where it is not suitable or appropriate to enter formal ADR processes.

We agree that it might not be suitable to enter into ADR where such processes add extra steps, or create extra costs and the matter is otherwise quite straight forward. By way of context, in the vast majority of adjustments resulting from audits and reviews taxpayers do not seek a review of those decisions (about 4% in income tax cases) and only a very small proportion are not resolved at that stage through less formal processes (less than 3% of taxpayers objecting to an income tax adjustment go on to litigation).

We agree to the review of PS LA 2007/23 (see recommendation 5.1), in consultation with NTLG ADR Sub-committee.

Public benefit and law clarification

4.11 The IGT recognises that in some instances there may be a public benefit in litigating (or prosecuting) a matter rather than seeking to arrive at a negotiated outcome.

4.12 The public benefit may be served in a number of ways. For example, the prosecution of taxpayers for fraud and evasion (such as those under Project Wickenby) or civil penalties levied against promoters of tax avoidance schemes may serve as a deterrent to others contemplating similar activity and result in a flow on future compliance effect. Such cases should be rare and outside of the norm.

4.13 There is also significant public benefit in clarifying uncertainties in the law particularly where a broad range of taxpayers may be affected. Such clarification would lead to more consistent and certain application of the law, thereby reducing time and cost for both the ATO and taxpayers in the long run.

4.14 Given the complexities inherent in the tax law, issues concerning deficiencies or uncertainties in the law have been raised and considered previously. While the terminology adopted by groups or people considering the issue vary, the conclusion is generally the same. That is, deficiencies where they are identified should be corrected as quickly as possible.

4.15 The Board of Taxation recognised in its 2007 report, *Improving Australia's Tax Consultation System*, that:[147]

> That minor policy and technical issues arise is not surprising given the complexity of tax and other law, the economy, and society generally. Issues can and do arise that were not, and in some cases could not be, anticipated when the policy was developed and the

147 Board of Taxation, *Improving Australia's Tax Consultation System*, Sydney, 2007, p. 45.

> legislation drafted. This is not a reflection on the capabilities of the stakeholders in the system — it mainly reflects complexity built up over decades.
>
> However, while such issues will arise, if they are not addressed in an effective manner, unintended expenses, complexity and compliance and/or difficult tax administration issues can arise. This can reduce community support for the tax system. That said, it is not realistic or appropriate to expect that all of these issues can be addressed. Ultimately it is a question of priorities and weighing the costs (including opportunity costs) and benefits of making particular changes.

4.16 Where there is a clear deficiency in the law, or an ambiguity which increases the cost of compliance for taxpayers, and the cost of administering the relevant provisions for the ATO, consideration should first be given to whether a changed ATO view on the interpretation or application of that provision may remove the uncertainty.

4.17 In one case reviewed by the IGT, the taxpayer applied to the AAT for review of a decision by the ATO to disallow the exempt status of certain income. The objections officer had correctly applied the ATO view, as contained in the relevant ruling, in determining the taxpayer's objection. At the AAT, the taxpayer applied for Test Case Funding which brought the matter before the ATO's Chief Tax Counsel, who considered that the ATO's view of the law was incorrect. This led to the matter being conceded, and the ATO view reconsidered and reissued.

4.18 If the ATO is of the view that it cannot interpret away uncertainties or ambiguities in the legislation then consideration should be given to why a change of the law cannot be effected, or an amendment to the relevant provisions passed, without the need for litigating cases aimed at testing the interpretation or application of those particular provisions.

4.19 As Justice Graham Hill, writing extra-judicially, noted:[148]

> There is a need for the legislature to cure defects from time to time. Yet there seems to be a refusal on the part of the government to admit there are defects and to make amendments other than amendments which may be thought necessary to overcome avoidance. In some cases, the courts may be able to resolve difficulties by applying a purposive construction but in the Australian constitutional context where there is a sharp separation of the legislative and judicial powers there is a limit to what one can expect of the courts. Ultimately the courts cannot act as legislators. Parliament cannot stand by and then blame the courts if a decision is one that does not favour the revenue when the problem lies not in how the legislation is to be interpreted in a common sense way, but in how it is written.

4.20 Legislative change provides a mechanism through which Parliament is able to amend the law to give effect to the intended policy outcome. It should be the preferred method of correcting defects or clarifying ambiguities in the law where these defects and ambiguities are clear.

4.21 The Joint Committee of Public Accounts and Audit (JCPAA) also generally supports this approach. In 2011, it noted that:[149]

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148 Justice G. Hill, *To Interpret or Translate? The Judicial Role for GST Cases,* speech delivered on 5 August 2005 at a conference organised by Monash University on "Interpreting the GST Law" cited in *Commissioner of Taxation v Multiflex Pty Ltd* [2011] FCAFC 142 at [1].

149 Joint Committee of Public Accounts and Audit, *Report 426 Ninth Biannual Hearing with the Commissioner of Taxation,* Canberra, 23 November 2011, p. 25.

> If substantial legislative problems have been identified, it is important that these issues are promptly fixed and that, after time, the public is notified of the improvements made.

4.22 The JCPAA recommended that:[150]

> … the Australian Taxation Office notifications to the Government, either directly or through Treasury, on tax policy and legislative problems be made public within 12 months of submission, along with the Government response.

4.23 Notwithstanding this general support, it is important to recognise that competing priorities, resources and limited Parliamentary time for consideration of such issues may see necessary amendments not tabled in a timely manner leading to prolonged uncertainty for both the ATO as administrator and taxpayers.

4.24 In cases where necessary law change cannot be readily effected, or where the scope of the defect or ambiguity is unclear, bringing a matter before the Courts to seek judicial clarification may result in an interpretation of a particular provision being affirmed or rejected. In the former instance, certainty may be achieved while in the latter, an adverse finding against the ATO may serve to highlight the uncertainty warranting Parliamentary intervention.[151]

4.25 Given the current pressures on the courts, seeking judicial clarification of an uncertain legislative provision may take many years. By way of example, in the case of Anstis, the High Court delivered its judgment on 11 November 2010, over three years after the decision of the AAT in the same case was delivered.[152] The IGT also notes, however, that in appropriate cases, the courts may provide mechanisms through which cases may be expedited with hearings listed and judgments delivered within a reasonably short timeframe[153] resulting in judicial clarification being obtained in a more timely manner.

4.26 The process of methodically working through the proposed public benefit process outlined above by the IGT is to provide a clearer test of the value to be obtained by employing the most appropriate course of action to final resolution. As in the Anstis case, the matter was considered so significant following the taxpayer's ultimate success in High Court that advice from both the administrator and Treasury led to the government seeking legislative change.[154]

4.27 While some individual cases may provide value in proving (or disproving) a particular principle, it may sometimes be more effective to accept a certain position as being meritorious with advice being provided to government to change the law prospectively rather than exhausting the court process.

4.28 Additionally, regard must be had to the fact that while bringing a matter before the court to have issues judicially tested and determined may at times be desirable, it should be noted that the litigation of a case can create an impost on private taxpayers whose cases are being relied on as vehicles to test uncertainties in the law in the form of additional legal costs.

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150 ibid., p. 26.
151 Justice G. Hill, 'The Judiciary and its Role in the Tax Reform Process,' (1999) 2(2) *Journal of Australian Taxation* 66, p. 66.
152 *Commissioner of Taxation v Anstis* [2010] HCA 40.
153 See for example: *Multiflex Pty Ltd v Commissioner of Taxation* [2011] FCA 789.
154 Tax Laws Amendment (2012 Measures No. 1) Bill 2012. The bill was introduced in the Senate on 10 May 2012.

4.29 A further difficulty associated with the use of private cases to test ambiguous areas of the law is that there exists a significant 'free rider' benefit for those taxpayers who ultimately enjoy the increased certainty of outcomes following litigation for law clarification purposes. This 'free rider' outcome creates a cost asymmetry which poses a very real concern for taxpayers.

4.30 Indeed, in a recent special leave hearing in the High Court, Qantas raised the issue via its legal counsel. Specifically, senior counsel for Qantas sought orders that if special leave were granted, the costs ordered in Qantas's favour in the court below should not be disturbed and that the ATO pay Qantas's costs of proceedings in the High Court. Senior Counsel noted in her request that the reason the Commissioner is being granted special leave to appeal is that the matter is one of 'public importance and for those reasons, it does not seem right that Qantas should have to pay the costs.'[155]

4.31 While the Court ultimately did not acquiesce to Qantas's request, it is a consideration that should be taken into account by the ATO as the system's administrator or by government as a policy consideration where such actions are undertaken and there is a clear public benefit to be obtained. As the High Court has noted in an earlier case:[156]

> It is common in this Court in cases where the resolution of a point is desirable from the point of view of a large and recurrent litigant, whether corporate (for example, an insurance company) or governmental (for example, the Commissioner of Taxation or the Australian Competition and Consumer Commission), but the other party to the litigation is not a recurrent litigant and is not well-positioned to meet adverse costs orders on the point being tested, for the grant of special leave to be made conditional on appellants paying the other side's costs in any event and on appellants not seeking to disturb costs orders in the courts below which were favourable to the other side.

4.32 The tension between public and private benefits in this area and the importance of these considerations are especially pertinent given the high costs associated with litigation.[157]

Test Case Litigation Program

4.33 To alleviate the cost burden in these cases for some taxpayers, the ATO has for a number of years maintained its Test Case Litigation Program. The program aims to resolve uncertainty and to create legal precedents 'that provide guiding principles on how specific provisions ... should be applied more broadly.'[158] One of the ways the Program does this is to identify appropriate cases to test uncertain or ambiguous areas of the law and to provide funding, where appropriate, to assist taxpayers to bear the legal cost burden of having these matters tested through the courts.

4.34 The Test Case Litigation Program is managed by the ATO's Strategic Litigation team.[159] The Strategic Litigation team was established following a recommendation of an

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155 *Commissioner of Taxation v Qantas Limited* [2012] HCATrans 36.
156 *CSR Limited v Eddy* [2005] HCA 64.
157 Michael Kirby, 'Alternative Dispute Resolution – A Hard-nosed view of its strengths and limitations' (2009) 28 *The Arbitrator and the Mediator* 1, p. 3.
158 Australian Taxation Office, *Test Case Litigation Program*, Canberra, 9 June 2009, viewed on 23 May 2012, <www.ato.gov.au>.
159 Australian Taxation Office, above n. 74.

internal review commissioned by the ATO in respect of its in-house legal service.[160] It is headed by a Senior Assistant Commissioner.

4.35 'The Senior Assistant Commissioner, Strategic Litigation provides technical leadership and is responsible for ensuring that strategic litigation is managed effectively, and is argued consistently with precedential ATO views. There are also three Senior Tax Counsel providing technical leadership in strategic litigation, two with responsibility for income tax issues and one with responsibility for indirect tax issues … The relevant Senior Tax Counsel may take direct responsibility, or closely monitor, the strategic litigation cases, regardless of other Tax Counsel involvement.'[161]

4.36 According to the ATO, strategic litigation refers to its most significant cases, the outcomes of which are of particular interest to the Commissioner and the community. Specifically, it includes cases:[162]

- where the revenue at risk is significant;
- where there is a significant compliance risk;
- likely to attract media interest (for example, prominent people or sensitive issues);
- raising a contentious question of law;
- before the High Court, the Full Federal Court or a State Court of Appeal; or
- involving general anti-avoidance provisions.

4.37 Therefore, while all cases which are funded under the Test Case Litigation Program are necessarily strategic litigation cases, not all strategic litigation cases receive test case funding.

4.38 The ATO reports on strategic litigation cases and cases funded under the Test Case Litigation Program in its Annual Report.[163] Additionally, the ATO also provides an update of significant litigation twice yearly at its June and December meetings of the NTLG.[164]

4.39 The IGT examined the ATO's Test Case Litigation Program in detail as part of the *Review of Tax Office management of Part IVC litigation* (the Part IVC review).[165] That review noted some stakeholder perceptions of a lack of consistency and independence in the granting of funding, and found that the ATO appeared to be funding matters which were progressed for law enforcement, rather than law clarification, purposes.[166]

4.40 To enhance greater confidence in the ATO's law clarification efforts, the IGT recommended, amongst other things, the establishment of an independent panel to manage the Program, greater transparency through the publication of test case details and, in line

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160 Knowledge Pond Pty Ltd, *Managing Legal Risk in the Australian Taxation Office: Aligning Resources and Functions*, September 2003. Report provided by the ATO to the IGT and is not publicly available.
161 Australian Taxation Office, above n. 74, para. 61.
162 Australian Taxation Office, *Significant Technical Issues*, Canberra, 10 January 2011, viewed on 2 December 2011, <www.ato.gov.au>; see also ibid, Attachment 1 to Annexure F.
163 Commissioner of Taxation, above n. 95, pp. 170 – 181.
164 Australian Taxation Office, *NTLG Minutes June 2011*, Canberra, 23 November 2011, viewed on 15 December 2011 <www.ato.gov.au>, item 10.
165 Inspector-General of Taxation, *Review of Tax Office Management of Part IVC Litigation*, Sydney, 7 August 2006, <www.igt.gov.au>.
166 ibid., p. 105.

with advice from the Solicitor-General, the ATO funding all cases in which it appeals an adverse decision.[167] Recognising the often limited resources of taxpayer applicants in the AAT, the ATO has advised the IGT that in most cases it provides funding for taxpayers where it appeals an adverse decision from the AAT to the Federal Court.

4.41 The IGT considers that this should further be extended to cases being advanced to clarify ambiguous points of law. In such cases, the IGT does not consider it appropriate that one taxpayer be asked to bear the burden of legal costs, regardless of that taxpayer's resources.

4.42 The decision regarding whether the ATO should provide funding to a taxpayer is currently made by the Chair of the Test Case Litigation Panel following recommendations made by the Panel. The current panel comprises an accountant, a solicitor, a former Federal Court judge, an ATO Senior Tax Counsel and the ATO's Chief Tax Counsel, who is also the Chair.

4.43 The ATO's published information on the program outlines a three-fold criteria for funding. These are:[168]

- there is uncertainty or contention about how the law operates;
- the issue is of significance to a substantial section of the public or has significant commercial implications for an industry; and
- it is in the public interest for the issue to be litigated.

4.44 In applying the above criteria, the Panel is guided by the following principles:[169]

- Cases involving questions of fact where there are established legal principles will generally not meet the criteria for funding.
- Our appeal against a decision of a court or tribunal usually indicates that an important issue is involved. If it is also in the public interest that the issue is clarified we may provide funding.
- Most cases accepted under the program involve reviews of our decisions on objections to assessments or private rulings. These can be applications to the Administrative Appeals Tribunal (AAT) to review a decision or appeals to the Federal Court, including further appeals from an AAT or Federal Court decision. However, we will consider other cases on debt-related issues, applications for declaratory relief and judicial review issues where clarification of the law is important.
- We prefer to fund cases that are brought before the Federal Court, rather than the AAT, because they are more likely to provide legal precedent to clarify issues. However, we still consider funding cases before the AAT or Small Taxation Claims Tribunal, particularly where the case is to be heard by a presidential member.
- As it is important to clarify uncertainty in the law as quickly as possible, we expect applicants to cooperate to achieve an early hearing.
- We take into consideration an applicant's financial capacity to pursue litigation, although we may still approve funding for applicants who have the capacity to fund their own case.

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167 ibid., p. 119.
168 ibid.
169 ibid.

- We do not usually fund cases that we consider involve tax avoidance schemes or attempts to gain a benefit clearly not intended by the law. However, we will consider these cases for funding if they test the proper meaning of anti-avoidance provisions or if funding the case is in the public interest.

4.45 Stakeholders generally support law clarification by litigating test cases in appropriate circumstances. However, stakeholders also raised two matters which should be borne in mind when litigating matters funded by the ATO under the Test Case Litigation Program.

4.46 First, noting the ATO's preference for test cases to be heard and determined by the Federal Court, stakeholders observed that the right of the taxpayer to commence proceedings in the AAT should be preserved. This is important given the AAT's special ability to stand in the shoes of the Commissioner which is not otherwise available in any other forums.

4.47 Second, if an issue is considered sufficiently important so as to warrant test case funding support, then all parties to that action should be afforded the opportunity to exhaust the appellate process. Where this is not actually, or not perceived to be, the case the process may be open to accusations of potential bias and claims that the law has not been fulsomely or exhaustively established on the specific point.

4.48 The notion that a judgment is very clear and does not require further surety may sometimes be in the eye of the beholder. It is a feature of the legal system that the higher appellate courts establish the law more conclusively for the benefit of both litigants and others more broadly. It seems much clearer and fairer for the appeal process to continue at either parties option in such circumstances.

4.49 In addition, stakeholders have also expressed concern that ATO officers sometimes reject proposals to engage in ADR with no reasons given for this rejection though in some cases, the absence of reasons has led taxpayers to suspect that the matter is being advanced to clarify a point of law.

4.50 In a recent case, *Commissioner of Taxation v Clark & Anor (No 2)*,[170] the Full Court of the Federal Court awarded indemnity costs to the successful taxpayers following the Commissioner's rejection of their Offers of Compromise pursuant to Order 23 of the *Federal Court Rules*. In opposing the application for indemnity costs, the Commissioner argued that in an appropriate case, the public interest may be better served by having the Court decide a case which has wider ramifications, rather than settling it upon the basis of purely commercial considerations.[171] However, the Court was not persuaded that the matter at hand was such a case, noting the Commissioner's rejection of the taxpayer's application for Test Case Litigation funding.[172]

4.51 The case recognises there are instances where it is appropriate for the Commissioner to reject reasonable offers of settlement. Namely, that there is a public benefit in having the matter judicially determined. However, it also suggests that where such is the Commissioner's intention, the decision to do so must be transparent and clearly communicated to the taxpayer.

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170 *Commissioner of Taxation v Clark & Anor (No 2)* [2011] FCAFC 142.
171 ibid., para. 28.
172 ibid., paras. 24 and 28.

4.52 In the same manner, where a taxpayer wishes to litigate their own matter, their right to do so is appreciated. However, where that action is genuinely at odds with an established interpretation of the law then there is no public benefit to be obtained by any public funding being provided.

4.53 The IGT considers that greater transparency and openness in respect of the ATO's identification of public benefit issues and its intention to progress certain cases to clarify the law would assist taxpayers and their representatives to better understand the ATO's position in respect of litigation and any responses to offers of settlement.

4.54 In the IGT's view, the Commissioner should clearly state, whether any litigated case has wider ramifications and involves a public benefit that would be better served by having the court decide the case. This should be communicated to the relevant taxpayers and their representatives.

4.55 Furthermore, as matters of law clarification may be of interest to broader taxpayer community, the ATO should look to publish information (sufficiently redacted to remove any identifying taxpayer information) regarding cases which the ATO is advancing to test or clarify ambiguous areas of the law.

4.56 The IGT notes that the ATO currently presents updates of deliberations and recommendations of the Test Case Litigation Panel at each of the meetings of the NTLG. However, there is a general time lag of several months in the publication of this information (for example, the 15 March 2011 Panel decisions were presented to the meeting of the NTLG on 22 June 2011. The Minutes of 22 June 2011 meetings were not published until 23 November 2011).

4.57 Additionally and with the aim of limiting compliance costs, the ATO should also suspend, or stay, tax disputes where those disputes bear facts or questions of law which are materially similar to those of a court proceeding that has been designated a test case. The IGT notes that the ATO has used this approach in relation to certain types of project work in the past, such as mass marketed scheme cases. Such an approach is already being utilised by the New Zealand IRD to limit the number of cases on substantially the same matter being heard thereby reducing compliance costs and limiting the resource impact on the courts. It also ensures that once a decision is issued in relation to the test case, that decision may be applied consistently to resolve similar issues in other cases.[173]

4.58 A more contemporaneous publication of cases advanced for law clarification may assist the ATO to achieve this outcome.

4.59 Even where matters are being progressed for law clarification purposes, there is scope for the parties to utilise ADR (including direct negotiation) to ensure an efficient progression of the matter through to hearing. The IGT notes that one of the principles guiding applications for test case funding requires 'applicants to cooperate to achieve an early hearing.'[174] The IGT considers that such a principle should inform the management of all cases which are advanced for law clarification purposes, regardless of whether they are

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173 Inland Revenue, *Disputing an Assessment*, Wellington, 2011, viewed on 2 February 2012, <www.nzird.govt.nz>, pp. 8 & 27; Inland Revenue, *Disputing a Notice of Proposed Adjustment*, Wellington, 2011, viewed on 2 February 2012, <www.nzird.govt.nz>, pp. 7 & 27

174 Australian Taxation Office, above n. 158.

formally funded by the ATO, through the use of ADR to settle statements of facts, processes and procedures including interlocutory litigation steps and ultimate orders sought where one or another party is successful.

4.60 Where a matter is not progressed on the basis of law clarification, the ATO should give careful consideration to all offers of settlement.[175] The IGT recently considered the ATO's approach to settlement in the Settlements review.

4.61 Similarly, the IGT considers that it is important to note that the Test Case Litigation Program should only be relied upon by taxpayers for cases in which there is a clear and fundamental disagreement as to the proper application of the law, which if clarified would benefit a broader group of taxpayers than those involved in the immediate dispute.

4.62 In other words, taxpayers should not view the Test Case Litigation Program as a means through which funding may be obtained to progress personal litigation goals that do not satisfy clear public benefit, and otherwise seek to avoid engagement with the ATO to resolve or settle matters through other means. Given the requirements of the CDRA 2011, both the ATO and taxpayers should take genuine steps to resolve disputes without litigation.

RECOMMENDATION 4.2:

The IGT recommends that:

1. *As soon as practicable, the ATO should consider and identify whether a case has wider ramifications and involves a public benefit that may be better served by having the courts decide the case. If the case is so identified, the ATO should:*
   - *(a) communicate this to the taxpayer and their representatives;*
   - *(b) provide litigation funding irrespective of the taxpayer's resources;*
   - *(c) engage with the taxpayer and their representatives to:*
     - *(i) reach agreement on those materials facts to which the parties can agree;*
     - *(ii) identify any material facts which are in contention and determine whether additional information may assist in resolving these matters;*
     - *(iii) settle the questions which need to be put to the Court at the hearing; and*
     - *(iv) clarify and settle any necessary interlocutory or procedural steps to expedite the matter for hearing.*
2. *The ATO publish a public register of cases in litigation, sufficiently redacted to remove identifying taxpayer information, which have wider ramifications and involves a public benefit. The register should be updated in a timely manner to reflect progress of the litigation and include the following information:*
   - *(a) the point of law to be clarified;*

175 See for example, *International All Sports Limited v Commissioner of Taxation (No 2)* [2011] FCA 1027.

RECOMMENDATION 4.2 (CONTINUED):

(b) the benefit expected from the clarification of the law and the wider ramifications which may arise if there is no clarification;

(c) why the particular case is appropriate to clarify the point of law; and

(d) what action the ATO is taking to mitigate the impact on other taxpayers while the case is being heard and determined, including consideration of suspension or stay of disputes which are materially similar in fact or questions of law and remission, or cessation of GIC accrual, for the period of the suspension in these cases.

ATO Response

Agree with 4.2.1(a), and with (c) provided the taxpayer and their representatives also commit to this course of action. Disagree with 4.2.1(b). Agree in part with 4.2.2.

A set amount of funding is available for the Test Case Litigation Program. There is a risk that recommendation 4.2.1(b) would extend test case funding to cases that do not meet the community's expectations about which cases should receive public funding. This could include, for example, cases involving tax avoidance schemes, instances where the taxpayer has not been willing to co-operate with the ATO to achieve an early hearing, or cases where the taxpayer has the financial capacity to pursue litigation without test case funding. There is also a risk that such an approach may encourage a more litigious approach to dispute resolution rather than ADR.

The Test Case Litigation Program has criteria that have been designed to ensure, from a community perspective, that the funding of a particular taxpayer's litigation costs is an appropriate expenditure of Commonwealth resources. That is, the case raises issues of uncertainty or contention about how the tax and superannuation laws operate and that are potentially of significant community interest. To assist in making this judgement our Test Case Litigation Panel comprises 5 members, 3 of which are non-ATO accounting and legal professionals. The panel provides independent advice on the merits of applications for test case funding and on the significance of the issues to the community.

Under existing court processes, taxpayers who are proven right may be reimbursed for their legal costs through court orders on costs.

Regarding recommendation 4.2.2, as noted in the report at paragraph 4.38, the ATO already reports on strategic litigation cases and cases funded under the Test Case Litigation Program that have wider ramifications and involve a public benefit in the Commissioner's Annual Report, and in updates twice yearly at its June and December meetings of the NTLG.

In relation to the specific wording of recommendation 4.2.2 we are concerned that ATO statements in a public register of cases whilst such cases are in the course of litigation may be perceived to be influencing the courts and tribunals.

Nevertheless the ATO will explore whether there is scope for more frequent updating of our register and whether there is more that we can add to the register. However, we are limited by law to only providing information that is available on the public record.

As for recommendation 4.2.2(d), decisions to defer objections can occur with the written consent of the taxpayer, in circumstances where it is agreed that the issue is already being considered in a current Part IVC case before either the AAT or Federal Court.

The ATO also already has a policy for remission of GIC which is set out in PS 2011/4. Basically, it states that under a 50/50 arrangement the taxpayer must pay all of the undisputed debts and at least 50% of the tax in dispute, and the ATO will allow a 50% remission of the GIC on the unpaid disputed tax, if the taxpayer's dispute is partly or wholly unsuccessful.

Declaratory Proceedings

4.63 Declaratory proceedings seek a ruling of the court on a point of law without asking the court to apply that to the facts, or to make any orders in respect of awards to one party or the other.

4.64 A number of submissions noted that in some instances declaratory proceedings may be used by the Commissioner or the taxpayer to clarify an ambiguous point of law without the need to progress a matter through the Part IVC process.[176] The Part IVC process can impose unnecessary costs and delays in cases where the facts are settled but the dispute concerns the ATO view or the application of that view to the facts.

4.65 Following the Full Federal Court's decision in *Commissioner of Taxation v Indooroopilly Children's Services (Qld) Pty Ltd,*[177] the Commissioner sought advice from the Commonwealth Solicitor-General, Chief General Counsel of the Australian Government Solicitor and another member of the NSW Bar regarding, amongst other things, the viability of using declaratory proceedings to clarify ambiguous points of law.[178]

4.66 The advice noted there were 'numerous situations in which it may be appropriate to seek a declaration in relation to the operation of Federal income tax legislation' and 'it is clear that a court will grant a declaration where, for example, no assessment has issued or where liability does not depend on a notice of assessment.'[179]

4.67 However, the advice went on to say that it was generally not appropriate for the Commissioner to use declaratory proceedings either prior to the issuance of a ruling or prior to the issuance of an assessment. This is so, even where the court has undoubted jurisdiction to make the declarations sought.[180] However, the advice did indicate this may not include cases where the facts were not disputed and the declaration would provide for the ascertainment of the taxpayer's liability.[181]

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176 See: *Oil Basins Ltd v Commonwealth & Anor* [1993] HCA 60; *Platypus Leasing Inc & Ors v Federal Commissioner of Taxation* [2005] NSWCA 355.

177 *Commissioner of Taxation v Indooroopilly Children's Services (Qld) Pty Ltd* [2007] FCAFC 16.

178 D. Bennett QC, H. Burmester QC and J. Hmelnitsky, *Application of Precedent to Tax Cases – Further Opinion on Declaratory Proceedings*, Sydney, 18 June 2007, viewed on 15 August 2011, <www.ato.gov.au>.

179 ibid., p. 6.

180 ibid., pp. 14–17.

181 ibid, pp. 16 - 18

4.68 Even in instances where there is no consensus between the parties, the IGT is aware that declaratory proceedings have been brought successfully by taxpayers. For example, in one case a taxpayer applied for declarations in the Federal Court that payment of royalties were not subject to withholding tax and succeeded in securing consent orders on the declarations sought.[182]

4.69 The IGT is of the view that while declarations may not be appropriate in all cases, there are some instances in which the use of declaratory proceedings may assist the Commissioner and taxpayer to clarify specific points of law having wider impact without the need to progress matters through the Part IVC process.

4.70 Furthermore, the IGT recognises that the Commissioner alone cannot bring applications for declaratory relief in the abstract, as in the absence of any justiciable controversy, the Court is likely to decline to rule on such an application as such a ruling may be considered an advisory opinion or otherwise based on hypothetical situations.[183]

4.71 The IGT considers that, given the above, there is scope for the parties to jointly make greater use of declaratory proceedings in cases where the facts and evidence are not in dispute and where there is a public benefit in having a judicial statement on specific questions arising in the case.

4.72 Through robust engagement and discussion, the parties could discuss and identify the issues under dispute, the questions needing to be put before the Court and any steps which could be taken to expedite the matter for hearing and determination. Such a process would assist in ensuring that the right questions are properly put before the Court for determination and provide a more efficient and effective means to obtain further certainty on how the law should be interpreted.

4.73 To facilitate a greater understanding of the circumstances and factors which may favour the use of declaratory proceedings, the IGT is of the view that there is benefit in the ATO supporting taxpayer opportunities to make greater use of declaratory proceedings in appropriate cases to clarify ambiguous points of law without the need for the taxpayer progressing a matter through the Part IVC process.

RECOMMENDATION 4.3:

The IGT recommends that, for the purpose of reducing compliance costs and unnecessary delays, the ATO consult on:

- *making use of declaratory proceeding opportunities in appropriate cases through engagement with taxpayers and their representatives; and*
- *when the use of declaratory proceedings may be appropriate and how the ATO will engage with, and support, taxpayers to progress these opportunities.*

Following the above consultation, IGT also recommends that the ATO provide its views on these matters in a practice statement.

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182 *News Sports Programming Pty Ltd & Ors v Commissioner of Taxation & Ors* (Federal Court proceeding NSD 916 of 2008); M. Jacobs, "ATO drops action against News", *The Australian Financial Review*, 11 September 2008.

183 D. Bennett QC, H. Burmester QC and J. Hmelnitsky, above n. 178, pp. 9 and 11.

ATO Response

Agree.

The ATO does engage with taxpayers on making use of declaratory proceedings, however our experience shows that there are limited circumstances where declaratory proceedings will provide clarification of a particular legal issue. While taxpayers can initiate declaratory proceedings, many significant tax matters often raise a question of law and a set of complex facts that are generally not suited to declaratory proceedings.

It should also be noted there is the risk of duplicating proceedings; this recently occurred in a matter where the Full Federal Court noted:

"… there are existing Pt IVC proceedings on foot in the AAT in relation to the 2006 Assessment. The pending of those proceedings would normally mean no declaratory relief should be made in relation to the 2006 Assessment"[2]

Although there have not been any approaches by taxpayers or professional associations for a public statement by the ATO on declaratory proceedings, we will consult with the NTLG Public Rulings Steering Committee to assess the priority of drafting a practice statement on declaratory proceedings.

[2] Mount Pritchard & District Community Club Limited v Commissioner of Taxation [2011] FCAFC 129

4.74 It has been suggested that an alternative mechanism to declaratory proceedings may be found in rule 30.01 of the *Federal Court Rules*. The rule allows a 'party to apply to the Court for an order that a question arising in the proceeding be heard separately from any other questions.'

4.75 The taxpayer and the Commissioner could 'reach some agreement that the taxpayer lodge an objection which raises all of the issues which the taxpayers wishes to litigate including the issue which the Commissioner wishes to have tested and then agree that the issue which the Commissioner wishes to have tested be one on which the Court should be asked to give a preliminary ruling as a separate question.'[184]

4.76 Such an approach necessarily entails some agreement by the parties as to the substantive matters and procedures to be adopted in litigation to ensure that any questions needing to be tested arise 'in the proceeding'. This provides opportunities for the taxpayer and Commissioner to make use of either direct discussions or those facilitated by a neutral ADR practitioner to establish this agreement.

184 J. Batrouney SC, *The Commissioner's Role in Interpreting Tax Law and Emerging Issues for Advisers*, paper delivered at the 46th Victorian State Convention, Melbourne, 11-13 October 2007, viewed 19 March 2012, <www.taxinstitute.com.au>, p. 13.

Valuations

4.77 At the other end of the spectrum to law clarification cases, certain types of disputes readily lend themselves to resolution through either direct negotiation or ADR. For example, disputes concerning market valuations.

4.78 During consultation, valuation disputes were consistently identified as a type of dispute which turns on specific facts or findings of fact that may be more readily and objectively ascertainable and, as such, were highly suitable for resolution through means other than litigation, such as ADR (and in particular, early neutral evaluation), where the parties' respective experts were unable to agree.[185] The IGT notes that clause 26 of the ATO's Code of Settlement Practice specifically identifies valuation disputes an area which may be appropriate for settlement.

4.79 One example in which ADR was successfully used to resolve the valuation aspect of a large dispute saw the ATO and the taxpayer engage in early neutral evaluation which was conducted by a former judge. The taxpayer's representative advised the IGT that this process was helpful as it allowed the ATO to objectively test some of its assumptions and its valuation approach, to take advice from the judge and to re-evaluate its approach based on this advice.

4.80 In another example, the taxpayer obtained a valuation for the purposes of determining GST payable on a sale transaction. The ATO did not agree with the adopted methodology and inputs which had been used in the valuation, and engaged the Australian Valuation Office (AVO) to review the initial valuation. The AVO supported the ATO's view that the methodology applied was not appropriate, though the taxpayers contend that the AVO had in fact not understood the methodology which had been adopted. After some discussion, the ATO agreed to engage another expert to review the valuation. That expert agreed with the taxpayer's valuer. However, the differences between the ATO and the taxpayer were not able to be resolved until the parties jointly appointed a further independent valuer to review the issues. The matter ultimately resolved, but only did so some two and a half years after the ATO commenced its investigation and after both the ATO and the taxpayer had incurred significant costs.

4.81 The above examples illustrate the effectiveness of ADR in assisting to resolve valuation disputes. The latter example, in particular, also illustrates the risk of valuation-based disputes being protracted and increasing costs for both the taxpayer and the ATO.[186] This is especially so where the parties need to engage additional experts to review initial expert reports well after the given events have taken place.

4.82 The Federal Court has sought to address some of the issues concerning disputes arising out of expert witnesses through the use of directed conferences as outlined in Practice Note CM 7.[187] The practice note states that 'it would be improper for an expert to be given, or to accept, instructions not to reach agreement. If, at a meeting directed by the Court, the

185 Australian Taxation Office, *NTLG Dispute Resolution Sub-committee meeting minutes June 2011*, Canberra, 6 October 2011, viewed on 2 December 2011, <www.ato.gov.au>, item 7.

186 The taxpayer's legal fees in the case in the preceding paragraph for its solicitor alone was approximately $250,000 by the time the matter concluded.

187 Federal Court of Australia, *Practice Note CM 7*, Sydney, 1 August 2011, viewed on 2 September 2011, <www.fedcourt.gov.au>.

experts cannot reach agreement about matters of expert opinion, they should specify their reasons for being unable to do so.'[188]

4.83 Following the IGT's Settlements review, the ATO agreed that 'disputes and settlements involving valuations will be used as a key area for exploring earlier resolution opportunities and strategies.'[189] As a result, the ATO issued staff instructions via its internal 'Work Processes Homepage' explaining that market value issues were to be resolved at the earliest possible point in time during an audit or review.

> **Earlier resolution of compliance disputes involving market value**
>
> Advice has been sought from a respected, expert, external valuer on how we can drive earlier resolution of potential disputes for efficient, effective and appropriate case outcomes. In giving this advice he referred to his extensive experience in litigation matters relating to tax-related valuations.
>
> The advice is as follows:
>
> > 'I would think that the first step is to ensure agreement exists on the basics: what is being valued, at what date, in what context and whether a market exists.
> >
> > Then attempt to form agreement on a range of possible "futures" for the asset. That should ensure that any debate is contained to the mathematical part of the equation rather than fundamentals.'
>
> **Active Compliance requirement aimed at earlier resolution of disputes**
>
> Where appropriate and feasible, all reasonable attempts to resolve issues surrounding market value are to be undertaken at the earliest possible time during an audit or review, before market valuation-related adjustments are made.
>
> On the basis of the above advice from an experienced tax-valuation expert, all team leaders managing valuation disputes in active compliance are required to pursue agreements on the matters referred to above with taxpayers before active compliance audit cases are finalised.[190]

4.84 In 2012 the Organisation for Economic Development and Cooperation published its report in relation to dealing with the challenges posed by transfer pricing cases. At the core of transfer pricing disputes is the proper valuation of the goods in question. The report noted that in many transfer pricing cases the parties' positions had become 'so deeply entrenched' that progress to settlement was slow, taking many months or even years.[191]

4.85 The report noted that many disputes of this kind could be progressed beyond the deadlock through a reassessment of the case, by reconsidering of the merits through 'fresh eyes' and updating the proposed plan of action jointly with the taxpayer. Where this failed to resolve the dispute, consideration was given to the use of ADR and, in particular, early neutral evaluation.[192]

4.86 The report also notes that 'business and administrators alike were interested in exploring further whether [early neutral evaluation] could be used or adapted for transfer

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188 ibid, para. 3.1.
189 Inspector-General of Taxation, above n. 135, p. 32.
190 Australian Taxation Office, Work Processes intranet page, document entitled 'Early dispute resolution attempts: valuation-related audit issues.'
191 OECD, *Dealing Effectively with the Challenges of Transfer Pricing*, 19 January 2012, <http://dx.doi.org/10.1787/9789264169463-en>, p. 46.
192 ibid.

pricing cases, particularly in reaching agreement that sufficient facts and evidence had been provided or obtained.'[193] It suggested that revenue authorities consider using early neutral evaluation in relation to transfer pricing cases which have stalled.[194]

4.87 The IGT is of the view that there is considerable merit in the use of ADR, and in particular early neutral evaluation, in the resolution of valuation disputes which are not resolved through direct discussions between the ATO and taxpayers. In such cases, the IGT considers that the matter should default to ADR prior to the finalisation of an audit, objection or the matter proceeding to litigation.

4.88 In addition to the current work the ATO is doing in relation to resolving valuation disputes, the IGT considers that there is merit in the ATO exploring what further specific procedures it could implement to avoid such disputes altogether, including:

- where it becomes necessary for an independent expert to be engaged, the ATO and the taxpayers jointly appoint the expert to review matters in contention, to agree on the parameters of the appointment, agree on the issues to be tested and the assumptions to be made; and
- where two experts conflict as to the issues in contention, utilising expert conferences, such as those in the Federal Court, to enable opposing experts to seek to resolve their different findings or to narrow the issues in contention.

4.89 In relation to the first dot point above, the IGT recognises that sometimes it may be difficult to seek agreement on these matters, particularly in valuation fields which are highly specialised and the pool of expert valuers is limited. The IGT nonetheless considers that in most common valuation areas, genuine attempts should be made to ensure such agreement as a means of reducing the likelihood and severity of any disputes which may arise.

4.90 The IGT's view on these issues seems to be supported by the ORR, where the ATO has noted:[195]

> Where we saw valuation disputes, the original decision could have benefited from stronger engagement between AVO and the taxpayer's valuer during the audit phase. Our new memorandum of understanding [MOU] with the AVO has been amended to increase expectations on AVO officers to be visible with the taxpayers to hopefully resolve more potential disputers [sic] during the audit phase.

RECOMMENDATION 4.4:

With a view to ameliorating the impact of potential valuation disputes, the IGT recommends that, where it becomes necessary to appoint an independent expert to either critique or conduct a valuation, the ATO adopt a more open process that seeks to accommodate joint appointment with the taxpayer where the parties agree on such aspects of the appointment as:

193 ibid., p. 47.
194 ibid.
195 Australian Taxation Office, above n. 189, p. 3.; Australian Taxation Office, Draft ATO – AVO Memorandum of Understanding, Schedule 1.

RECOMMENDATION 4.4 (CONTINUED):

- *the independent expert to be retained;*
- *the accepted independence of the agreed expert;*
- *the requirements of the appointment;*
- *the issues for expert consideration; and*
- *any assumptions which are to be made by the expert.*

ATO Response

Agree.

The ATO is willing to agree to the appointment of a third party expert or suggest such an appointment in circumstances where it is necessary to do so.

Our practical experience with valuation related matters has been that most taxpayers do not wish to share an expert and generally prefer to retain their own valuation experts. Nonetheless, our approach to the resolution of valuation disputes involves both parties agreeing to a resolution process and committing to accepting the outcome of that process. Joint commitments are important for resolution of disputes in these circumstances.

RECOMMENDATION 4.5:

With a view to resolving valuation disputes without resorting to litigation, the IGT recommends that the ATO:

- *where both parties agree, adopt a process of expert valuer conferencing, like those utilised by the Federal Court, to ensure that conflicting experts are afforded an opportunity to meet independently and discuss their different expert opinions with a view to resolving or narrowing these differences;*
- *where the expert opinions cannot be reconciled at the conferences, implementing a procedure to ensure that all valuation disputes be referred to ADR (for example, early neutral evaluation) unless there are clear reasons why ADR would be inappropriate (for example, where engagement in ADR impinges on international agreements the ATO has with other jurisdictions); and*
- *where an ATO officer decides not to engage in ADR in these cases, that officer must provide reasons as to why ADR is not appropriate in the circumstances and obtain authority from a duly authorised senior officer.*

ATO Response

Agree.

We also note that the recommendation acknowledges that there would be cases where formal ADR would not be appropriate.

Where taxpayers wish to proceed with formal ADR in circumstances where we think such a process is not appropriate, we will ensure that the matter is considered by a duly appointed officer and, subject to that review, our reasons provided to the taxpayer.

4.91 More recently the ATO has, following consultation with the Australian Property Institute and the AVO, published a Valuations Issues Paper[196] in which it identifies a number of recurring issues in margin scheme valuations and outlines its position in respect of each. The Issues Paper concludes:[197]

> The ATO accepts that valuations can, by their very nature, be a subjective assessment of a property's value and in many cases there are interpretive assessments of impacts on the property value. Regardless of this subjectivity there is still an expectation that values will fall within a 'reasonable range'. This is regardless of the valuer who is valuing the property or the method adopted.
>
> Where the AVO opinions are supported by evidence, and also align with the ATO's perception of reasonableness, these will be referred to the relevant valuer to enable these noted elements of the valuation to be reviewed. If there is sufficient merit in the valuer's adopted assumptions and conclusions, such that these can be considered reasonable, the valuation can be accepted as a complying valuation. Where the valuer's assumptions and conclusions are not sustainable based on evidence, or are not reasonable, the valuation cannot be considered a complying professional valuation.

4.92 Stakeholders have expressed some concern with the IGT that there should have been broader consultation with other valuations experts prior to the publication of the Issues Paper, and that its publication may create further disputes.

4.93 The IGT is currently undertaking a review to examine the ATO's implementation of agreed recommendations arising out of reviews released since November 2008. The IGT will examine the ATO's implemented strategies to resolve certain aspects of valuation disputes as part of that review.

Australian Valuation Office

4.94 An ancillary issue has also been raised with the IGT concerning the AVO. The AVO is a business line within the ATO that is located in eleven ATO offices as well as throughout a number of regional sites around Australia. It also provides a wide range of valuation services for federal, state, territory and local governments on a fee-for-service basis. It is appreciated that the ATO is one of the AVO's main clients.

4.95 Many submissions demonstrated a strong perception of a lack of independence by the AVO when acting as an adviser or expert for the Commissioner in valuation disputes. This, it was submitted, resulted in an unwillingness of taxpayers to accept the AVO's findings which leads to the engagement of further experts to review the issues in contention.

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196 Australian Taxation Office, *Valuations Issues Paper*, Canberra, 17 January 2012, viewed on 20 January 2012, <www.ato.gov.au>.

197 ibid.

4.96 It has been suggested to the IGT that issues concerning the AVO's independence may be addressed by removing the AVO function from the ATO altogether and establishing it as a wholly separate and independent agency under the oversight of a Commonwealth Valuer-General.

4.97 As this review did not specifically investigate the AVO, the IGT will not make any formal recommendations in this regard. However, the IGT considers that the ATO of its own volition should consult with stakeholders to better understand their concerns regarding its use of the AVO as experts in valuation cases and to address these concerns accordingly. The IGT may consider a review into taxpayer concerns regarding the ATO's interactions with the AVO in developing his future work programs.

WHO SHOULD INITIATE ADR?

4.98 The IGT considers that all parties to a dispute bear responsibility for initiating ADR (including direct negotiation) in appropriate cases. This is especially relevant given the requirements of the CDRA 2011 for the parties to take genuine steps to resolve a dispute prior to commencing litigation.

4.99 For the ATO, the obligation goes beyond the CDRA 2011. As previously discussed, there are a number of other legislative and policy requirements which impose on it an obligation to consider ADR, including the LSD 2005 and PS LA 2007/23. The IGT notes that in its submission to the *Issues Paper on the Review of the Legal Services Directions*, NADRAC relevantly recommended that the directions should be amended to instruct that, an agency:[198]

- commence legal proceedings itself only after ADR has been initiated and (a) has been declined by the other party or (b) has been attempted without satisfactory resolution; and

- where it is the respondent to an application (which is more common), suggest, or agree to participate in, ADR at the earliest possible opportunity.

4.100 However, the IGT notes that neither the LSD 2005 nor the ATO's internal policies specifically require that it initiate ADR where it is considered appropriate.[199] The IGT is of the view that it is implicit in these requirements that, where ADR is considered appropriate, the ATO should initiate ADR with taxpayers.

4.101 However notwithstanding these obligations, some practitioners and taxpayers have noted that in their experience the ATO has rarely initiated ADR in seeking to resolve disputes.

4.102 Practitioners observed that it should be incumbent on the ATO to make the first attempts to resolve a dispute with a taxpayer, especially with self-represented taxpayers and those with access to limited resources. This is so as a dispute with the ATO can involve a

198 NADRAC, above n. 137.

199 See for example: Attorney-General's Department, above n. 20, and Australian Taxation Office, above n. 40, both of which only require the ATO to 'consider' ADR.

considerable imbalance of power — that is, where the ATO having significant resources may have greater influence over the ultimate outcome.

4.103 The ATO's ADR Register does not currently record data as to which party initiated the ADR. At the IGT's request, the ATO compiled data in relation to which party initiated the ADR. That data shows that of the 250 relevant cases:

- the ATO, its solicitor or its counsel initiated ADR in 67 cases;
- the taxpayer initiated ADR in 19 cases;
- the ADR was ordered by a Court or Tribunal in 86 cases;
- the parties jointly agreed to the ADR in 12 cases;
- the ATO was not party to the ADR in 2 cases; and
- data was not available in respect of 64 cases.

4.104 Although 26.8 per cent of of these cases were found to be initiated by the ATO the majority proceeded to ADR following a direction from the Court or Tribunal (34.4 per cent). The IGT considers that some of the delay in initiating ADR (that is leaving it until it is formally ordered by a Court of Tribunal) may have contributed to the perception that the ATO does not often initiate and engage in ADR with taxpayers.

4.105 During the review process, the ATO advised the IGT that in an effort to enhance the data captured by the ADR Register as a way to better monitor ADR participation in ATO disputes, a number of updates were being implemented. Some of these were completed in February 2012. The IGT has been advised that there are further planned updates to enhance the register and to incorporate it into the ATO's enterprise case management system, Siebel. One proposed addition to the updated register is a field requiring ATO officers to record who initiated the ADR process.

4.106 The IGT considers that there is merit in the ATO's work in this regard and is of the view that data from the Register serves a twofold purpose:

1. to better inform the ATO of the effectiveness of its use of ADR and whether there are any skill gaps which may be addressed by appropriate training; and
2. the data may be published to inform the taxpayers of the ATO's commitment and efforts in relation to ADR usage and to encourage taxpayers to consider and approach the ATO to engage in ADR where disagreements arise.

RECOMMENDATION 4.6:

1. With a view to ensuring an accurate and meaningful collection of data on the ATO's use of ADR, the IGT recommends that the ATO's suite of future planned improvements to the ADR register should include information such as:

- *who initiated the ADR process;*
- *who represented the ATO and the taxpayer at the ADR;*

RECOMMENDATION 4.6 (CONTINUED):

- *how many people were present for each party at the ADR and their respective roles;*
- *whether a person with authority to settle the dispute for the ATO and the taxpayer was present at the ADR; and*
- *whether these persons also had authority to settle any issues in relation to the underlying debt arising from the tax dispute.*

2. The IGT further recommends that the ATO publish its findings from the ADR Register, in its Annual Report or another publication, to demonstrate its achievements in, and affirm its commitment to, the use of ADR in the resolution of tax disputes.

ATO Response

Agree in principle.

The ATO has been progressively improving the register, and will continue to make future improvements in the way we collect data about our use of formal ADR processes. From 1 July 2012, changes will be made to our IT systems, to progressively replace the current ADR Register. System changes to further configure the register's reporting criteria will have to be assessed for priority against other system change requirements of the broader organisation.

The ATO agrees to improve the register by including information such as who initiated ADR and who represented both the taxpayer and the ATO in formal ADR. We will also include on the register whether the people attending the ADR had authority to settle within a ceiling, noting that in our experience people attending ADR on behalf of taxpayers only have authority to negotiate and settle up to a point.

The ATO agrees to publicly publish relevant ADR information, to the extent that it is able to do so and the taxpayer does not object to it.

Taxpayers initiating ADR

4.107 In submissions to the IGT, taxpayers and their representatives have outlined their experiences when approaching the ATO to enter discussions with a view to either narrowing the issues in dispute or resolving the matter without recourse to litigation. Stakeholders have advised that such approaches are sometimes problematic as the designated ATO audit or objections officers appeared to be too inexperienced, lacked necessary skills, lacked authority or were generally perceived to be unwilling to commit to meet with taxpayers and their representatives.

4.108 As an example, in one case the IGT was advised that both the ATO officers and the taxpayers were able to identify the issues in dispute and agreed that ADR was appropriate. However, despite the understanding between the parties, the ATO was unable to initiate and engage in ADR in an efficient manner as it took the ATO officer some time to identify and escalate the case to appropriate ATO personnel for a decision to be made regarding engagement in ADR. The submission noted that this particular dispute is ongoing.

4.109 Some stakeholders perceive that existing escalation processes are not effective because the escalation point is often the ATO officer's immediate team leader or manager. Stakeholders consider that in these circumstances their concerns are not being objectively considered.[200]

4.110 In such cases, stakeholders advise they have had to rely on professional contacts with Senior Executive Service (SES) officers to intervene and act as circuit breakers. Stakeholders observed that whilst this may address the immediate problem, it was not an ideal solution as it necessarily imposed on an SES officer not involved in the dispute and resulted in some taxpayer concerns of potential 'retaliation' or a breakdown in working relationships.

4.111 It was also suggested by certain stakeholders to the IGT that these professional contacts with ATO SES officers are more available to 'the big end of town' or those able to afford the professional services of advisers who were engaged in forums and conferences with ATO SES officers. These stakeholders believe that such an approach is inefficient, providing ad hoc solutions, potentially discriminating against smaller, less-resourced and less-sophisticated taxpayers. A submission to the IGT also noted that the comparative difficulty of smaller taxpayers to contact and address senior ATO officers may be impeding opportunities for engagement in early negotiations to resolve issues in dispute.

4.112 The IGT has been made aware of some work undertaken by the ATO to address this concern. This is discussed below.

Points of Escalation

4.113 Stakeholder concerns regarding the need for greater clarity in escalation processes and team leader oversight were raised with the IGT in the Large Business review. The IGT made a number of recommendations in that review, including that risk review and audit team leaders should:[201]

- have end-to-end accountability for the timely and effective coordination of risk reviews and audits;
- have effective oversight of review and audit case officers and other staff involved in the process; and
- ensure there is proper dialogue and engagement with taxpayers through active participation in key workshops and meetings.

4.114 The IGT further recommended that a senior executive officer should be appointed to '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 ADR is appropriate and ensure that genuine steps are taken to resolve potential disputes.'[202]

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200 Similar issues were raised with the IGT in: Inspector-General of Taxation, above n. 71, point 7.52, p. 97.
201 ibid., p. 83.
202 ibid.

4.115 Consistent with these recommendations, the ATO has advised that the LB&I business line has taken steps to clarify and enhance escalation process by reviewing its standard pro-forma audit correspondence to clearly provide a point of contact to whom a taxpayer or their representative may escalate issues of concern, including requests to engage in discussions, in cases where the taxpayer is unable to address these issues with the appointed audit officer.

4.116 The IGT is of the view that this approach provides clear channels of escalation for taxpayers without the need to sidestep the appointed audit officers and suggests that such arrangements would be of most benefit where:

- the senior officers to whom matters are escalated are relatively senior and sufficiently experienced to appreciate the application and benefits of ADR and other dispute resolution techniques; and
- such senior officers should provide assurance to the taxpayer and their representatives that their own view was considered independently and balanced against those of the audit officer to manage the risk of perception or otherwise that their decision is based only on the ATO audit officer's views.

4.117 Ensuring that clear and effective escalation channels are communicated to taxpayers not only provides taxpayers with a legitimate avenue of recourse where it is perceived that ATO officers are not acting appropriately, it also adds a level of accountability for ATO officers and enables team leaders and managers to be apprised of issues early, to engage and manage issues before they crystallise into disputes.

4.118 The IGT considers that there is significant merit in the approach adopted by LB&I to ensure clear communication of escalation channels. However, the IGT recognises that such processes may not be administratively efficient when applied in business lines with high volume work and a larger taxpayer base.

4.119 Further, the IGT recognises that given the time lag in reviews and audits and officers moving roles, the inclusion of escalated contact points in correspondence alone will not be sufficient. The ATO's Wealthy and Wise booklet which sets out procedures, commitments and expectations in relation to the HWI taxpayer segment provides that where taxpayers are unable to resolve issues or concerns directly with the designated case officer, they should escalate these issues to:[203]

> … a more senior officer also advised to you at the start of the compliance activity. The senior officer will review the issue (including the relevance and scope of information requests) and work out a process for addressing your concerns. They may need to discuss the issue with you and the case officer. If your concerns are not adequately addressed at this level, further avenues are open to you. Details of contact points will be available through a home page for highly wealthy individuals on our website at www.ato.gov.au.

4.120 The IGT considers that the approach adopted in relation to HWIs is appropriate and should be expanded to include all taxpayers as, ultimately, all taxpayers should be able to readily obtain the details of senior officers within the ATO to whom matters of concern may be escalated to be addressed.

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203 Australian Taxation Office, above n. 50, p. 37.

RECOMMENDATION 4.7:

The IGT recommends that the ATO clarify the lines of escalation by:

- *updating the Taxpayer's Charter to include a commitment to providing taxpayers with the contact details of senior officers to whom they can escalate matters of concern;*
- *revising and updating processes to ensure that taxpayers are advised of both the designated ATO audit or review officer's details and the details of a more senior officer at the outset of any risk reviews and audits; and*
- *ensure that all escalation contact officers are sufficiently senior and possess sufficient skills and knowledge to adequately address taxpayer concerns.*

ATO Response

Agree as tailored to relevant market segments.

We will update the relevant Taxpayer Charter publication *If you're subject to review or audit* to reflect our current practice in the larger and more complex cases. The practice in those cases is to advise taxpayers and advisers of ATO escalation points at the outset of any compliance activity (see also pages 7 and 44 of the Large business and tax compliance booklet). Typically those people are the team leader's manager or an Assistant Commissioner.

We are concerned about the efficiency impacts of applying this recommendation without differentiation to all markets. To promote effective management and early resolution of less complex and higher volume cases, we do provide a contact point in our correspondence as well as providing taxpayers with information about their options for escalation. In line with the observations on high volume cases at paragraph 3.9 of the report, we think these tailored approaches substantially meet the thrust of this recommendation.

Access to ATO Contacts

4.121 The ATO has had in place for a number of years, a telephony contact point to assist tax agents to escalate tax technical matters to appropriate subject-matter experts. The Professional to Professional (P2P) service is available to tax agents who have been unable to resolve technical matters after conducting relevant research and relying on information available on the ATO website, as well as utilising a dedicated tax agents' telephony service.

4.122 The P2P service provides a senior ATO contact, whom the tax agent may contact or email to outline the technical issue and their attempts to resolve it. The senior ATO contact reviews the matter and puts the tax agent in contact with relevant ATO subject-matter experts to either resolve the issue or assist the tax agent to identify proper channels to address the issue.

4.123 One of the benefits of the P2P is the ability to directly contact a senior ATO officer who has a broader understanding of the ATO's operations and structure and is able to apply this knowledge and draw on his or her resources to quickly and easily channel the tax

agent's query to the appropriate personnel. Coupled with this, the IGT was advised that the major business lines have also appointed their own representatives to liaise and work with the P2P officer to better handle these queries. The result is that queries which come through the P2P service are directed to the appropriate area within a few days.

4.124 In response to findings of the ATO's Legal Practitioners Services Survey[204] in 2008 which identified, amongst other things, the need for improved access to ATO staff by legal practitioners, the P2P service was extended to the 19 members of the ATO's Legal Practitioners Working Party (LPWP) in March 2010 on a trial basis. The ATO noted that use of this service during the trial period had been limited,[205] but the IGT has received feedback from those who used the service that it provided an effective point of contact within the ATO to escalate matters of concern.[206] Similarly, the IGT has been advised by ATO officers participating in the service that there is merit in it but that a larger pilot needs to be conducted to better assess the service's utility to tax practitioners.

4.125 The IGT is of the view that facilitating more efficient and effective contact between taxpayer representatives and appropriate ATO officers would enhance communication and engagement in resolving matters, or disputes, thereby reducing the need to resort to more formal channels. The IGT supports an extension of the P2P program to legal practitioners and for the ATO to investigate and report on the findings of an extended pilot.

4.126 In order to encourage sufficient levels of participation in the expanded program, the ATO should actively promote the existence of the program and invite legal practitioners to participate and provide feedback on the effectiveness of the initiative in addressing taxpayer concerns and disputes. The ATO has acknowledged the need to promote the P2P program, generally and to a broad base of legal practitioners as part of the program's expansion.[207]

RECOMMENDATION 4.8:

To better assist taxpayers and their representatives to get in touch with the right areas of the ATO for dispute resolution purposes, the IGT recommends that the ATO:

- *further promote the Professional to Professional program to a broader group of tax and legal practitioners; and*
- *assess and report on the utility of the Professional to Professional program.*

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204 Australian Taxation Office, *Legal Practitioner Services Survey 2008*, Canberra, March 2009, viewed on 28 October 2011, <www.ato.gov.au>.

205 Australian Taxation Office, *Legal Practitioners Working Party minutes 13 October 2010*, Canberra, 10 November 2011, viewed 21 October 2011, <www.ato.gov.au>.

206 Australian Taxation Office, *Melbourne Regional Tax Practitioners Working Group minutes, October 2010*, Canberra, 31 August 2011, viewed 21 October 2011, <www.ato.gov.au>, item 8.

207 Australian Taxation Office, *Legal Practitioners Working Party Minutes August 2011*, Canberra, 23 February 2012, viewed 14 May 2012, <www.ato.gov.au>, item 3; M. D'Ascenzo, *Tax Practitioner Action Plan*, speech delivered to the CPA Sydney Professional Accounts Group Annual Dinner, Sydney, 3 February 2012, viewed on 23 May 2012, <www.ato.gov.au>.

ATO Response

Agree.

AT WHAT POINT DURING THE COMPLIANCE PROCESS SHOULD THE PARTIES ENGAGE IN ADR?

4.127 There was no clear consensus of any optimal time at which ADR should be engaged. Stakeholders were varied in their views as to when ADR is most effective and appropriate.

4.128 A submission noted that there were two critical points at which ADR may most effectively be applied. The first is at the very beginning of a dispute where the parties genuinely want to avoid litigation and the other being towards the end where both parties have retained Counsel and advisers who are able to cast fresh eyes over the dispute with a view to resolution.

4.129 Other submissions noted that the parties are able to consider ADR at any stage of the dispute, and as early as possible, even if only to enable the parties to agree (or agree to disagree) on facts. Some practitioners emphasised that for ADR to be effective it must occur prior to issuance of an objection decision as, once this occurs, the taxpayers and their representatives are completely focused on filing evidence to challenge the decision.

4.130 Statistics provided by the ATO from the ADR register notes that of 250 tax dispute cases which proceeded to ADR, 231 (92.4 per cent) were conducted during litigation at first instance. Of the remaining cases, 14 proceeded to ADR on appeal (from a decision of the AAT to the Federal Court or from a single judge of the Federal Court to the Full Court), one occurred during the objection stage and two during the pre-assessment period. The remaining two cases did not report data on this point.

4.131 It has been noted that the ATO has also traditionally looked at resolution of tax disputes after issuing a position paper but prior to issuing an amended assessment, as well as between lodgment of the appeal and the hearing.[208] It has been posited that opportunities exist for the ATO to consider resolution of tax disputes at other points in time, such as following lodgment of an objection but before commencement of any litigation.[209]

4.132 The point in time at which the parties should or could engage in ADR is dependent on a number of factors including the nature of the dispute, the parties to the dispute and the facts and evidence which are already in the parties' possession or knowledge.

4.133 The IGT considers that there are a number of points throughout the compliance process during which ADR could be utilised. These points may include the time at which the facts have been agreed, position paper has been issued or at the objection stage.

4.134 The Part IVC process necessitates the taxpayer taking the first step in challenging a decision by way of objection and then litigation. In light of the requirements imposed by the CDRA 2011, it necessarily falls on the taxpayer as the potential applicant to take genuine steps to resolve the dispute prior to commencing action in the Federal Court. Equally, the

208 G. Williams and C. W. Jackson, 'New Ways to Fix Tax Disputes', *Charter*, June 2011, p. 50.
209 ibid, p. 51.

Commissioner as the respondent to these proceedings needs to be responsive to the efforts of the taxpayer.

4.135 To ensure a streamlined and expedited process, the IGT is of the view that the ATO should implement a process through which a taxpayer or their representative can quickly and easily engage the ATO in ADR (including direct negotiation) at different points in time during a dispute.

4.136 The ATO has advised the IGT that on some occasions, taxpayers have requested the ATO to engage in ADR without clear reasons as to the objectives sought. In these instances, the ATO has rejected ADR because it considered that engagement at that point in time would increase costs and delay resolution of the dispute overall.

4.137 Through review of the case files on the ATO's electronic case management system, the IGT identified a case in which the taxpayer had not appreciated the nature of ADR and what it was designed to achieve. The IGT notes that the taxpayer sought to engage only as a means of providing further information to the ATO and to better understand its reasoning and position. As discussed earlier, with improved early engagement, such a situation could be avoided. In another case that the IGT examined, the request to engage the ATO in ADR was sufficiently detailed, with an annexure providing the reasons for the requested engagement as direct settlement negotiations had failed. This request was appropriately escalated to a relevant senior ATO management officer for consideration. At the time of writing this report, the case had not yet been finalised.

4.138 The above cases demonstrate the extremes of the range of taxpayer experience in engaging the ATO in an ADR process. To some extent it depends on the level of sophistication of the taxpayer. However a more uniform and improved experience for all taxpayers may be achieved by providing better information to the public as discussed in Chapter 5.

4.139 As ADR is a process which the parties must design for themselves to suit the dispute in question, it is undesirable to be too prescriptive in relation to when ADR should be entered. Rather, the IGT considers that it would be beneficial for the ATO to:

- affirm its commitment to ADR in relation to all taxpayers in the Taxpayer's Charter so that taxpayers may hold ATO officers to account where engagement is denied without sufficient reason;
- adopt a process which favours engagement in ADR and implement a mechanism through which the taxpayer may request the ATO engage in ADR quickly and easily throughout the end-to-end process; and
- in consultation with external stakeholders, determine what guidance may be given to taxpayers regarding information needing to be provided when seeking to engage the ATO in ADR.

4.140 The IGT considers that the ATO should reflect and reinforce its commitment through corporate documents such as PS LA 2007/23 and the Taxpayers' Charter, and provide guidance to taxpayers as set out in Recommendation 5.2 in the next chapter.

RECOMMENDATION 4.9:

Subject to the caveats previously outlined regarding when ADR may not be appropriate, the IGT recommends that the ATO consults with external stakeholders on developing a mechanism which enables taxpayers to request initiation of ADR (including direct negotiation) with the ATO, to wholly or partly resolve matters in dispute at the most appropriate point in time, such as:

- *once agreement has been reached on the facts or both parties believe that the facts in contention have been sufficiently narrowed;*
- *prior to a position paper or reasons for decision being issued;*
- *after the position paper has issued but prior to the amended assessment;*
- *prior to the lodgment of an objection; and*
- *prior to issuance of an objection decision.*

Where the ATO considers that ADR is not appropriate, or not appropriate at a particular point in time, the reasons for the ATO's view in this regard should be communicated to the taxpayer with an alternative as to how the issues concerning the taxpayer could otherwise best be addressed.

ATO Response

Agree in part.

There will be situations where there is a dispute on a procedural or preliminary issue where informal or formal ADR processes are an appropriate way of progressing the matter.

In relation to questions of liability and entitlements, the ATO has statutory responsibilities and it is important that the community has confidence that the ATO is resolving cases appropriately and with integrity. This requires a proper process to establish the facts so as to make a proper assessment of taxpayers' liabilities or entitlements.

In the larger, more complex cases, it is often only after the issue of a position paper that we have a considered articulation of facts and law to enable us to consider the appropriateness of a formal ADR process.

We agree that any decisions with respect to ADR should be clearly communicated to taxpayers. However, taxpayers might want to take their own advice as to how they wish to progress their dispute. We would of course share with them possible alternatives if they were prepared to engage with us.

CHAPTER 5 — ADR ENGAGEMENT

MANAGEMENT OF EXPECTATIONS AND RULES OF ENGAGEMENT

5.1 ADR is designed to achieve a number of different outcomes including settlement of disputes in full or in part, a narrowing of the issues, clarifying facts and evidence or fostering constructive relationships. It is axiomatic that ADR is most successful when both parties enter the process with the same mindset and expectations. Stakeholders have impressed upon the IGT that where expectations are misaligned, engagement in ADR may in fact delay and protract the dispute, adding to costs and eroding the relationship between the parties.

5.2 It is especially important that the ATO manages taxpayers' expectations in respect of settlement of a dispute and its approach to settlement. This is to ensure that taxpayers entering into ADR fully appreciate the ATO's position as a statutory body and the duties and obligations which bind the Commissioner in the exercise of his power to settle.

5.3 To an extent, stakeholders already appreciate that the Commissioner cannot settle matters in exactly the same manner as a commercial litigant. It has been noted that whereas commercial litigants sacrifice only private rights when agreeing to settlement:[210]

> What the statutory office holder may be sacrificing when compromising a claim is not merely the quantum to be secured from a person, or the extent of a penalty to be imposed upon a person, but a considered view of the meaning and operation of the law as it ought to be applied and, perhaps, as it is applied to others in like circumstances.

5.4 As noted previously, the IGT considered the ATO's settlement processes in the Settlements review. In that report, the IGT noted that the Code of Settlement Practice provided 'scope for the Tax Office to consider on a case-by-case basis whether primary tax should be discounted to reflect litigation risk in circumstances where the particular facts, evidence, application of the law or application of the Tax Office's view of the law to the facts presents sufficient difficulties that warrant settlement.'[211]

5.5 In respect of settlement, the ATO has stated that 'attempting to resolve disputes involves finding a balance between competing considerations and calls for the application of discretion and judgment. Accordingly, our approach to settlements may differ from the approach adopted by private litigants seeking a purely commercial settlement.'[212] The Commissioner's exercise of discretion to settle a dispute is tempered by the 'good management' rule — the ability to make sensible decisions having regard to the best use of scarce resources.[213]

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210 Justice G T Pagone, *The Model Litigant and Law Clarification*, Speech delivered to the ATP Leadership Workshop, Melbourne, 17 September 2008, viewed on 16 January 2012, <www.supremecourt.vic.gov.au>, p. 10.
211 Inspector-General of Taxation, above n. 135, p. 14.
212 M. D'Ascenzo, above n. 33.
213 Section 44 of the *Financial Management and Accountability Act 1997*.

5.6 Necessary in this exercise of the Commissioner's discretion is considering whether the:[214]

> … cost of litigating (including internal ATO costs) is out of proportion to the possible benefits, having regard to the prospects of success (including collection of the tax), and likely award of costs, assessed as objectively as possible there are complex factual or quantum issues in contention, or evidentiary difficulties, or there is genuine uncertainty as to the proper application of the law to the facts, sufficient to make the case problematic in outcome or unsuitable for resolution through the AAT or courts, (for example, where the issue is peculiar to the particular taxpayer, and the opposing positions are each considered reasonably arguable).

5.7 During consultations for this review, stakeholders claimed that the Commissioner was not utilising his power to full effect when considering settlements, especially in large cases where significant offers of settlement were made and rejected without clear reasons.

5.8 Some stakeholders believed that the Commissioner appears to have reservations regarding settlement of certain matters owing to the risk of perceived favouritism, or scrutiny by, for example, the Australian National Audit Office or Parliament. Certain stakeholders have suggested that one way to alleviate this concern is to legislate to grant the Commissioner a specific power to settle disputes.

5.9 The IGT canvassed these issues with stakeholders. The general consensus was that the Commissioner already held a general power of administration which, if fully and effectively exercised, should empower him to interpret and apply the tax laws in a way which would mitigate adverse consequences for taxpayers and to settle disputes on a basis appropriate to the particular circumstances of a case. Concern was expressed to the IGT that any further specific power may operate to restrict the generality of existing provisions, lack appropriate checks and balances and create greater uncertainty and dispute.

5.10 Whether a further specific power to settle is granted to the Commissioner is a matter for Parliament to consider. However, and as mentioned earlier, the Commissioner must in all disputed cases, consider whether there is some public benefit in having the matter progressed for judicial determination. If not, the Commissioner must give careful consideration to whether a matter may be settled and, if so, on what basis. A failure to do so could expose the ATO and the Commonwealth to unnecessary cost and expense.[215]

5.11 Furthermore, stakeholders have expressed the view that the ATO should:

- actively manage taxpayer expectations when engaging in ADR, that is, where there are matters which the ATO cannot discuss or there are limitations on authority, inform the taxpayer prior to engaging in ADR;
- ensure that its representatives are technically proficient so as to be able to engage in meaningful discussions on the merits of the case and be able to properly assess the strength of each party's case;
- where it becomes apparent that issues of law and principle are unable to be resolved at ADR, the parties should be able to limit the process to a discussion on facts, procedure or matters going forward so that the case may be progressed efficiently and effectively; and

214 Australian Taxation Office, above n. 45, para. 26.
215 See for example: above n. 170; above n. 175.

- frustrations may arise where the ATO's representative is seen to be just reiterating the ATO's position without considering the viability of the taxpayer's views and is unwilling to put forth counter offers. Accordingly, sufficient time is needed for taxpayers to voice their views and for those views to be considered.

5.12 By way of example, a number of cases have been brought to the IGT's attention in submissions which highlight the need for expectations to be clearly managed and communicated. A few of these cases are outlined below for illustrative purposes.

5.13 In one submission, involving a conciliation case, the taxpayer advised that there was very little interjection on the part of the ADR practitioner to ensure that they and their advisers had an opportunity to put forward their views. This was despite the fact that the ADR practitioner acknowledged that they were best placed to explain the nature of their business, the industry and the transaction which was subject of the conciliation. In their view, the conciliation just added unnecessary time delay and cost to the matter.

5.14 In another submission, practitioners advised the IGT that the taxpayer put forth a number of offers of settlement to the ATO. While this was received by the ATO's representatives, it was rejected without counter offers and the ATO representatives said they were only there to see what the taxpayer would put forth by way of settlement offers.

5.15 In a further submission, the IGT was advised that the ATO representative at ADR refused to consider settlement of any amount below a particular point. This was despite the fact that it was clear to all the parties present that the taxpayer had no such funds available and therefore could not enter a settlement on those terms. The IGT was advised that the ADR ultimately failed because the ATO refused to negotiate an achievable settlement sum.

5.16 When participating in ADR, the ATO seeks to manage expectations through correspondence which outlines the ATO's approach to ADR, limitations on its ability to settle matters on a purely commercial basis and factors which favour settlement and those that do not. The IGT also notes that the standard letter also invites the taxpayer to provide any further information in support of their position which may not have previously been provided.

5.17 Further, PS LA 2007/23 also notes the importance of establishing and agreeing on protocols as between the parties when it has been decided that engagement in ADR is appropriate. Specifically, the Practice Statement notes the following important features of any such protocol may include:[216]

- the type of ADR process to be used;
- where the ADR process will be conducted (ideally at a neutral venue);
- the role of the ADR practitioner;
- the terms and conditions of the engagement of the ADR practitioner;
- the responsibilities of the ADR practitioner;
- all communications during an ADR process are 'without prejudice' and confidential;
- what records are made and kept of the ADR process;

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216 Australian Taxation Office, above n. 40, para. 49.

- whether any documents arising in the course of the ADR are admissible in later proceedings or for any other purpose;
- whether legal advisers are permitted during the ADR process; and
- early termination of the ADR process.

5.18 While the IGT acknowledges that the factors identified in PS LA 2007/23 are relevant and appropriate, taxpayers (such as those who seldom engage in ADR) may not have the requisite knowledge or experience to negotiate and agree on mutually acceptable protocols for the ADR process. Engaging in ADR under these circumstances may result in taxpayer dissatisfaction with the process and may increase costs where other advisers need to be engaged to assist in the pre-ADR discussions.

5.19 It is, therefore, essential that processes necessary for ADR engagement are straightforward and efficient. In this regard, the IGT believes that improvements can be made to better ensure that all parties approach ADR with clear and achievable expectations.

5.20 The IGT believes that greater clarity of expectations when engaging in ADR will also assist less experienced ATO staff to better appreciate their roles and responsibilities when agreeing to, and participating in, ADR.

RECOMMENDATION 5.1:

With a view to managing expectations when engaging in ADR, and ensuring that the ATO's approach to ADR is current and effective, the IGT recommends that the ATO in consultation with external stakeholders review and update Practice Statement PS LA 2007/23 to include, inter alia*, clear statements of expectations of taxpayers and of the ATO when engaging in ADR, and avenues of recourse where those expectations are not met.*

ATO Response

Agree.

The ATO agrees to review and update PSLA 2007/23. It has been an important guiding document but it is now five years since it was drafted and it is appropriate to update and expand the document, to reflect current approaches to ADR.

The review will be in consultation with the NTLG ADR Sub-committee and the Inter-Agency ADR Forum.

WHAT TYPE OF ADR SHOULD BE USED?

5.21 While the IGT notes that it is not desirable to be prescriptive in ADR processes and protocols, some discussion as to those matters requiring consensus between the parties is warranted.

5.22 Where more formal ADR techniques need to be employed, submissions made to the IGT have noted the importance of utilising the most appropriate form of ADR having regard to the parties involved, the questions in dispute, timing and the cost involved.

5.23 While mediation as a form of assisted negotiation is arguably the most commonly utilised and understood of the ADR processes, ADR encompasses a large number of different dispute resolution processes which may be employed, and which vary in the degree of their formality, cost and level of intervention, as outlined in the diagram below.

Figure 2: The degree of informality, consensuality and intervention in the various dispute resolution processes.[217]

5.24 ADR techniques may broadly be categorised as facilitative processes, advisory processes and determinative processes.

5.25 Facilitative dispute resolution processes are those in which the practitioner 'assists the parties to identify the disputed issues, develop options and consider alternatives and endeavour to reach an agreement about some issues or the whole dispute.'[218] Mediation and facilitated negotiations are examples of facilitative processes.

5.26 The IGT considers that mediation and facilitated negotiations may be used in a wide range of disputes with varying levels of complexity including disputes as to payment of debt, the correctness of penalties or the existence of further evidence which may prove or disprove certain facts or contentions. The IGT notes that this type of process may assist

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217 Diagram adapted from D. Spencer and T. Altobelli, *Dispute Resolution in Australia: Cases, Commentary and Materials*, 2005, Lawbook Co., Sydney, p. 26.

218 NADRAC, *Dispute Resolution Terms*, Canberra, September 2003, viewed 16 January 2011, <www.nadrac.gov.au>, p. 7; see also NADRAC, above n. 1, p. 67.

smaller taxpayers and less complex disputes as it is less formal, less intimidating and allows the parties to retain control of any agreements reached.

5.27 Advisory dispute resolution processes are processes in which the practitioner 'considers and appraises the dispute and provides advice as to the facts of the dispute, the law and, in some cases, possible or desirable outcomes, and how these may be achieved.'[219] Conciliation, early neutral evaluation and case appraisal are examples of this type of ADR.

5.28 Early neutral evaluation and case appraisal may be appropriate in cases where the ATO and taxpayers seek the advice of an appropriate ADR practitioner to test assumptions or their positions in respect of a dispute. The IGT considers that factually complex disputes or those concerning valuations, such as disputes in transfer pricing, lend themselves to early neutral evaluation and case appraisal.

5.29 Determinative dispute resolution processes are processes in which the practitioner 'evaluates the dispute (which may include hearing of formal evidence from the parties) and makes a determination.'[220] Examples of this type of process include arbitration and expert determination.

5.30 The ATO has expressed a view that determinative processes are not 'generally appropriate for ATO disputes.'[221] Given the high level of formality and cost involved in determinative processes (as they usually involve experts, presentation of evidence and submissions and legal representatives for both sides), and the absence of precedential value of any determinations made, the IGT agrees that determinative processes should generally not be utilised in tax disputes.

5.31 Ultimately, the IGT considers that determination of the most appropriate ADR technique to utilise will vary from case to case and be informed by the dispute to be resolved, the parties involved, the parties' objectives and the relative cost. As submissions note, a one-size fits all approach to ADR will not work and that it must always be borne in mind that ADR is a process the parties design for themselves. Hybrid ADR processes[222] are illustrative of the flexibility available to the parties when designing ADR processes to suit their needs. What is most effective and appropriate in one case may not be so in another.

5.32 Without being prescriptive, the IGT considers that there would be some benefit (especially for taxpayers and advisers who may be less familiar with ADR) in the ATO consulting with key stakeholders and publishing a plain-English guide which outlines some of the common ADR techniques, in what types of disputes the ATO considers that each may be appropriate, what taxpayers may expect, and what may be expected of them, when engaging in certain ADR processes.

5.33 The IGT considers that such a publication would also assist less experienced ATO staff members to better appreciate and align their understanding of ADR techniques when approached by taxpayers or their representatives.

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219 ibid, p. 4; see also NADRAC, above n. 1, p. 65.
220 ibid, p. 6; NADRAC, above n. 1, p. 66.
221 Australian Taxation Office, above n. 41, para 23.
222 NADRAC defines these as 'processes in which the dispute resolution practitioner plays multiple roles. For example, in *conciliation* and in *conferencing*, the dispute resolution practitioner may facilitate discussions, as well as provide advice on the merits of the dispute. In *hybrid* processes, such as *med-arb*, the practitioner first uses one process (*mediation*) and then a different one (*arbitration*).'

SELECTING THE MOST SUITABLE ADR PRACTITIONER

5.34 Stakeholder submissions to the IGT have noted that the person who is best placed to assist the parties to resolve a dispute will largely depend on the specific factors in that dispute, including the parties involved, the nature, complexity and size of the dispute, the procedures to be employed during the ADR and the costs involved.

5.35 There are a number of different types of ADR practitioners who are able to assist in ADR. Some of these include:

- registrars of the Federal Court and the AAT;
- members of the AAT;
- retired judges;
- junior and Senior Counsel;
- solicitors; and
- professionals engaged in ADR.

5.36 Different ADR practitioners will approach their task differently. It is dependent on the ADR process in which they are engaged to assist and much of the variation in style turns on the ADR practitioner's personality rather than any specific training. By way of example, one stakeholder noted that where retired judges were used in mediation, some sought to give non-binding judgments rather than lead the parties to see reason through negotiation.

Retired judges

5.37 It has been suggested that engaging a retired judge to assist in an ADR process was most effective as it was perceived that judges were no longer involved in legal practice and were less likely to be influenced by one or the other disputing party. Furthermore, it was also noted that where the matter in dispute concerns very large taxpayers and complex issues, a retired judge may command greater respect, attention and acceptance by the parties, where their views are more likely to lead the parties to re-evaluate their positions.

5.38 Balanced against this, other submissions to the IGT have also noted that retired judges may not always be best placed to assist the parties to arrive at a facilitated outcome. It is argued that the judicial experience for judges is to receive evidence and render a decision in favour of one or another party, rather than guiding parties to objectively re-assess their case with a view to arriving at a negotiated outcome.

5.39 In summary retired judges were thought to be well-placed and most effective in advisory ADR processes to assist the parties where they sought evaluative non-binding advice. However, it has also been suggested that where retired judges were retained, care needed to be taken to ensure that the judge's non-binding views did not foreclose possibilities contemplated by either of the parties for possible terms of settlement.

5.40 The IGT has been advised that the AAT has sought to differentiate between ADR processes and allocating them to those who are best placed to assist the parties. When ADR processes, other than case conferencing, are utilised, more facilitative processes such as

mediations are conducted by conference registrars, who are trained and accredited mediators. However, in advisory processes, which require the independent third party to voice a view on the issues, a member or senior member of the AAT is engaged to assist the parties as they were considered better placed to advise the parties as to different aspects of the dispute.

Legal Qualifications

5.41 Within the context of tax disputes, ADR practitioners need not necessarily be legally trained where the issues needing to be resolved turned on facts, rather than the law, and required some other area of expertise.[223] For example, in disputes concerning conflicting expert valuations, a regarded expert specialising in valuations may be better placed to assist than someone who is legally trained but does not possess valuation skills and experience.

5.42 However, it was noted that if the issue in dispute required the parties to discuss interpretation and application of the law, then an ADR practitioner who is legally trained with appropriate tax expertise may be better placed to assist as an understanding of the legislation was required.

5.43 The ATO has noted that where external ADR practitioners need to be engaged, it seeks to ensure that the practitioner engaged is an 'independent, impartial and neutral person who is sufficiently trained and experienced in ADR processes to conduct the particular ADR process agreed on by the parties or directed by the court or tribunal. The experience of the ADR practitioner must be sufficient to deal with the level of complexity or sensitivity of the particular dispute.'[224]

5.44 Ultimately, the IGT is of the view that the ADR practitioner selected should be sufficiently skilled to ensure the integrity of the process, provide a balanced and open forum for discussions and develop trust and credibility with both parties.

5.45 Statistics provided to the IGT show that by and large, ADR in tax disputes are conducted by registrars of the AAT or the Federal Court. The ATO has advised the IGT that where an ADR practitioner is not otherwise appointed by the Court, the ATO collaborates with the taxpayer and their representatives to select the most appropriate ADR practitioner. The IGT supports this collaborative approach, but notes that smaller taxpayers and advisers who may not often engage in ADR may not be familiar with ADR practitioners and are therefore not well-placed to make an informed decision.

5.46 In this regard, the IGT considers that where the ATO is dealing with individuals or less sophisticated taxpayers (and especially those who are self-represented), the ATO should actively work to ensure that the taxpayer is aware of the different types of ADR practitioners available, their relative skills and experiences as well as the costs involved.

5.47 The ATO has advised that it is currently in the process of updating its intranet site with a national list of organisations and agencies which may be able to assist in providing

223 F. Dixon QC, above n. 85, p. 1.
224 Australian Taxation Office, above n. 40, para. 44.

details of ADR practitioners.[225] It considers that such a list may assist its staff to better appreciate the different types of ADR available and who may be retained to assist in the resolution of a dispute. The ATO also intends to incorporate this information in its DMP to assist taxpayer access.

5.48 While the IGT acknowledges that this may go some way to assisting taxpayers and their advisers to make better informed decisions, a more general guide may yield greater benefit to taxpayers and their advisers. Accordingly, the plain-English guide referred to in paragraph 5.32 could also include a list of ADR practitioners and the types of disputes and ADR processes for which each may be best suited.

RECOMMENDATION 5.2:

The IGT recommends that the ATO consults with stakeholders on developing a plain-English guide which outlines:

- *different ADR processes which may be used in resolving tax disputes and the type of ADR practitioner that may be best suited for each ADR process;*
- *examples of the types of disputes in which each technique may be appropriate;*
- *details or information taxpayers should provide when seeking to initiate ADR with the ATO to enable both parties to assess the appropriateness of engaging in ADR, and what ADR process to employ;*
- *ATO expectations of the taxpayers and what the taxpayer may expect from the ATO and other parties when participating in particular ADR processes;*
- *the roles and responsibilities of the ADR practitioner in different types of processes; and*
- *any other relevant matters.*

In developing the guide, consideration should be given to whether a suite of pro-forma supporting materials should be included to assist the parties in dispute to quickly and easily reduce matters agreed to writing. Such supporting materials may include:

- *an ADR agreement which addresses each of the matters outlined in paragraph 49 of PS LA 2007/23 and other relevant matters;*
- *a case summary which clearly identifies issues of fact and law that are in dispute and any matters which are outside the ambit of the ADR; and*
- *a statement of matters agreed between the parties at the conclusion of the ADR.*

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225 For example, Lawyers Engaged in Alternative Dispute Resolution (LEADR), the Institute of Arbitrators and Mediators Australia (IAMA) and the Attorney-General's Department's Access to Justice website <www.accesstojustice.gov.au>.

ATO Response

Agree.

The ATO has already discussed the possibility of co-designing such a guide with the NTLG ADR Sub-committee. In doing this we will also consult with the Inter-Agency ADR Forum and other relevant stakeholders. As part of the consultation process, we will consult on whether a suite of pro-forma materials would be useful and should be included in the guide.

5.49 The IGT is aware that NADRAC has recently released a consultation draft of its publication *Your Guide to Dispute Resolution* which was prepared in line with Terms of Reference from the former Attorney-General.[226] To ensure consistency within the federal government framework, the ATO should be mindful of the NADRAC guide in implementing recommendation 5.2.

Using trained ATO officers to facilitate an ADR process

5.50 As mentioned in Chapter 1, the United States' IRS has in place a number of initiatives to assist in the resolution of tax disputes including Fast Track Mediation and Fast Track Settlement.

5.51 Fast Track Mediation is an in-house mediation service between the taxpayer and the IRS officer. A trained IRS appeals officer acts as mediator to assist the parties in their discussion and to arrive at a mutually acceptable resolution. This IRS appeals officer has no decision making powers and is unable to bind either party to a resolution if none is achieved through the usual mediation course.[227]

5.52 Fast Track Settlement[228] is a process aimed at large and mid-sized business taxpayers and is a non-binding process in which an Appeals officer assists the IRS and the taxpayer to resolve factual and legal issues in contention.[229] It differs from Fast Track Mediation in that the Appeals officer is able to render a delegation order from the settlement to settle disputes on the same issue with the same taxpayer (for a different period) or with another taxpayer involved in the same transaction or taxable event.

5.53 In both instances, the IGT observes that the IRS utilises internally trained officers within the Appeals office to guide the taxpayer and the IRS officer through the discussions with a view to resolving the dispute.

5.54 It should be noted that the IRS Appeals area is an independent unit within the IRS with a statutory prohibition against ex parte communication (see Chapter 6). In the current

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226 NADRAC, *Your Guide to Dispute Resolution*, distributed to stakeholders for comment and not yet publicly available.

227 Internal Revenue Service, *Publication 3605: Fast Track Mediation: A Process for Prompt Resolution of Tax Issues*, viewed on 15 November 2011, <www.irs.gov>; see also S. Thomas 2007, above n. 31, p. 127

228 Settlements approved by Appeals under this process may form the basis of Delegation Order 4-24 which 'gives examination case managers the authority to apply that settlement where the same issue is under examination for other tax periods.' The Delegation Order applies to both the taxpayer and another taxpayer directly involved in the transaction or taxable event.

229 S. Thomas, above n. 31, p. 128; Ernst & Young, above n. 28, p. 56; Internal Revenue Service, *Internal Revenue Manual*, viewed on 15 November 2011 <www.irs.gov/irm>, para. 1.2.43.25

ATO structure, it is unlikely that taxpayers would regard ATO officers acting as ADR facilitators to be sufficiently independent. Such taxpayer perceptions are likely to render any effort in using ADR ineffective.

5.55 Given the above and the availability of highly skilled private sector ADR practitioners,[230] the IGT considers that trained ATO officers would be better utilised to act as circuit breakers to guide the taxpayer and original ATO decision maker (such as an ATO auditor) through discussions to settle any differences in understanding and resolve potential disputes without resort to ADR, as discussed in Chapter 3 above.

WHO REPRESENTS THE PARTIES AT ADR?

5.56 The Federal Court's mediation guide for litigants notes that 'it is essential that the people attend the mediation with sufficient knowledge of the relevant issues in dispute and the authority to make decisions about how it might settle after the mediation.'[231]

5.57 Similarly, the ATO's PS LA 2007/23 requires 'those attending the ADR must have a good understanding of the facts, issues, law, public rulings and ATO policies etc underpinning the dispute'[232] and 'tax officers attending the ADR must be fully conversant with the relevant ADR process.'[233]

5.58 The ATO considers that at least two officers should attend an ADR, and these officers may include the business line decision maker, an officer from TCN, an external legal service provider, an officer from the LSB, the business line officer or counsel retained to act for the ATO.

5.59 Submissions have noted that careful consideration needs to be given to who attends ADR on behalf of both the ATO and the taxpayer to ensure that discussions are able to be progressed in a meaningful and efficient manner.

5.60 A chief concern raised in submissions is where the representatives are emotionally tied to the dispute such that their presence at ADR may hinder efforts to resolve the issues in contention. Both taxpayers and the ATO as parties need to carefully consider and manage this.

5.61 For individuals and other small taxpayers, this is often unavoidable as it is often the case that there is no one else who is able to attend with authority to settle. For the ATO, it has been suggested that the presence of the ATO auditor (being the original decision maker) may be counter-productive to the ADR process. The IGT recognises the presence of the ATO auditor at ADR may lead to a perception that the ATO is simply attending to restate its original position rather than seek to better understanding the taxpayer's perspective to arrive at a negotiated outcome.

5.62 However, from the ATO's perspective, as a large organisation, it depends on a strong collective expertise to drive its work and decision making. In long-running and

230 F. Dixon SC, above n. 85, pp. 2 and 3
231 Federal Court of Australia, *Mediation*, Sydney, 2010, viewed on 27 June 2011, <www.fedcourt.gov.au>, p. 3.
232 Australian Taxation Office, above n. 40, para. 53.
233 ibid., para 54.

complex matters, the ATO may need to draw on the knowledge of the original internal decision maker to supplement their understanding of the history of the case. The IGT considers that such instances should be avoided and that the ATO should ensure that those attending the ADR are fully across the issues of fact and law underlying the case.

5.63 There is an important independence of thinking and consideration that is required to ensure that senior ATO officers have attended to these issues appropriately in the design of the ADR process for a given case.

5.64 It is also imperative that consideration be given to the number of attendees at ADR. Submissions have noted that sometimes both sides attend ADR with too many representatives, leading to a blurring of the roles and responsibilities of the attendees and making settlement discussions difficult as the flow of negotiation is disrupted. It has been submitted where there were too many attendees there is a heightened risk of:

- persons being present without any particular role to play or simply to defend their initial decisions;
- the ADR process becoming unwieldy because of the complex stakeholder positions, resulting in the need to break down the ADR event into smaller sub-issues to enable direct discussions on more specific matters; and
- a perception (by each side) that the attendees are there to maintain their respective positions and bolster existing arguments, rather than seeking to reach a shared understanding and mutually acceptable outcome.

5.65 The conduct of ADR is ultimately a matter for the parties, and the ADR practitioner. However, the IGT considers that with improved cooperation the ATO and taxpayers will be able to manage each other's expectations in ADR. This can be achieved through greater communication and clearer understanding of the purpose of the ADR, the parameters for discussion, the number of attendees and their respective roles and responsibilities. Effective communication is critical to ensure that both parties participate in the ADR with realistic expectations and a clear understanding of the rules of engagement.

AUTHORITY TO SETTLE

5.66 Submissions to the IGT indicated that ADR works best where the attendees for both the ATO and the taxpayer have full authority to engage in discussions on all aspects of the dispute and to settle matters where appropriate. Similarly, the Federal Court's guide to mediation states, that if a person is attending on behalf of an organisation, 'the Court requires the attendee be an authorised officer who is able to make a decision about how the dispute might be settled.'[234]

5.67 Concerns were raised with the IGT that often, the representatives attending on behalf of the ATO are insufficiently authorised to settle matters which hampers the effectiveness of ADR. The complaint is not new and is not specific to the ATO. It is a matter which the federal government and the judiciary have recognised and acknowledged more generally.[235] The former Attorney-General has noted that 'in most cases it should be possible

234 Federal Court of Australia, above n. 230.

235 Federal Court of Australia, *Minutes of Federal Court Users Committee meeting*, Melbourne, 21 March 2007, viewed on 27 June 2011, <www.fedcourt.gov.au>.

for a government representative to obtain appropriate authority to settle in advance'[236] save in limited circumstances where new evidence is presented which changes the basis of the authorisation.

5.68 The ATO's material suggests that in order to facilitate appropriate and timely resolution of a dispute it will participate in ADR fully and effectively whilst ensuring that its representatives have authority to settle and have clear instructions on the possible terms of settlement acceptable to the ATO.[237]

5.69 The ATO advises that in tax matters, an executive level officer from the LSB will attend ADR processes. Further, it instructs these officers that prior to entering negotiations or ADR processes, the executive officer is to confer and agree with the business line SES officer (and TCN officer where one is involved) on the range of settlement options which would be acceptable to the business line.[238]

5.70 The ATO further notes that while it endeavours to have decision makers attend ADR in most instances, where this is not possible, it will make the decision maker available by telephone to its representatives. The ATO also states that where this is the case, it will make this clear to the parties at the commencement of the ADR.[239]

5.71 The ATO does not generally record data regarding the attendance of decision makers at ADR. At the IGT's request, some of this data was compiled in relation to the 250 tax matters in which the ATO engaged in ADR. Of these, the data shows:

- 52 cases in which the decision maker was present at ADR;
- 42 cases in which the decision maker was available by phone;
- 19 cases in which the ADR did not proceed;
- 4 cases in which the decision maker was neither present nor available by phone;
- 2 cases in which the ADR was conducted 'on the papers' (that is, not face to face); and
- 131 cases in which the data was not available.

5.72 Where a decision maker is not present, the ATO ensures that one of the attending officers at ADR is vested with authority to settle within set parameters based on discussions with the decision maker beforehand and that if the decision maker is not able to be contacted for further instructions from the ADR, ATO staff should 'acting within their levels of authority, exercise their own judgment in deciding whether to accept the terms of settlement being offered.'[240]

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236 R. McClelland MP, above n. 9.
237 Australian Taxation Office, above n. 40, para. 52.
238 Australian Taxation Office, above n. 56.
239 ibid.
240 ibid.

5.73 However, the IGT has been advised that such arrangements are not a complete answer as the ATO cannot canvass every eventuality, especially in ADR where offer and counter-offers are made so that the parties can arrive at a mutually acceptable settlement.

5.74 Another concern raised by stakeholders is that the absence of decision makers from the ADR process is not conducive to full and frank discussions to resolve disputes. Submissions note that in such instances, the ADR is rendered less effective by reason of ATO officers not being able to progress discussions, not being in a position to discuss offers to settlement or put counter-offers to the taxpayer and disrupting general ADR proceedings by halting discussions to leave the room to contact the decision maker where discussions have progressed outside established parameters.

5.75 Such instances necessarily lengthen the ADR process, putting both the ATO and taxpayers to additional expense as a result of increased fees to advisers and representatives in attendance and, especially for smaller taxpayers, the opportunity cost of having to take time away from the conduct of their business.

5.76 Perhaps most importantly is that the absence of the ultimate decision maker from the ADR process means that the taxpayer is unable to address their concerns directly to the person who will determine the matter. Further, as the taxpayer is not privy to the conversations between the ATO officer and the decision maker, there is no way for the taxpayer to know whether or not their stated position has been put fully to the decision maker by the ATO officer.

5.77 The IGT appreciates the resource constraints on the ATO's senior staff, and moreover of the need to manage delegations and authorisations appropriately and robustly so as to guard against the possibility that such delegations and authorisations may be incorrectly or inappropriately exercised. Similarly, the IGT recognises the impact of disputes on taxpayers with executive staff attending ADR and, in the case of smaller taxpayers, a disruption to business as usual.

5.78 The IGT therefore considers that there is benefit to senior ATO staff being engaged in and present at ADR (whether in person or through an electronic medium such as video conferencing). This would both enable greater opportunity to address and resolve issues of concern, while developing stronger continuing working relationships between the taxpayer and the ATO. As submissions put to the IGT, unlike commercial litigants, taxpayers and the ATO will have a continuing working relationship and management of this beyond single disputes is essential.[241]

5.79 In the IGT's view, the presence of decision makers at ADR is necessary to ensure the expeditious resolution of disputes at minimum cost to the parties and of paramount consideration. Accordingly, the IGT considers that it is appropriate when participating in ADR for both parties to have the decision makers present, or a person vested with the same level of authority as the ultimate decision makers.

241 See: OECD, above n. 29.

Tax disputes and debt

5.80 All tax disputes ultimately relate to money, either in the form of tax owing by, or refunds due to, the taxpayer. It was posited that when taxpayers enter ADR, their ultimate goal is to address both the underlying tax technical dispute and any tax debts which eventuate as a result. A suggestion was made in submission that one of the reasons taxpayers may initiate or progress a dispute, albeit reluctantly, was to defer or manage the payment of a debt due to financial circumstances or difficulties.

5.81 A limited number of cases examined by the IGT as part of this review showed some individual and smaller business taxpayers filing applications in the AAT which were ultimately dismissed for want of prosecution. While it is difficult to gauge the mindset of these taxpayers in bringing applications with no follow through, the IGT considers that a number of these cases lend support to the suggestion that these applications may have been brought as a means to manage the underlying ATO debt collection activities.

5.82 The IGT is of the view that where taxpayers feel they are better able to discuss debt aspects of disputes, the propensity to file matters in the AAT for the above reasons may be reduced. Accordingly, where the parties are able to address both the technical issue and any potential debts owing in ADR or direct negotiations, it presents a more efficient and favourable forum at which taxpayers and the ATO can air and address outstanding issues holistically.[242]

5.83 One submission noted that at ADR, the ATO has considerable bargaining power by reason of legislative provisions which render debts collectable regardless of an ongoing dispute as to the correctness of the assessment or decision of the ATO giving rise to the debt.[243] It was suggested that the ATO should defer debt collection in disputed cases, save where there is a real and genuine risk of asset dissipation.

5.84 The ATO's policy in relation to the recovery of tax debts that are the subject of dispute is contained in Practice Statement *PS LA 2011/4 Recovering Disputed Debts* (PS LA 2011/4).[244] This practice statement, which is binding on ATO staff, provides that the Commissioner may commence recovery action, even before determination of an objection, based on a risk review of the tax debtor[245] and that in most cases where there is little or no risk, the Commissioner may enter into a 50/50 arrangement, in which the taxpayer pays to the Commissioner 50 per cent of the disputed debt, to minimise the taxpayer's exposure to general interest charge.

5.85 PS LA 2011/4 also states that even where the taxpayer chooses not to enter a 50/50 arrangement, recovery action is unlikely to be commenced prior to determination of an objection, or decision of the AAT or Federal Court is handed down, unless the Commissioner considers that circumstances of the case point to an unacceptable level of risk.[246]

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242 Inspector-General of Taxation, above n. 135, p. 30.
243 See: sections 14ZZM and 14ZZR of the *Taxation Administration Act 1953*.
244 Australian Taxation Office, *Practice Statement PS LA 2011/4 Recovering Disputed Debts*, Canberra, 14 April 2011, viewed 16 January 2012, <www.ato.gov.au>.
245 ibid., para 10; see also Australian Taxation Office, *Practice Statement PS LA 2011/6 Risk and Risk Management in the ATO*, Canberra, 14 April 2011, viewed 16 January 2012, <www.ato.gov.au>.
246 ibid., paras 37 and 38.

5.86 There is also an option under this statement for the Commissioner to defer recovery action where:[247]

- the tax debtor has entered into a 50/50 arrangement;
- the Commissioner considers that a genuine dispute exists in regard to the assessability of an amount; or
- the Commissioner is pursuing arguments which are inconsistent with a previously published ATO view or go against the weight of precedent cases (that is, the Commissioner is challenging the previously accepted position).

5.87 It was further noted in submissions that where both the officer dealing with the tax technical issue and those tasked with ultimately collecting the debt were present at ADR, there was a greater chance of resolution and settlement as such a discussion necessarily addressed the matter holistically. The ATO's records do not presently record whether officers authorised to discuss recovery of tax debts are present at ADR concerning tax disputes.

5.88 The IGT sees considerable merit in an ATO officer with authority to discuss debt and payment issues attending ADR. The IGT believes that this may assist both the taxpayer and the ATO to address the issues holistically. Further, the IGT is of the view that there should be a mechanism through which taxpayers may make submissions to the ATO for deferral of recovery action at the time of lodgment of an objection, or commencement of review or appeal applications. The IGT believes that such a mechanism will allow the parties to focus their efforts on resolution of the dispute in its entirety without the need for collateral action.

RECOMMENDATION 5.3:

The IGT recommends that, when participating in ADR, both parties ensure that their representatives are authorised to discuss and settle all aspects of the dispute, including the tax technical as well as any associated tax debt, and are fully engaged and present in the ADR process.

ATO Response

Agreed, subject to the qualification in 4.6 of our comments on authority to settle.

The ATO recognises the importance of having an appropriately authorised officer present and has provided all of its senior officers in Legal Services Branch with authority to settle both the dispute and the underlying debt (within specified monetary limits). We agree with the recommendation that all parties need to be so authorised.

While the ATO will use its best endeavors to ensure its representatives are authorised to discuss and settle the case is physically present at any formal ADR process, there will be the occasional case when that is not possible. In such circumstances the ATO decision-maker will attend and participate by phone or video conference.

247 ibid., para 41.

POST ADR FOLLOW UP BY THE ATO

5.89 Currently, the ATO receives feedback from its officers on ADR processes and outcomes through case callovers and SILC meetings. Internal ATO stakeholders to a particular case convene to discuss progress and key events in that case in these meetings. The ATO has also advised the IGT that feedback has been received through liaison with the AAT and the Federal Court whose registrars conduct the majority of ADR (particularly conferences, mediations and conciliations) in relation to tax dispute matters.

5.90 Submissions to the IGT noted that, particularly in conferences at the AAT, the performance of ATO officers has been positive with them understanding their roles and actively identifying opportunities for other processes. The submissions note that conciliations and mediations are often requested by the ATO, and these are particularly effective where the relationship between the ATO and taxpayers is potentially acrimonious due to a protracted or difficult dispute.

5.91 If the ATO's engagement is not of a high standard, it may damage current relationships with the taxpayers, delay resolution and serve to undermine broader ATO dispute resolution initiatives. The IGT considers that there is merit in the ATO formally monitoring and recording the performance of its staff at ADR to provide feedback and better identify areas for improvement in both the skills and expertise of its officers.

5.92 One suggestion which has been raised with the IGT is for an independent officer of the ATO (that is, an officer not involved in the specific matter in dispute), or a researcher independent of the ATO, to speak with the taxpayer and their representative after the ADR event to seek feedback from them as to the performance of the ATO's representatives and whether there was room for improvement.

5.93 The IGT generally supports this suggestion and considers that feedback from taxpayers' representatives attending the ADR as well as the ADR practitioners would provide valuable learnings on the quality of ATO engagement and potential areas for improvement for ATO officers. Additionally, it will also identify opportunities for the ATO to recognise its officers for good performance in ADR as a means of encouraging greater engagement. However, in seeking such feedback, the ATO should ensure that it differentiates between the taxpayer's comments in relation to engagement and their comments in relation to the specific outcomes.

RECOMMENDATION 5.4:

The IGT recommends that, for the purpose of identifying opportunities to enhance its dispute resolution capability, the ATO should:

- *implement an independent system to collate and assess feedback from all parties, their representatives and ADR practitioners as to the effectiveness of the process, including the conduct of the ATO's representatives when engaging in ADR and any suggestions for improvement; and*
- *publish this feedback to imbue public confidence in the use of ADR, internally recognise good performance of ATO representatives and to identify areas for improvement.*

ATO Response

Agree.

The ATO sees merit in implementing an independent system to collate and assess feedback from all parties and the ATO agrees to publish the feedback on an annual basis. As successful ADR depends on the effective participation of all parties, the feedback should include the conduct of all parties.

FLEXIBILITY IN STATUTORY TIMEFRAMES BETWEEN AMENDED ASSESSMENT AND OBJECTION

5.94 The IGT recognises that in some instances, ADR may not be possible owing to a lack of time for the parties to properly assess their position, seek to understand the other party's position and to engage in identifying and resolving the issues. For example, it has been suggested that sometimes the period between an amended assessment being issued and an objection being required to be lodged is insufficient to enable the parties to engage in ADR.

5.95 The ATO is unable to exercise discretion in relation to certain timeframes in this regard. Section 14ZW of the TAA 1953 only provides for the Commissioner to exercise his discretion to extend the period for a taxpayer to lodge an objection *after* the original period has lapsed.[248]

5.96 During consultation for this review, it was suggested that where timeframes to lodge objections are approaching expiry, some taxpayers may feel the need to lodge bare objections to preserve their rights and to supplement the objection with further information following a request from the ATO.[249] Consequently, where objections do not contain sufficient information for the Commissioner to properly arrive at a conclusion, this may necessitate more formal requests for information from taxpayers thus protracting timeframes and increasing costs for both taxpayers and the ATO.

5.97 The IGT considered the issue of amendment timeframes (both for the ATO and for taxpayers), and taxpayer's applications to extend the time for lodgement of objections as part of the Objections review[250] and noted that the ATO currently accepts many late objections. The Department of Treasury also note this in the *Report on Aspects of Income Tax Self Assessment*.[251]

5.98 The IGT considers that where taxpayers are unrepresented, or where the matters in contention are particularly complex, sufficient time for the taxpayer to appreciate the ATO's decision and its reasons is critical for them to be able to communicate points of disagreement. Similarly, for the ATO to have sufficient time to engage with taxpayers in considering the taxpayer's position would be beneficial in ensuring that any objections lodged are considered and better focused if the matter is not able to be resolved. Therefore, the IGT

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248 Section 14ZW(3) of the Taxation Administration Act 1953.
249 Department of Treasury and Australian Taxation Office, *Tax Issues Entry System*, <www.ties.gov.au>, item 0020-2011.
250 Inspector-General of Taxation, above n. 35, p. 32.
251 Department of Treasury, *Report on Aspects of Income Tax Self Assessment*, Canberra, August 2004, p. 36.

considers that some discretion on the part of the Commissioner to extend objection timeframes before they lapse for the purposes of engagement in ADR may be beneficial to both the taxpayer and the ATO.

5.99 On 13 September 2011, a stakeholder registered a request through the government's Tax Issues Entry System (TIES) to amend section 14ZW (and consequential amendments where necessary) to enable the Commissioner to exercise his discretion to grant extensions of time for lodgement of objections before the original period has elapsed. The TIES provides an opportunity for taxpayers and their representatives to raise issues relating to the care and maintenance of the Australian Government's tax and superannuation systems.[252]

5.100 The IGT notes that the TIES 'care and maintenance issues are about making sure the existing law operates in the way it was intended, by correcting technical or drafting defects, removing anomalies and addressing unintended outcomes. Care and maintenance issues could involve minor policy changes, though they typically would not have a significant revenue impact.'[253]

5.101 The IGT believes that there is considerable merit in the government reviewing the tax legislation to allow greater scope for certain flexibility in granting extensions of time for taxpayers to object in that it enables both parties to arrive at a better understanding of the issues in dispute and progress matters, (whether by way of dispute resolution or more formal Part IVC processes).

5.102 However, this should be balanced against the need to ensure that statutory timeframes are not improperly extended simply to delay finalisation of tax disputes. The IGT believes that the imposition of conditions on the extension, such as limiting it to the purpose of enabling the parties to participating in ADR, limiting the maximum extension period and limiting the number of times such extensions may be granted, would provide that balance.

RECOMMENDATION 5.5:

1. The IGT recommends that the government consider amending the TAA 1953, and consequential amendments to other Acts, to enable the ATO to grant taxpayers, at the taxpayers' request, an extension of time to lodge an objection where the extension is required for the purposes of enabling the ATO and the taxpayer to engage in ADR.

2. In doing so the IGT recommends that the government consult with the ATO and external stakeholders to impose proper safeguards against potentially unintended consequences such as delaying the finalisation of case outcomes in inappropriate circumstances, including such measures as limiting the number of extensions or the length of such extensions.

ATO Response

This is a matter for Government.

252 Department of Treasury and Australian Taxation Office, above n. 249.
253 ibid.

CHAPTER 6 — SEPARATE APPEALS AND REVIEW

6.1 In the IGT submission to the Tax Forum,[254] the position was advanced that the ATO's dispute management framework would be much enhanced by establishing a separate appeals area within the ATO to improve its current handling of objections and conduct of litigation. While it is hoped that the ATO's current T-project would reduce the likelihood of disputation through the engagement of more senior ATO experts earlier in the compliance process, it is acknowledged that not all disputes will be resolved at that time, or at a later stage.

6.2 Stakeholders have noted that, given the increasing complexities in the tax law, the need for a sufficient level of ATO expertise throughout the end-to-end process is critical. In this regard, stakeholders have noted that the ATO's claims of the limited internal expertise available to it are concerning.

6.3 Stakeholders consider that it is incumbent on the ATO as the monopoly administrator to ensure that it is responsive to the increasing complexities and new challenges. Maintaining a sufficient level of independence and expertise at the objection and litigation stages is crucial to meeting these challenges. As the Administrative Review Council noted:[255]

> A good system of internal review is one which is transparent in process and affords a quick, inexpensive and independent review of decisions. Such a system is beneficial both to applicants and agencies. Its aim should be to encourage better primary decision making by agencies, and the delivery of a cost effective and time efficient review process to applicants.

6.4 An appeals area, such as proposed by the IGT, would provide an independent internal review at the objection stage, providing continuous feedback to better inform and enhance primary decision-making and support better selection of cases for litigation. Furthermore, by having specialised litigators as well as technical experts, it should also result in better management of the entire litigation process.

6.5 The ultimate goal of a separate appeals area is, therefore, to ensure that only genuine and fundamental disputes on interpretation or application of law are litigated, resulting in cost savings for both government and taxpayers.

INDEPENDENT INTERNAL REVIEW AT THE OBJECTION STAGE

6.6 The ATO acknowledges the importance of independent review. It notes:[256]

> Independence during the review process ensures that tax officers act in an objective and impartial manner, free from any conflict of interest or inherent bias or undue influence. Independence promotes

254 The federal government's Tax Forum which was convened on 4 – 5 October 2011; Inspector-General of Taxation, *A Submission to the Tax Forum*, Sydney, September 2011. A copy is included in Appendix B to this report.

255 Administrative Review Council, *Internal Review of Agency Decision Making*, Report 44, Commonwealth of Australia, Canberra, 2000.

256 Australian Taxation Office, Work Processes intranet page, document entitled 'Independence'.

> fairness and perceptions of fairness, and minimises the incidence of taxpayer dissatisfaction and complaints.

6.7 In the IGT's Objections review, stakeholders expressed concern about the perceived lack of independence in the objections process where an ATO objection officer is located within the same business line as the original decision maker, albeit in a different section. This has led to certain stakeholder concerns that there is a perception of bias in the resolution of objections and that the process was merely formality before the matter progressed to the AAT or Federal Court.[257]

6.8 The IGT found that in relatively simple matters, there was a greater degree of independence with objections officers having more of an appreciation of their role and the role of the original decision maker. However, in larger more complex cases these respective roles and responsibilities became blurred. This was partly due to the complexity of the facts or the relevant law and ATO's scarce technical resources.[258]

6.9 The ATO recognises this independence issue as a risk, noting that:[259]

> … in some circumstances there may be a trade-off between maintaining independence during the review process and the nature and extent to which the reviewer seeks input from the original decision maker. Ultimately, it will be an exercise of judgment on the part of the reviewer.

6.10 The ATO, however, in considering this independence trade-off has noted that:[260]

> Contact with the original decision maker should not be used as a substitute for independent re-examination of the dispute. Whilst it is acknowledged that efficiencies can be gained through contact with the original decision maker (particularly in complex disputes) such contact should not be used to replace the reviewer's own understanding and research.

6.11 Similar concerns regarding the perceived lack of independence of the objections process have also been raised by certain stakeholders with the IGT during consultations for this review. This perception was strongest where the matters concerned complex transactions (such as transfer pricing) or unsettled areas of taxation law (such as Division 7A of the *Income Tax Assessment Act 1936* (ITAA 1936)) where there was a lack of sufficient subject-matter experts.

6.12 One suggestion which was put to the IGT during consultations for this review was that there should be an option, in complex cases, for the taxpayer to bypass the objection process and apply directly to the AAT or the Federal Court.

6.13 A similar suggestion was considered by the IGT as part of the Objections review in which stakeholders called for greater flexibility to seek external review where, for instance, the ATO and taxpayer have fully considered the facts, evidence, issues and application of the law early in the dispute and there is a difference of opinion on the tax implications between the ATO and the taxpayer.[261]

6.14 The IGT concluded in that report that 'the objection stage is an important part of the dispute resolution process, even where the Tax Office and the taxpayer have formed a

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257 Inspector-General of Taxation, above n. 35, p. 10.
258 ibid., p. 11.
259 Australian Taxation Office, above n. 256.
260 ibid.
261 ibid., p. 119.

conclusive view on the law. Properly framed, a re-examination of facts, issues, evidence and law by an independent officer may provide scope for the resolution of the dispute without the need to proceed to litigation, for instance, through mediation or settlement negotiations.'[262]

6.15 In that report, the IGT recommended, amongst other things, that the ATO implement arrangements for:[263]

> A fast-tracked process to external review be made available that would allow an objection decision to be expedited where resolution of the dispute at the objection stage is unlikely as it deals with the Tax Office view of the law (as expressed in a ruling, determination or other interpretative advice) and the facts are agreed.
>
> Where an objection officer has sought input from the original decision maker on material facts, evidence or technical view, and the objection officer is likely to disallow the objection, the taxpayer is given an opportunity to respond on these material facts, evidence or technical view.

6.16 The ATO agreed to implement these recommendations. As part of an upcoming review into the ATO's implementation of agreed recommendations, the IGT will review the extent to which there is a sufficiently expedited process for objections in which it is considered that resolution is unlikely to be achieved through any alternate means other than litigation.

ATO MANAGEMENT OF LITIGATION

6.17 Some concerns have also been raised with the IGT in relation to the ATO's management of litigation. In particular, focus has been directed at the ATO's litigation case losses when progressing matters through the courts and on appeal. Recent statistics from the ATO suggest that while it continues to enjoy high success rates of litigation in the AAT, its success rate in the Courts has decreased over the past few years. The figures are outlined in the tables below.

Table: Success rates in the AAT 2009-10 to 2011-12 (YTD)[264]

Year	Fully Favourable to ATO	Fully Favourable to Taxpayer	Partially Favourable
2009-10	63%	9%	28%
2010-11	76%	9%	15%
2011-12 (YTD)	69%	14%	17%

262 ibid., p. 14.
263 ibid., p. 120.
264 Australian Taxation Office, above n. 96, p. 9. See also: J. Granger, above n. 63.

Table: Success rates in the Courts 2009-10 to 2011-12 (YTD) [265]

Year	Fully Favourable to ATO	Fully Favourable to Taxpayer	Partially Favourable
2009-10	56%	35%	9%
2010-11	47%	38%	15%
2011-12 (YTD)	45%	45%	10%

6.18 Further, statistics gathered by the IGT from publicly available sources indicate that since the case of *WR Carpenter*[266] in which judgment was delivered in July 2008, the ATO has litigated or been party to fifteen matters in the High Court of Australia. Of these:

- ten were tax technical challenges and the Court delivered only one wholly favourable judgment for the Commissioner,[267] eight were in the taxpayers' favour and one case in which the appeals of both parties were dismissed;[268]
- three matters turned on challenges arising out of debt collection activities or the operation of provisions of the corporations law, two of which were favourable to the Commissioner; and
- two were constitutional challenges to the validity of enactments administered by the ATO and were argued by and on behalf of the Commonwealth.[269]

6.19 In 2011, the JCPAA queried the Commissioner on the ATO's losses in general tax law litigation. In response, the Commissioner noted that the ATO's 'success rate is still very positive in terms of numbers'[270] but expressed some concern of 'worrying signs in relation to the courts' approach to the general anti-avoidance provisions of the law.'[271]

6.20 In respect of general anti-avoidance litigation matters, that is those concerning the application of Part IVA of ITAA 1936, some stakeholders have suggested that the reason for the ATO's losses may be due to poor case selection by the ATO in matters appropriate for litigation. In this regard, stakeholders have expressed concerns in relation to the ATO's in-house legal services function.

6.21 In particular, it was queried whether officers internal to an organisation, such as those within the legal services section of the ATO, could objectively review the facts and evidence of a case and determine, independently of the compliance section, whether the matter should be settled, defended or appealed. In a recent judgment, Justice Logan of the Federal Court of Australia stated:[272]

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265 Australian Taxation Office, above n. 96, p. 11; Commissioner of Taxation, above n. 108, p. 32; Commissioner of Taxation, above n. 95, p. 107.

266 *WR Carpenter & Anor v Commissioner of Taxation* [2008] HCA 33

267 *Commissioner of Taxation v Bargwanna* [2012] HCA 11 in which the High Court found for the Commissioner.

268 *Commissioner of Taxation v Bamford; Bamford v Commissioner of Taxation* [2010] HCA 10

269 *Pape v Commissioner of Taxation* [2009] HCA 23 and *Roy Morgan Research v Commissioner of Taxation* [2011] HCA 35.

270 Joint Committee of Public Accounts and Audit, above n. 149, pp. 18 and 19.

271 For example, *RCI Pty Limited v Commissioner of Taxation* [2011] FCAFC 104. On 10 February 2012 the High Court denied the Commissioner special leave to appeal the decision of the Full Federal Court.

272 *Deputy Commissioner of Taxation v Maxwell William Prentice as Trustee of the Personal Insolvency Agreement of Craig Kirrin Gore* [2011] FCA 1535 at [26]; see also *Pacific Exchange Corporation Pty Ltd v Commissioner of Taxation* [2009] FCA 1155 at [58] – [59].

> It is a matter of concern to me in this case that the objective detachment which is an incident of a truly independent solicitor acting for the Commissioner has not been apparent. That is not in any way to criticise counsel but, rather, to emphasize the singular importance of an independent solicitor acting for a client. That role is to act as something of a reality check for a client. Where a solicitor is in house, and Mr Tanna [the Australian Taxation Office Solicitor] has that status, there is a risk which must constantly be guarded against of client capture. I was left to wonder on the hearing of this application, having regard to the material before me, whether that particular phenomenon had occurred here.

6.22 Additionally, in light of a number cases which were progressed through litigation despite advice to the contrary, where there was no law clarification purpose and significant offers of settlement were made, stakeholders have voiced concern that ATO litigation may be directed, not by the legal services section, but by certain senior officers who were involved.

6.23 One submission suggested that the removal of the litigation function from the ATO altogether would assist to ensure greater independence of advice and improve the performance of the ATO in tax litigation.

6.24 In his valedictory lecture,[273] the ATO's former Chief Tax Counsel and Special Tax Adviser, Kevin Fitzpatrick, voiced his view that the ATO needed to adopt a better strategy to improve its litigation capability through more targeted and better focused litigation efforts. He also suggested that the management of tax litigation could be enhanced through some officers within the ATO's TCN specialising in litigation and having responsibility for strategically important cases.[274]

6.25 Mr Fitzpatrick further suggested that greater consistency of tax decisions may be achieved through a permanent panel of special appellate judges.[275] That is, tax litigation matters may be determined by a broader pool of judges or tribunal members, but on appeal, it should be heard by a narrower group of appellate judges with specialist tax knowledge.

6.26 This suggestion for the establishment of some specialist forum to adjudicate tax litigation is not novel. Such a model already exists in such jurisdictions as the United States[276] and Canada.[277] There is some stakeholder support for the establishment of a specialist tax court or tribunal, akin to the Trade Practices Tribunal, composed of 'a judge, an economist and perhaps someone from business or the tax office so that the decision of the tribunal will necessarily be informed by the internal deliberations of those with the required knowledge and training.'[278]

6.27 The IGT notes that a similar suggestion was also raised in the *A Tax System Redesigned* report (the Ralph Report).[279] Specifically, the Ralph Report noted that given the large number of cases proceeding through the courts and tribunals each year, contributing to both delays and uncertainty 'the tribunal and court arrangements applying to tax disputes need themselves be reviewed and all options for improvement considered.'[280]

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273 Kevin Fitzpatrick, 'A Long Innings,' (2012) 46(9) *Taxation in Australia* 394.
274 ibid, p. 395.
275 ibid, pp. 395 and 396.
276 See United States Tax Court, at <www.ustaxcourt.gov>.
277 See Tax Court of Canada, at <www.tcc-cci.gc.ca>.
278 Justice G.T. Pagone, *Some Problems in Legislating for Economic Concepts – A Judicial Perspective*, paper delivered to the Treasury Revenue Group on 2 December 2010, Canberra, viewed on 16 January 2012, <www.treasury.gov.au>.
279 J. Ralph, *A Tax System Redesigned*, Commonwealth of Australia, Canberra, 1999.
280 ibid., p. 148.

6.28 The Ralph Report outlined two options for consideration to reform in this area. These options were:[281]

- the establishment of a specialist taxation tribunal to facilitate effective tax dispute resolution, possibly as a division of the proposed Administrative Review Tribunal or Federal Magistrates Court; or
- the creation of a dedicated Tax Court, possibly as part of the Federal Court, presided over by judges with specialist tax knowledge.

6.29 Opponents of the suggestion that Australia would benefit from a specialist tax court argue that tax law does not exist in isolation and judges are often called upon to elucidate and apply 'concepts of general law as they impinge on the operation of tax statutes.'[282] Furthermore, a specialist tax court poses a potential concern of being seen to be 'too close' to repeat litigants (that is, the Commissioner who will either be applicant or respondent in all matters).[283] This is likely to create a real risk of diminished confidence in the determinations of any such court.

6.30 Countering this argument is the suggestion that the risk of distortion and institutionalisation of the law through the application of specialist perception may be addressed by a general appellate court with a broader pool of judges.[284]

6.31 The IGT notes that both the Federal Court of Australia and the AAT[285] have designated tax specialists and, through internal arrangements, ensures that tax cases are heard and determined by judicial officers possessing appropriate taxation expertise. Specifically, the New South Wales registry of the Federal Court has established a specialist panel of tax judges to ensure that tax dispute matters are allocated to a judge on the panel.[286] Each registry of the Federal Court also has a tax list coordinating judge who is tasked with ensuring that tax matters are expedited, that issues are brought to light early and the matter is either resolved or set down for hearing as soon as possible.[287]

6.32 The IGT raises this matter as a point of discussion and notes that any reform in this area falls outside of the IGT's jurisdiction. Should it become necessary to consider the need for a specialised tax court, the IGT is of the view that the Attorney-General's Department may be better placed to investigate and advise as to whether such an establishment would be in the public benefit and create value for the community as a whole.

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281 ibid.

282 Justice M. Kirby, 'Hubris Contained: Why a Separate Tax Court should be Rejected', (2007) 42(3) *Taxation in Australia* 164; Justice G. Hill, 'Great Expectations: What do We Expect from Judges in Tax Cases?' (1995) 69 *Australian Law Journal* 992.

283 ibid.

284 Justice G.T. Pagone, above n. 278.

285 Justice G. Downes, 'Twenty-Five Years of Tax Cases in the AAT; Eleven Years of the "practical business tax"', Speech delivered to the Corporate Tax Association 2011 GST Corporate Intensive, 15 October 2011, Sydney, viewed on 19 March 2012, <www.aat.gov.au>.

286 Federal Court of Australia, *Panels for the Individual Docket System*, Sydney, 1 November 2011, <http://www.fedcourt.gov.au/how/panels.html#taxation.>; A similar panel also existed previously in the Victorian registry however, at a recent Tax List Users Forum meeting on 18 April 2012, the Federal Court advised the attendees that the Victorian panel would no longer be maintained owing to resourcing constraints.

287 Federal Court of Australia, *Practice Note TAX 1*, Sydney, viewed 8 August 2011, <www.fedcourt.gov.au>.

SEPARATING OBJECTION AND LITIGATION FUNCTIONS FROM AUDIT FUNCTIONS

6.33 The IGT considers that separating the objections and litigation functions from the investigative arm of the ATO will assist in enhancing both the actual and perceived independence of review of original ATO decisions. A separate appeals and review area seeks to empower a separate ATO litigation section to independently assess the evidence and prospects of a case before progressing to originate litigation or appeals for adverse decisions. In effect, the ATO's litigation function would, like the Director of Public Prosecutions in criminal matters, have ultimate discretion as to which matters the ATO would litigate, which would be conceded and which should otherwise be settled.

6.34 Such a structure existed in the ATO prior to 1994 in the form of its Appeals and Review Group. However, following an internal review, a restructure took place whereby the functions formerly exercised by Appeals and Reviews were subsumed into business lines which were created contemporaneously. These business lines have evolved since then but to date they still house both the objections and the audit areas.[288]

6.35 The IGT notes that the restructure came about, in part, from recommendations of the JCPA in its 1993 report. In that report, the JCPA noted:[289]

> In the event that the decision making process within the ATO is amended to require that decisions on assessments and prosecutions are made after a process of internal review, the functions of the officers of the Appeals and Review Group would be effectively reallocated to staff within the mainstream decision making process. In the Committee's view, those functions should properly be conducted in every case not merely those that go to objection. Thus, the resources of the Appeals and Review Group should be allocated to general decision making areas.

6.36 The report recommended that:[290]

> The Australian Taxation Office reallocate the resources of the Appeals and Review Group to the performance of internal review within the on-going decision making processes of the Australian Taxation Office.

6.37 The ATO's 1993-94 Annual Report also alluded to a separate internal review in relation to the organisational restructure.[291] The IGT has not been able to review this report as it cannot be found despite the ATO's best efforts.

6.38 The IGT acknowledges that the decision to disband Appeals and Review was driven by the ATO's desire to improve compliance through improvement of its client focus.[292] However, as outlined in the IGT's Objections review and following concerns raised by stakeholders in this review, the IGT considers that it is now necessary to revisit the need for, and benefits of, a separate appeals and review function.

6.39 The IGT notes that since 1998 such a model has existed in the United States' IRS, with Congress having legislated to mandate the restructure:[293]

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288 Australian Taxation Office, *Working for All Australians 1910 – 2010: A Brief History of the Australian Taxation Office*, Commonwealth of Australia, Canberra, 30 September 2011, p. 220.
289 Joint Committee of Public Accounts, above n. 81, pp. 270 and 271.
290 ibid.
291 Commissioner of Taxation, *Annual Report 1993 - 1994*, Canberra, 1994, p. 10 and 11.
292 ibid.
293 Subsection 1001(a)(4) of *the Internal Revenue Service Restructuring and Reform Act 1998*.

> The Commissioner of Internal Revenue shall implement a plan to reorganize the Internal Revenue Service. The plan shall […] ensure an independent appeals function within the Internal Revenue Service, including the prohibition in the plan of ex parte communications between appeals officers and other Internal Revenue Service employees to the extent that such communications appear to compromise the independence of the appeals officers.

6.40 Taxpayers who disagree with IRS decisions are able to elect to conference (either by correspondence, telephone or in person) with an Appeals officer and are asked to be prepared to discuss all disputed issues at the conference.[294] The Appeals officer is sufficiently authorised to separately and independently settle or pursue matters arising out of IRS decisions. Central to the independence of the Appeals section is the direct reporting by the Chief, Appeals, to the Commissioner of the IRS.

6.41 Technical views applied by the Appeals area are set by the Office of Chief Counsel. Chief Counsel is 'the legal advisor to the Commissioner of Internal Revenue and the Service's officers and employees on all matters pertaining to the interpretation, administration, and enforcement of the internal revenue laws and related statutes.'[295]

6.42 Appeals officers are required to either apply the views set by Chief Counsel, or to seek advice from Counsel in respect of an issue. Where the officer seeks to depart from Chief Counsel's views, the Appeals officer must escalate the matter to the Chief, Appeals, for consideration and rectification of any errors in a timely manner and to ensure consistency of views adopted by Appeals.[296]

6.43 Similar arrangements exist in New Zealand with the IRD's Adjudication Unit, being a part of the Office of the Chief Tax Counsel, providing an independent and impartial decision based on issues arising out of IRD decisions.[297] The Unit is separate from the audit and investigative arm of the IRD and, in order to maintain transparency and independence, all correspondence between the Unit and either of the disputing parties is conducted through the Field Liaison and Communication Unit.[298]

6.44 While the IGT does not consider that the ATO needs to strictly adopt the United States model, the IGT considers that a separate appeals and review section would provide an avenue for taxpayers to raise concerns regarding an ATO view, and have the alternate interpretation or view considered as part of the independent review. The IGT believes that this would ensure that only genuine and fundamental disputes on interpretation or application of the law are litigated.

6.45 The IGT also appreciates that a separate appeals and review area may on occasions give rise to internal tensions within the ATO such as auditors' perceptions that 'cases are given away' and reviewers' perceptions that auditors' decisions are not technically robust. The IGT considers that tensions of this nature are not necessarily undesirable in ensuring robust and tested outcomes are achieved, thereby reducing the overall level of taxpayer disputes and the cost to the broader tax system.

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294 Internal Revenue Service, *Publication 556: Examination of Returns, Appeal Rights, and Claims for Refund*, viewed 2 February 2012, <www.irs.gov>, p. 9.

295 Internal Revenue Service, *Internal Revenue Manual*, viewed 2 February 2012, <www.irs.gov>, part 33.1.1.1

296 ibid., part 8.6.3.

297 Inland Revenue Department, *The Adjudication Unit – its role in the dispute resolution process*, Wellington, 5 November 2007, viewed 2 February 2012, <www.nzird.govt.nz>.

298 ibid.; Inland Revenue Department, *Managing communications associated with a dispute referred to the adjudication unit*, Wellington, 10 February 2006, viewed 2 February 2012, <www.nzird.govt.nz>.

6.46 Accordingly, the IGT considers that there is significant merit in the ATO undertaking a restructure to:

- separate its objections and litigation functions from its investigative function;
- ensure actual and perceived independence and impartiality of the objections function through implementing clear protocols regarding communication between objection officers and other compliance officers, including a general prohibition against ex parte communication save where all parties are informed of and given an opportunity to participate in such communication taking place; and
- empowering a separate internal function to independently assess and determine whether matters should be settled (and if so, to facilitate such) or whether matters should be defended in litigation.

6.47 However, the IGT recognises that such a restructure would be a major undertaking and that some time may be required for the ATO to build up sufficient internal capability to manage a separate appeals and review section. Furthermore, public and professional confidence in the independence and expertise of staff within such an area would take time to develop.

6.48 As such, the IGT considers that his recommendation in this regard may be implemented in stages, with the ATO first developing a separation of the audit and objection/litigation functions in respect of the most complex matters, where perceptions of lack of independence are most acute.

6.49 The IGT notes that such an approach would help to inform the ATO and provide relevant learnings in respect of a larger roll out of the recommendation. It may also be informative for the government in respect of any legislative or regulatory changes which it may make in line with the IGT's recommendations to the Tax Forum.

RECOMMENDATION 6.1:

In working towards a fully functioning independent appeals area to be headed by a new Second Commissioner as set out in the IGT's October 2011 submission to the Tax Forum, the IGT recommends that the ATO establish a pilot 'Appeals Section':

- *under the leadership of the current Second Commissioner – Law to carry out the objection and litigation function for the most complex cases;*
- *establish clear protocols regarding communication between Appeal officers and compliance officers, including a general prohibition against ex parte communication, save where all parties are informed of, and consent to, such communication taking place; and*
- *empower the appeals function to independently assess and determine whether matters should be settled, litigated or otherwise resolved (for example, ADR).*

ATO Response

Disagree.

The establishment of an additional Second Commissioner statutory officer and any specific roles are matters for Government.

The NTLG, professional associations and taxpayers involved in dispute resolution involving more complex issues have all expressed their preference for engaging law experts early in the dispute process. They also want access to all those involved in the decision making process, in the same spirit as having key experts at the table for ADR. This preference for earlier engagement and increased levels of collaboration is consistent with the underlying principles of the Transforming Tax Technical Decision Making Project. A proposal that quarantines access to ultimate decision makers until later in the process would be inconsistent with the preference of taxpayers and advisers to resolve issues as early in the process as possible and would be expected to add to the cost of resolving disputes and the time taken to do so.

While the recommendation only proposes a pilot, the organisational logistics of such a pilot would be burdensome. For example, how are cases to be classified, there is also significant work associated with developing relevant guidelines and protocols, and there is a diversion of senior expert staff away from earlier resolution of the more complex cases.

APPENDIX 1 — TERMS OF REFERENCE AND SUBMISSION GUIDELINES

PURPOSE OF THIS DOCUMENT

The Inspector-General of Taxation (IGT) is seeking your submissions on his review into the Australian Taxation Office's (ATO) use of Early and Alternative Dispute Resolution (EDR and ADR, respectively). This review is listed on the IGT work program that was released on 4 April 2011.

This document outlines the background to the review, followed by the formal terms of reference and the submission guidelines.

BACKGROUND

In conducting compliance verification activities, such as reviews and audits, the ATO and taxpayers may disagree on a range of matters, including views of the law, relevance of facts and evidence and the application of law to the facts. Under Part IVC of the *Taxation Administration Act 1953*, the law provides taxpayers with a right of applying for internal review of certain ATO decisions (an objection) and a right of appeal to the courts.

Tax litigation is, therefore, sometimes unavoidable. Despite this, it is increasingly recognised as a costly and time-consuming process attended by uncertainty and mistrust. As taxpayers and administrators look to build and maintain strong working relationships, reduce costs and streamline processes for compliance and enforcement, both are realising the need for, and the benefits of, alternative approaches to dispute resolution[1]

The ATO considers that a fair and timely system for resolving disputes with taxpayers is pivotal to establishing confidence in the administration of the tax system. It is preferable to identify areas of dispute as close to the original decisions as possible and try to resolve them at that point.[2] Both EDR and ADR can provide means to resolving disputes in a manner that is less costly and more timely than that under the Part IVC process.

ADR encompasses a variety of methods which may be used to resolve legal disputes other than the traditional method of referring the matter to a Court or Tribunal for determination.[3] Common examples of ADR include settlement negotiations, mediation, conciliation and

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1 Ernst & Young, *Tax Administration without Borders*, viewed on 12 July 2011 < www.ey.com>, p.3; Organisation for Economic Co-operation and Development, *Study into the role of Tax Intermediaries*, viewed on 13 July 2011 <www.oecd.org>, p.75.

2 Commissioner of Taxation, *Annual Report 2009-10*, Australian Taxation Office, Canberra, viewed on 30 June 2011 <www.ato.gov.au>.

3 National Alternative Dispute Resolution Advisory Committee (NADRAC) website, viewed on 27 June 2011 <www.nadrac.gov.au>.

arbitration. Other examples include conferences, case appraisals and neutral evaluations, all of which are often utilised by the Administrative Appeals Tribunal.

EDR contemplates preventative intervention to resolve disputes early, effectively and legitimately. It aims primarily to avoid unnecessary disputes and, where this is not possible, to reduce both the frequency and severity of disputes.[4] An example of this may be a conference between the taxpayer and the ATO to clarify facts which may be relied upon for the purposes of an amended assessment.

EDR and ADR are not mutually exclusive and may often overlap. As defined above, ADR generally refers to dispute resolution techniques employed close to, or during, the litigation process whereas EDR refers to processes which are employed prior to litigation being contemplated.

In recent years, the use of EDR and ADR has gained momentum and support from the judiciary,[5] government[6] and practitioners.[7] It has been adopted in various forms in the United Kingdom,[8] the United States[9] and New Zealand,[10] amongst others, in the administration of those respective taxation regimes.

The ATO's Law Administration Practice Statement PS LA 2007/23 *Alternative Dispute Resolution in ATO Disputes and Litigation* requires that 'officers playing a role in the management of ATO disputes particularly those in litigation must consider whether it would be appropriate to participate in some form of ADR to attempt to resolve the dispute'[11] and provides further guidance as to those matters which the ATO considers may be suitable for ADR. Similarly, the ATO's *Code of Settlement Practice* (the Code) provides further guidance on the settlement of tax disputes and the use of ADR.[12]

The current taxation legislative regime does not impose any mandatory obligation on the ATO to consider and participate in EDR and ADR. However, other policies and laws do impose such an obligation. These include:

- the Model Litigant Policy, which binds all agencies (including the ATO) under the *Financial Management and Accountability Act 1997*, requires that agencies endeavour 'to avoid, prevent and limit the scope of legal proceedings wherever possible, including by giving consideration to alternative dispute resolution

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4 Law Society of New South Wales, *Early Dispute Resolution (EDR) Task Force Report*, viewed on 27 June 2011 <www.lawsociety.com.au>.

5 Speech: 'The Future of Litigation: Dispute Resolution in Jurassic Park?' delivered by the Hon. Robert French, Chief Justice of the High Court of Australia at the Bar Association of Queensland Annual Conference on 7 March 2009, viewed on 27 June 2011 <www.hcourt.gov.au>.

6 Attorney-General's Department, *Encouraging Access to Justice through Alternative Dispute Resolution*, Media Release 29 March 2009, viewed on 27 June 2011 <parlinfo.aph.gov.au>; *Civil Dispute Resolution Act 2011* (Cth); Attorney-General's Department, *Legal Services Directions 2005*, viewed on 30 June 2011 <www.ag.gov.au>.

7 Law Council of Australia, 'Submission to the Senate Legal and Constitutional Affairs Committee regarding the *Civil Dispute Resolution Bill 2010*', viewed on 28 June 2011 <www.lawcouncil.asn.au>, p. 3.

8 Her Majesty's Revenue and Customs, *Alternative Dispute Resolution Pilot*, viewed on 27 June 2011 <www.hmrc.gov.uk>; see also Ernst & Young, above n 1, p. 50.

9 Internal Revenue Service, *Fast Track Settlements*, viewed on 27 June 2011, <www.irs.gov>.

10 New Zealand Inland Revenue, *Dispute Resolution Process*, viewed on 27 June 2011, <www.ird.govt.nz>.

11 Australian Taxation Office, *Law Administration Practice Statement PS LA 2007/23 Alternative Dispute Resolution in ATO Disputes and Litigation*, viewed on 28 June 2011 <www.ato.gov.au>, para. 8.

12 Australian Taxation Office, *Code of Settlement Practice*, viewed on 28 June 2011 <www.ato.gov.au>, para. 37.

before initiating legal proceedings and by participating in alternative dispute resolution processes where appropriate';[13] and

- the *Civil Dispute Resolution Act 2011*, which comes into effect on 1 August 2011, will require applicants who institute certain civil proceedings in the Federal Court or Federal Magistrates Court (including proceedings concerning taxation disputes)[14] to file a 'genuine steps statement' detailing steps taken to resolve the dispute prior to commencing proceedings, or providing reasons as to why no such steps had been taken.[15] The respondent must file a 'genuine steps statement' in response indicating whether it agrees with the applicant's statement and if not, the reasons for the disagreement.[16]

Following the IGT's reviews into *Aspects of the Tax Office's Settlement of Active Compliance Activities*[17] and *The Underlying Causes and the Management of Objections to Tax Office Decisions*,[18] the ATO has embarked on a program of work to improve its ability to resolve disputes at an earlier point in time.

During the consultation on the current IGT work program, external stakeholders expressed general support for the ATO's use of EDR and ADR but noted concerns that:

- the ATO utilises ADR sparingly and, as a consequence, foregoes opportunities to quickly and cost-effectively resolve disputes without the need for litigation;
- the ATO does not currently make sufficient use of EDR techniques in order to narrow and address issues in dispute as they arise during the compliance verification process;
- where the ATO has been willing to negotiate, its representatives were sometimes insufficiently skilled and/or lacked appropriate authority to progress the negotiations to a meaningful and productive end; and
- there is room for improvement in the way that both the ATO and the taxpayers approach and engage in EDR and ADR.

It is also important to note the ATO has statutory obligations which prevent it from settling liabilities in the same manner as private parties. There is a perception and, on one reading of the Code, a general rule that the Commissioner of Taxation (the Commissioner) will not enter into settlements where the outcome would be contrary to the ATO's established view of the law. However, when read as a whole, the Code does seek to provide a balance between this general rule (to minimise the risk of treating tax liabilities as negotiable debts) and scope for the ATO to consider, on a case-by-case basis, whether primary tax may be discounted having regard to litigation risk, particular facts and evidence and the application of the law to the facts warranting settlement.

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13 Attorney-General's Department, above n. 6, Appendix B sub-paragraph 2(d).
14 Part 4 of the Act outlines those proceedings which are excluded from the operation of the Act.
15 Section 6.
16 Section 7.
17 Inspector-General of Taxation, *Review into aspects of the Tax Office's settlement of active compliance activities*, viewed on 30 June 2011 <www.igt.gov.au>, p. 13.
18 Inspector-General of Taxation, Review into the underlying causes and the management of objections to Tax Office decisions, viewed on 30 June 2011 <www.igt.gov.au>.

Additionally, submissions to the IGT have asked whether the ATO could do more to embrace the philosophy of timely and cost-effective dispute resolution with ADR and EDR being the adopted norm and resorting to litigation only where the dispute has impacts wider than the interests of the parties in dispute.

The terms of reference for this review is set out below followed by submission guidelines to assist you in preparing your submission.

Terms of reference

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

The Commissioner has also requested that the IGT undertake this review pursuant to paragraph 8(3)(b) of the IGT Act 2003.

The IGT will identify the instances and matters in which the use of EDR and ADR would be most desirable, and will review the extent to which the ATO currently utilises EDR and ADR in that context.

The IGT will also look to identify opportunities for improvement.

The review will have a particular focus on:

Engagement

- *the extent to which the ATO identifies matters in which the use of EDR or ADR may be desirable and those matters in which it may not be desirable;*
- *the extent to which the ATO engages, either of its own volition or at the request of a taxpayer, in EDR and ADR to resolve or narrow issues in dispute;*
- *the accessibility of EDR or ADR to a taxpayer seeking to resolve a dispute with the ATO; and*
- *the quality of the ATO's engagement and whether ATO representatives demonstrate a focused attention on the holistic resolution of issues in contention.*

Expertise

The extent to which the ATO is sufficiently skilled to identify opportunities for the use of EDR and ADR, to engage in EDR and ADR and to appropriately manage and resolve disputes without resort to litigation, including whether the ATO:

(1) utilises the most appropriate EDR or ADR method, having regard to timeliness, costs involved, the taxpayer and the issue(s) in question;

(2) engages the most appropriate facilitator to assist with resolving the dispute, having regard to the selected EDR/ADR technique, timeliness, costs involved, the taxpayer and the issue(s) in question; and

(3) has sufficient access to the skills and expertise to effectively carry out EDR and ADR techniques in disputes with taxpayers and their representatives.

Authority

Whether ATO officers engaging in EDR and ADR are the relevant decision-makers for the purpose of the dispute and, if not, the extent to which those ATO officers are invested with sufficient authority to settle disputes with taxpayers.

Whether there are sufficiently expedited processes in place for ATO representatives in EDR or ADR to obtain, or supplement previously granted, authority to settle and whether these processes are clearly understood by relevant ATO officers.

Timeliness

Whether the use of EDR and ADR techniques may be applied to resolve or narrow disputes earlier in the ATO's compliance verification/objection process.

The IGT may also examine any other relevant concerns raised or potential improvements.

Consultation Process

The IGT welcomes your engagement in the consultation process on this review. To facilitate this action, the IGT will:

- post the terms of reference on the IGT website (www.igt.gov.au) and call for submissions through such channels as print media;
- seek submissions on this review from members of the public, or from particular associations, industry bodies or organisations; and
- request relevant information and documents from the ATO.

Submissions

The IGT invites you to provide written submissions to assist with this review. Your submission should address the terms of reference set out above and the issues and questions outlined in the submission guidelines below. It is not expected that each submission will necessarily address all of the issues and questions raised.

The closing date for submissions is 26 August 2011. Submissions can be sent by:

post to:	Inspector-General of Taxation GPO Box 551 SYDNEY NSW 2001
fax to:	02 8239 2100
email to:	adr@igt.gov.au

Confidentiality

Submissions provided to the IGT are dealt with in strict confidence (unless you specify otherwise). This means that the identity of the taxpayer and/or of the adviser and any

identifying information contained in such submissions will not be made available to any other person, including the ATO. Sections 23, 26 and 37 of the IGT Act 2003 safeguard the confidentiality and secrecy of such information–for example, generally the IGT cannot disclose the information as a result of an FOI request or as a result of a court order. Furthermore, if such information is the subject of legal professional privilege, disclosure of that information to the IGT is protected and will not result in a waiver of that privilege.

SUBMISSION GUIDELINES

We envisage that, broadly, your submission may be divided into two parts:

- a detailed account of your experience with EDR or ADR and the ATO; and
- recommendations to improve the ATO's use of EDR and ADR and how this would benefit all parties involved.

Your experience with EDR/ADR and the ATO

In the first part of your submission, you should provide detailed accounts of experiences in seeking to resolve disputes with the ATO through alternative means other than litigation. In doing so, you may wish to provide details of:

Prior to seeking EDR or ADR

- the dispute(s) you sought to resolve;
- whether the ATO approached you to offer any alternatives or options to resolve the dispute(s), and if so, the details of these processes;
- if the ATO did not initiate any EDR or ADR process, the steps you took to resolve the dispute(s) with the ATO, including whether you sought to engage the ATO in EDR or ADR;
- the response from the ATO in relation to steps you took, including whether the ATO agreed to any requested formal or informal EDR or ADR, and any other action on the ATO's part;
- if you engaged in an EDR or ADR process with the ATO, at what point did this occur and what EDR or ADR process was utilised;
- whether the EDR or ADR process was formalised, at the outset, by way of a mediation agreement, or other formal document outlining the agreed terms on which the EDR or ADR would be conducted;
- if the ATO did not agree to engage in EDR or ADR, the reasons which were provided to you for this refusal (if any) and any action you took to progress the matter further, including whether you sought to engage with officers at a more senior level and the accessibility to these senior officers;

During the EDR or ADR process

- the number of people who attended on your behalf and on behalf of the ATO, and their respective roles and qualifications in the process;
- whether at the EDR or ADR, all of the issues in contention were brought to light and discussed;
- whether you felt the ATO was sufficiently prepared to engage in EDR and ADR, and if its representatives demonstrated a clear and precise understanding of your position, the facts and evidence which support your position and the issues in contention;
- the facilitator who was engaged and whether in your view, that facilitator was best placed to assist in progressing the matter to resolution, having regard to the EDR or ADR technique which was employed;
- whether the dispute(s) was(were) resolved either in full or in part, or the issues in contention narrowed, and the factors which you feel contributed to this, including but not limited to the behaviours and skills of the ATO representatives;

After the EDR or ADR process

- if the dispute(s) was(were) resolved, or the issues in contention were narrowed, whether the agreed matters were formalised in a deed of settlement, heads of agreement or similar documentation;
- if the dispute(s) was(were) resolved, what aspects of the dispute(s) were the ATO willing to concede (for example, primary tax, interest or penalties) and the reasons given;
- how long the dispute resolution process took, from initiation to finalisation;
- if the dispute(s) was(were) not resolved, provide reasons (for example, the parties were unable to agree on a technical point requiring judicial determination or the personalities attending the ADR for either party);
- if the dispute(s) was(were) not resolved, and the matter proceeded to litigation, whether you felt advantaged or disadvantaged in litigation by reason of the matters which had been disclosed during the course of the EDR or ADR;
- the impact of, and costs involved in, seeking to resolve the dispute(s) before progressing the matter to litigation;
- the degree to which these costs and impacts were minimised, or could have been minimised, by you or the ATO; and
- any other experience that you consider relevant.

Specific examples arising from your experiences would greatly assist us to both identify and examine potential systemic issues more efficiently and effectively. The accounts of your experiences should take into consideration the terms of reference above.

For these examples, it would be useful to provide a time line of events outlining your key interactions with the ATO including any correspondence, telephone communications, information requests and responses from the ATO (if applicable).

It is important to provide details of specific factors, including the ATO practices and behaviours that, in your view, delayed resolution of the dispute(s) and resulted in increased costs and impact to your business.

The IGT also seeks examples of positive factors in the ATO's use of dispute resolution techniques which have assisted you to address disputes in a timely and effective manner, and which have minimised cost and disruption to you.

Opportunities for improvement

In the second part of your submission, we invite you to identify opportunities to improve the ATO's use of EDR and ADR. Your submission may outline alternative frameworks, actions, practices or behaviours which, in your view, could minimise any adverse or detrimental impacts arising from the current system and its operation.

At the outset, based on your experiences in negotiating with the ATO, you should consider whether there is currently an appropriate balance between the need to minimise the risk of treating tax as a negotiable debt and allowing the ATO some room to settle appropriate matters. If not, where do you consider that balance should lie?

Comments would also be welcome on whether the Commissioner should be given broader powers to settle disputes and, if so, how should this be effected. One possibility would be to amend or clarify the scope of section 8 of the *Income Tax Assessment Act 1936* (and corresponding sections in other relevant acts).

In providing specific comments on EDR and ADR, you may wish to consider:

- at what point in the existing ATO processes should it consider whether EDR or ADR should be employed. The different points at which EDR or ADR may be utilised include:
  - Before the finalisation stages of audit;
  - Position paper issued by the ATO;
  - Notice of Amended Assessment issued by the ATO;
  - Objection lodged;
  - Objection decision issued by the ATO;
  - Appeal filed in the AAT or Federal Court;
  - Hearing of the Appeal;
- what factors should be considered when determining whether a matter is suitable for EDR or ADR and, in particular, what types of cases lend themselves

to EDR or ADR (for example, disputes involving valuations) and what types do not (for example, cases involving elements of fraud);

- who, in your view, and having regard to the timing and nature of the disputes and the costs involved, would be most appropriate to assist in resolving disputes with the ATO. Possible choices of facilitators include:
  - barristers who practice in dispute resolution;
  - solicitors with specialist dispute resolution training;
  - retired judges;
  - people not legally trained, but who are skilled and accredited negotiators/mediators;
- whether the facilitator should be a trained ATO officer who is not involved in the dispute(s) in question or whether the facilitator should be an independent third party such as those listed above;
- whether ADR is more effective when conducted under direction from a Court or Tribunal; and
- whether matters should only be litigated where judicial determination is necessary to clarify the law and the determination would have an impact on the broader community.

You may wish to include experiences you have had in the resolution of disputes with other government departments, overseas revenue authorities or other parties not connected with the Commonwealth of Australia.

Other issues

Lastly, your submission may wish to address any other specific points that you consider important in the context of the ATO's use of either EDR or ADR.

APPENDIX 2 — THE IGT'S SUBMISSION TO THE TAX FORUM

Tax Forum — next steps for Australia

A submission to the Tax forum

INSPECTOR-GENERAL OF TAXATION

SEPTEMBER 2011

EXECUTIVE SUMMARY

The Inspector-General of Taxation (IGT) welcomes the opportunity to participate in the Tax Forum and is pleased to provide this submission to generate debate on one of the designated topics: namely, Tax System Governance.

Governance is a key aspect of any tax system. The approach of tax administrators has a direct bearing on policy implementation and taxpayer confidence through application of fairness, certainty, transparency, minimisation of compliance costs and reduction in unnecessary complexity. Accordingly, the development of a more effective and comprehensive set of governance arrangements for the Australian Taxation Office (ATO) has strong merit.

This submission outlines three key options for consideration. These are:

1. Establishment of a management board (such as those of an advisory or supervisory nature) to bring into the ATO a diverse mix of expertise and experience including information technology, human resources, finance and communication.

2. Appointment of additional Second Commissioners from the private sector to diversify the ATO Executive Committee, inject a wider range of experiences and perspectives and also provide intelligence on trends in corporate governance and taxation risks. These additional Second Commissioners to be appointed to lead the more contentious areas of the ATO, including one as head of a separate appeals area.

3. Enhancement and centralisation of the ATO scrutineer function to provide a single port-of-call for taxpayer grievances with tax administration, be they specific disputes or systemic issues. A more co-ordinated approach to ATO scrutiny would also minimise duplication and the cost of external scrutiny.

The three options form an integrated package that provides synergistic benefits beyond each as stand-alone considerations. The package supports a more comprehensive governance framework aimed at providing the ATO with a wider range of expertise to deal with present and future challenges, as well as improving taxpayer experience.

The management board has strong stakeholder support and the Government is currently considering its implementation. The IGT recommends that options 2 and 3 be also considered by the Tax Forum to further address the systemic issues identified by business and tax professionals.

INTRODUCTION

The Tax Forum convened by the Australian Government provides a unique opportunity for the Australian community to contribute to the future direction of Australia's tax and transfer system. The IGT welcomes the opportunity to provide this submission and participate at the Forum.

The IGT is well-positioned to explore and contribute to a number of matters regarding tax administration given his office's function, expertise and broad-based consultative relationship with both government agencies and private-sector stakeholders at all levels in the community.

In seeking to address the designated topics for the Forum, this submission focuses on specific matters affecting governance of the ATO. The submission takes a three pronged approach by addressing the need for a management board (such as those of an advisory or supervisory nature), diversification in the ATO Executive Committee and an improved ATO scrutineering function.

There are a range of other important tax administration system issues that the IGT is also considering, but these may be addressed in the conduct of the IGT's core work program.

This submission draws upon earlier IGT submissions to the Australia's Future Tax System (AFTS) review dated 3rd and 30th of September 2009 respectively.

CURRENT ATO GOVERNANCE ARRANGEMENTS

External governance

The external governance arrangements currently overseeing the ATO are considerable, many of which have evolved in a piecemeal fashion over the last thirty years.

The Commonwealth Ombudsman, established in 1977 as part of the federal government's coordinated approach to administrative law reform development, is, in the main, responsible for investigating taxpayer complaints. In addition, the Australian National Audit Office (ANAO) carries out performance and financial statement audits.

Following the Ralph Review in 1999, the Board of Taxation was established to provide a business and community perspective on the tax system, including advice on improvements that can be made to the implementation of tax laws.

The IGT, established in 2003, reviews systemic tax administration issues and reports to the Government with recommendations for improvement for the benefit of all taxpayers.

The ATO also has formal accountability to ministers and Parliament through its annual reporting and appearance before parliamentary bodies such as the Joint Committee of Public Accounts and Audit (JCPAA) and the Senate Economics Legislation Committee. Since 2007, the JCPAA has held a biannual public hearing with the Commissioner of Taxation in the interests of greater public accountability and transparency. More recently the JCPAA has foreshadowed greater scrutiny of the ATO through the biannual public hearings having given notice to the Commissioner that he will be required to address issues or concerns raised by scrutineer agencies such as the IGT, the Ombudsman and the ANAO.

Internal governance

The Commissioner of Taxation has established the ATO Executive Committee to assist him in setting the longer term direction of the ATO and to administer aspects of Australia's tax and superannuation systems, while delivering the ATO's commitments to government.

The ATO Executive Committee currently comprises eight senior tax officers including the Commissioner (as Chair), the Second Commissioners and other senior ATO officers (as nominated from time to time by the Chair). Currently, the additional senior ATO members are the Chief Finance Officer, the First Assistant Commissioner ATO People, the Chief Information Officer and the Chief Operating Officer. Independent advisers and other senior ATO representatives may be required to attend and present a report relating to their area of responsibility as a standing item.

CASE FOR REFORM

The issues relating to ATO governance and the need to reform are not new and date back to the 1975 Asprey Review. The IGT believes that there is merit in the Tax Forum considering the adequacy of these arrangements given:

- international trends establishing comprehensive governance frameworks, including the creation of management boards and specific governance functions;
- strong community support for ATO governance reforms to ease the burden of compliance on taxpayers including reducing compliance costs; and
- underlying concerns regarding ATO capabilities and approaches evidenced in IGT reviews and community consultations.

INTERNATIONAL TRENDS AND PERSPECTIVE

Management boards are now a characteristic of many revenue authorities around the world, including the United States and United Kingdom.[1] It is important that Australia keeps pace with international changes in tax administration and adopts those features that would likely deliver benefits in the Australian context. A 2006 International Monetary Fund (IMF) Working Paper[2] also notes that management boards have now become a common feature of a comprehensive governance framework.

UNITED STATES TAX ADMINISTRATION GOVERNANCE

The Internal Revenue Service (IRS) Oversight Board (the IRS Board) was created by the IRS Restructuring and Reform Act of 1998 (USA). The IRS Board has seven Presidential appointees together with the Secretary of Treasury and the IRS Commissioner. The aims of the IRS Board are to improve accountability, continuity, expertise and to provide a private sector perspective.

ROLE AND RESPONSIBILITIES OF THE IRS BOARD

The IRS Board operates much like a corporate board of directors, but is tailored to fit a public sector organisation. The IRS Board provides the IRS with long term guidance and direction, and applies its private sector experience and expertise in evaluating the IRS progress in improving its service. Specifically, the responsibilities of the IRS Board are to:

- review and approve the IRS budget;
- review and approve the IRS strategic plan;
- select and evaluate some senior IRS executives; and
- submit the annual report to Congress.

The IRS Board meets five or more times a year and has a number of committees that assist in its functions and responsibilities — they include an operations committee (which oversees the service and enforcement functions of the IRS), an operations support committee (which oversees the human capital, training, information technology and support functions at the IRS) and the executive committee (which oversees agency-wide personnel matters at the IRS). These committees also meet quarterly to review the array of performance measures against targets. The IRS Board

1 Organisation for Economic Co-Operation and Development, Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2010), 3 March 2011, pp. 31-36.

2 Kidd, M. and Crandall, C., *Revenue Authorities: Issues and Problems in Evaluating Their Success*; IMF Working Paper 06/240; 1 October 2006.

is also active in ensuring that it remains informed — for instance, it holds IRS briefings, it attends Congressional Committees, it makes a number of field visits to both IRS and stakeholder sites and maintains a Stakeholder Outreach Program, which includes conducting annual public meetings, attending nationwide tax forums, conducting an annual taxpayer satisfaction survey and maintaining an ongoing relationship with tax professionals.

Under the law, the IRS Board cannot be involved in specific law enforcement activities, including audits, collection activities or criminal investigations. It also cannot be involved in specific procurement activities and it does not develop or formulate tax policy or practice in relation to existing or proposed tax laws.

The IRS notes that there are a number of major trends affecting tax administration including the increasing complexity of tax administration, growing human capital challenges, an increase in electronic data, online transactions and related security risks and accelerating globalisation. The IRS believes that the existence of a management board allows it to adapt to these changing circumstances by injecting a wider range of experience, expertise and approaches to tax administration.

Role and responsibilities of the Taxpayer Advocate Service

In addition to the IRS Board, the Taxpayer Advocate Service (TAS) was also established to help taxpayers resolve problems and recommend changes. The TAS is an independent organisation within the IRS whose employees assist taxpayers who are experiencing economic harm, who are seeking help in resolving tax problems that have not been resolved through normal channels or who believe that an IRS system or procedure is not working as it should. The functions of the TAS are set out in the Taxpayer Bill of Rights as follows:

- to assist taxpayers in resolving problems with the IRS;
- to identify areas in which taxpayers have problems in dealing with the IRS;
- to propose changes in the administrative practices of the IRS to mitigate those identified problems, to the extent possible; and
- to identify potential legislative changes that may be appropriate to mitigate such problems.

The TAS is headed by the National Taxpayer Advocate, who is appointed by the head of the Treasury and reports directly to the Commissioner of Internal Revenue.

Taxpayers may be eligible for assistance if:

- they are experiencing economic harm or significant cost (including fees for professional representation);
- they have experienced a delay of more than 30 days to resolve their tax issue; or

- they have not received a response or resolution to the problem by the date that was promised by the IRS.

The Office of Systemic Advocacy is part of the larger TAS organisation. Systemic advocacy means addressing broad issues that impact groups of taxpayers, including both individuals and businesses. These issues normally:

- affect multiple taxpayers;
- affect segments of the taxpayer population, locally, regionally or nationally;
- relate to IRS systems, policies, and procedures;
- require study, analysis, administrative changes or legislative remedies; and
- involve protecting taxpayer rights, reducing or preventing taxpayer burden or ensuring the equitable treatment of taxpayers.

The Office of Systemic Advocacy works within the IRS to resolve issues involving procedures and policies by bringing those issues to the attention of IRS management and by making legislative proposals in the annual report to Congress where necessary.

The TAS provides two annual reports to Congress — one which identifies the priority issues the Office of the Taxpayer Advocate will address in the coming fiscal year and the other which includes a summary of the most serious problems encountered by taxpayers, recommendations for solving those problems and other IRS efforts to improve customer service and reduce taxpayer burden.

UNITED KINGDOM TAX ADMINISTRATION GOVERNANCE

The United Kingdom's HM Revenue and Customs (HMRC) is a non-ministerial department similar to that of the ATO. This makes it different from most other government departments which work under the direct day-to-day control of a minister.

Legislation for the creation of the new HMRC department was enacted in 2005 and included provision for the creation of a management board comprising a Non-Executive Chairman, five internal HMRC Executive Committee members and four external Non-Executive Directors (the HMRC Board).

Role and responsibilities of the HMRC Board

The Chairman leads the HMRC Board which sits a minimum of ten times a year and has the following responsibilities:

- development and final approval of HMRC's overall strategy;
- development and final approval of HMRC's communications strategy and sign off for significant communications identified within it;
- development and final approval of the culture and values objectives and strategies;
- approval of the final sub-strategies of business lines and functions;
- approval of final business plans (including the annual financial plan);
- advising the Chief Executive on the appointment of senior executives; and
- ensuring the strength of the HMRC Board and committees by participating in the appointment of and advising on the ongoing competence of board members, Executive Committee members and other key appointments.

The HMRC Board's Non-Executive Directors are senior business figures from outside the department who bring a diverse mix of expertise and skills from across both the public and private sector. HMRC looks to its Non-Executive Directors to:

- bring guidance and advice;
- support and challenge management about the department's strategic direction; and
- provide support in monitoring and reviewing progress.

In approving the strategies and plans, the HMRC Board must ensure that the views of HMRC's stakeholders are taken into account.

The HMRC Board is supported by the People, Ethics & Responsibilities and Audit & Risk committees to assure the highest standards of corporate governance are in place. Membership of these committees is drawn exclusively from the Non-Executive Directors, with each committee having its own terms of reference setting out its membership, responsibilities, reporting and information requirements.

In addition to the HMRC Board, the Chief Executive Officer is responsible for providing leadership and direction to the department and runs all aspects of HMRC's business, ensuring delivery of the strategic objectives and driving continuous improvement.

The Permanent Secretary for Tax reports to the Chief Executive as the Deputy Chief Executive and is the senior tax professional in HMRC. The Permanent

Secretary has specific well-defined accountabilities in the areas of tax policy and tax strategy.

The Chief Executive Officer and the Permanent Secretary, together with the other Commissioners, make up the Executive Committee, which is the executive decision making body for HMRC. Following the strategic direction provided by the HMRC Board, the Executive Committee oversees the whole breadth of HMRC's work and is responsible for driving forward continuous improvement and change agendas. It initiates and supervises at a high level the practical steps required to deliver the department's vision.

The Executive Committee's responsibilities include:

- ensuring effective and efficient delivery of the department's business;
- shaping departmental behaviours, policies, processes and structures to achieve our objectives;
- leading and promoting change to secure improved performance — including successful delivery of the portfolio of major programmes and projects;
- reviewing overall business planning and performance and its contribution to the delivery of departmental objectives and targets;
- oversight of the development and management of business lines and function strategies;
- ownership and management of key strategic risks;
- managing external relations with stakeholders and promoting the department's good reputation; and
- providing oversight of HMRC's governance arrangements to ensure they remain robust and appropriate.

International Monetary Fund Working Paper

An IMF Working Paper[3] found that 75 per cent of surveyed revenue authorities had boards, and nearly all were empowered management boards with specific responsibilities and oversight functions. While the IMF paper was not unequivocal on the real influence of management boards in improving tax administration, it did note management boards with private sector representation may be able to inject a more business-orientated approach to the workings of a revenue authority and thus bring more rigour to financial and human resource matters.

The IMF paper also lists a number of considerations concerning the design of a comprehensive governance framework, including the roles and responsibilities of the

3 Ibid; Note also, reference to this paper in Crandall, C., *Revenue Administration: Autonomy in Tax Administration and the Revenue Authority Model*, IMF Technical Notes and Manuals, 18 June 2010.

government, the board and the Chief Executive Officer, so as to ensure that revenue authorities discharge their functions and remain accountable as a public institution. Excerpts of the relevant sections of the IMF Working Paper are contained in Appendix 1.

Community calls for ATO governance reforms

In submission to the AFTS review, a number of stakeholders (for example, the Group of 100 (G100), Corporate Tax Association, Australian Bankers Association (ABA) and the Business Coalition for Tax Reform) suggested the need to improve the pre-existing governance models through the introduction of a management board. In support of such a proposal, the G100 submission pointed to increasing complexity in response to economic and social trends and the need to keep pace with global business developments. Likewise, the ABA submission pointed to various examples of ATO approaches where it considers that problems are getting more difficult, not better, and, in the ABA's view, indicates that there are systemic issues involved in achieving consistency and balance in tax administration.

The G100 submission suggested that a complex system without someone capable of administering that system objectively, consistently and in a timely manner will fail irrespective of improvements to the policy settings. It noted that the ATO has over the years been given a number of duties apart from responsibility for the collection of tax including administering social welfare programs, superannuation and pension programs, the administration of certain aspects of charitable institutions and other support services to various government agencies. The G100 stated that this increase in scope of ATO activities places additional stresses and strains on its resourcing, human capital needs, managerial capability, governance and risk management framework.

The G100 submitted that the operation of market forces means that the majority of the ATO staff, including those in senior ranks and managerial positions, have little or no experience in the private sector and that their entire cultural upbringing and corporate mindset has been fashioned by a public sector outlook and upbringing. The G100 believed that, because of the different culture sets between the private sector and the human capital upbringing within the ATO, there is a 'disconnect' which results in a sense of distrust and lack of empathy. The G100 considered that this disconnect can only be systematically addressed by introducing oversight, including external guidance as part of an overall risk management and governance framework, so as to lead to an improvement in ATO culture and performance.

Similarly, the ABA and the Business Coalition for Tax Reform recommended the need for a broader cultural change in tax administration so as to have more regard to underlying policy and greater recognition of business realities. The ABA submitted that such a cultural change requires internal processes within the ATO, not more external reviews. In support of a board, the ABA referred to the establishment of the Board of Taxation in relation to tax policy as a significant success and submitted that it should be considered as a model for the ATO.

The G100 also expressed particular concern that the perceived culture within the ATO demonstrated a bias to revenue collection. It noted that while the function of the ATO is to enforce and administer the law based on the 'rule of law' and in a manner which advances the objectives of timely, consistent and objective administration of the law, it did not believe that the ATO culture is consistent with this.

The G100 submitted that while the ATO states that applying the rule of law is a key value, there was a need to have robust governance and risk frameworks capable of overseeing management to ensure that the ATO embraces and 'lives out' such values.

The G100 submission also presented the results of a high level survey of its members that suggested a strong culture within the ATO, manifested in senior executives as well as other tax officers, whose sense of public duty results in a culture whereby maximising the revenue wherever possible becomes the key, if not primary, objective.

The Business Coalition for Tax Reform also believed that the ATO, at times, was inclined to adopt technical positions which would result in greater revenue collection if upheld, which often surprised tax practitioners in the sense that they had thought the law was settled, and which were regarded by many as being inconsistent with policy.

Importantly, beyond the establishment of a management board, the Business Coalition for Tax Reform considered that active steps need to be taken to bring in suitably experienced private sector personnel to fill roles at Commissioner and Second Commissioner level so as to bring in a much needed fresh perspective to the ATO.

UNDERLYING CONCERNS REGARDING THE ATO'S CAPABILITIES AND APPROACHES

The IGT's consultative process, combined with the reports of previous IGT reviews, provide a useful input when considering the deeper issues that might underlie the tensions in tax administration and the calls for improvements to the ATO governance arrangements by business and tax professionals.

The principles of good tax administration mentioned in the explanatory memorandum to the IGT Act — namely, fairness, transparency, simplicity and efficiency — are subscribed to by the ATO. However, these principles are perceived sometimes to succumb to the pressure of other forces such as resources, capabilities, complexity, revenue collection and sometimes to the design of the system itself. The IGT also supports stakeholder views that an injection of a wider range of experiences and perspectives into the governance and management of the ATO would assist in responding to these pressures.

Over the years, the ATO has established a substantial public consultation framework with the community and the profession in the development of its work initiatives. It should also be recognised that there has been an increase in the external independent scrutineering function over the ATO during that time. Scrutineer reviews and related reporting, including those of the Ombudsman, the ANAO and the IGT, have also been important additions to the tax system. The increased participation of private-sector stakeholders in ATO consultation and scrutineer functions improve transparency, accountability, technical decision making and practical robustness of the system.

Notwithstanding the above ATO initiatives, the IGT notes that concerns about tax administration continue to surface from the business sector, especially from medium to large businesses and from those that represent them. This may in part be due to the large business sector being subjected to more compliance action by the ATO, but it may also be due to the smaller taxpayers (including individuals) not being as well equipped as the business sector to identify and raise any collective or individual concerns.

Underlying concerns from the business sector relate to the ATO's capabilities and approaches in developing and applying its view of the law in significant compliance issues or on new laws. In addition, the business sector often expresses concern over a prevailing, unchecked compliance influence in the approaches and actions of the ATO. These aspects of tax administration have also arisen as significant factors in several IGT reviews.[4]

Taxpayers are more likely to perceive fair treatment where the ATO openly considers whether it has contributed to specific problems. In the course of community consultations, many taxpayers and tax professionals expressed the view that ATO 'gloss' on tax disputes erodes confidence in the tax system and believed that the ATO should openly acknowledge both its positive and negative involvement. It has been suggested that the ATO should do more to report the full reality of its return on active compliance investment, factor community perceptions into its risk analyses, and potentially re-focus its resources to achieve better voluntary compliance at reduced costs to the community.

The IGT is currently reviewing the ATO's compliance focus on Small to Medium Enterprises, its implementation of recommendations arising out of the Treasury's *Review on Aspects of Income Tax Self-Assessment* and the ATO's use of early and alternative dispute resolution. The IGT notes that in the course of these current reviews a number of taxpayer concerns, which were previously raised, have resurfaced.

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4 For example, ATO Management of Part IVC Litigation, Potential Revenue Bias in Private Binding Rulings, Settlement of Active Compliance Activities, Delayed or Changed ATO Advice on Significant Issues (the so-called 'U-turns' review), Private Binding Advice, Public Binding Advice and Large Business Risk Review and Audit Policies, Procedures and Practices.

PREVIOUS REVIEWS THAT CONSIDERED ATO GOVERNANCE ARRANGEMENTS

The Joint Standing Committee of Public Accounts (as it then was) in 1993 considered the need to restructure the senior management structure of the ATO. It believed that the administration of the ATO and the taxation system generally would benefit significantly from the injection of opinions and strategies developed externally to the culture of the ATO and from the strengthening and formalisation of tax advisory committees.[5]

The IGT notes that a management board to oversee the ATO was proposed at the time of the Ralph Review and supported by professional bodies. Ultimately, the Ralph Review did not believe the establishment of a policy-constrained board of directors would be helpful to either government or the business community. The Review saw a need to have an independent and business-focused advisory Board of Taxation to assist up front in the development of clear and improved business taxation policy processes and in monitoring the performance of the administrative functions against the Taxpayers' Charter. The Ralph Review, in not favouring a board responsible for the administration of the ATO, believed that the Board of Taxation approach offered the prospect of greater certainty and less conflict in the downstream administration of business tax laws and therefore would minimise the problems which had given rise to the requests for external control over the administration of the ATO.

It should be noted that, at that time, the decision to proceed with the Board of Taxation and leave ATO governance arrangements unchanged may have been influenced by the impending introduction of substantial tax policy reform and that the focus, rightly, was more on achieving the right policy rather than the administration of the new policy or law. The growing support for reforming ATO governance arrangements amongst business taxpayers and tax professionals, together with the continued surfacing of concerns regarding the ATO's capabilities and approaches, would indicate that we now need to also consider ways of further improving tax administration in Australia.

LIMITATIONS OF ASPECTS OF CURRENT ATO GOVERNANCE ARRANGEMENTS

Reliance on consultative forums

The ATO publicly places strong emphasis on consultation and engagement with stakeholders in the care and management of the tax system as a means to embed trust and confidence. The ATO has established a large number of consultative forums to ensure that it understands external perspectives. The Commissioner of Taxation reports using around 50 consultative forums with taxpayer, business and tax

5 Joint Standing Committee of Public Accounts, 326th Report: *An assessment of tax – An inquiry into the Australian Taxation Office,* Canberra, 1993.

professional representatives to foster good compliance and to reduce compliance costs.

However, the sole reliance on consultative forums as a governance process needs re-examining in light of the ongoing stakeholder concerns with aspects of the ATO's administration, including its capabilities and approaches.

First, consultative forums only provide an input into ATO decision-making, allowing stakeholders to identify and raise problems and concerns. However, there is some dissatisfaction with the degree to which such input is reflected in the final outcome. In an IGT review context, the ATO's handling of over 60 examples of perceived 'U-turns', many of which were raised at ATO consultative forums, suggests that the ATO consultation process is not a complete solution for taxpayers and their representatives to voice and address concerns.

Second, the effectiveness of consultative forums relies upon tax officers taking on board issues and concerns raised by taxpayer, business and tax professional representatives and advancing them through the ATO decision-making hierarchy. This is not considered to be a substitute for an injection of taxpayer, business and tax profession experiences and perspectives within senior ATO management.

Role of Parliament

As noted by Dr Ken Henry in his speech '*Confidence in the operation of the tax system*'[6] the ultimate 'owners' of the Australian tax system are the Australian community. Parliament might be thought of as the community's ultimate board of directors, with the Commissioner being accountable to it for the administration of his office. The Commissioner also appears before parliamentary committees to explain his administration of the tax laws such as during Senate estimates hearings and the biannual hearings of the Joint Committee of Public Accounts and Audit.

The parliamentary committee process has significant practical limitations in scrutinising the ATO (due to the ATO's size, scope and complexity in function). A review of ATO administration often requires significant amounts of information, judgement and interpretation, which also includes the examination of case files, correspondence, internal ATO communications and tax officer meetings. The parliamentary review process is not designed for that level of scrutiny and is often reliant upon information provided by the ATO which may not always present every perspective (as was evidenced with the ATO's *Moving On* document[7] and the JCPAA's findings in its *Tax Administration* report[8]).

The IGT has also found that taxpayers are reluctant or unwilling to raise their concerns in the administration of the tax system directly with the ATO or in

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6 Henry, K., 'Confidence in the operation of the tax system', speech delivered to the Taxation Institute of Australia conference on 13 March 2009, Sydney, available at <www. taxreview.treasury.gov.au>.

7 Australian Taxation Office, *Moving On*, 50.1 Supplementary submission to submission 50 into the JCPAA Inquiry reviewing a range of taxation issues within Australia, June 2006, available at <www.aph.gov.au>.

8 Joint Committee of Public Accounts and Audit, *Report 410 Tax Administration*, Canberra, 2008.

parliamentary committees. A number of stakeholders have expressed concern about a fear of ATO retribution against those who publicly criticise the ATO's conduct or approaches.

OPTIONS FOR REFORM

The IGT believes that there is merit in establishing comprehensive ATO governance arrangements in line with international tax administration developments and community expectations.

There is growing support for the tax system to inject a wider range of experiences and perspectives into ATO management. This is evidenced by the ongoing community feedback together with the wide ranging issues investigated by the IGT and previous parliamentary committee reports. A great majority of the systemic issues identified by the IGT may have been better handled if there was a greater appreciation of taxpayer and business perspectives.

While the current ATO governance arrangements are considerable, there are a number of shortcomings that warrant examination in developing a more effective structure. The shortcomings include, a reliance on consultative forums as a substitute for a more participatory form of tax administration, practical limitations of the parliamentary committee process and the piecemeal development of the current governance arrangements, in particular the executive agencies overseeing the ATO and its administration.

The key objective of any governance changes should be to promote greater representation of taxpayer, business and tax professionals' perspectives at the senior levels of tax administration. It should allow for the better fulfilment of the administrative design principles espoused in the Ralph Report — namely engendering taxpayer trust, facilitating and enforcing taxpayer compliance and ensuring a responsive administration.

The IGT believes that the following options should be considered in an attempt to improve ATO governance arrangements:

1. Establishment of a management board (such as those of an advisory or supervisory nature) to bring a diverse mix of expertise, experience and skills from across both public and private sector into the ATO including areas such as information technology, human resources, finance and communication;

2. Appointment of additional Second Commissioners from the private sector to diversify the ATO Executive Committee, inject a wider range of experiences and perspectives and provide intelligence on trends in corporate governance and taxation risks; and

3. Enhancement and centralisation of the ATO scrutineer function to provide a single port-of-call for all taxpayer concerns or grievances about the ATO.

The optimal outcome is expected to be achieved by implementing all three options listed above as an integrated package, providing synergistic benefits beyond the options as stand-alone considerations. Whilst a board has strong stakeholder support, the IGT would suggest that for the type of systemic issues identified by business and tax professionals, options 2 and 3 should also be considered.

OPTION 1 — ESTABLISHMENT OF A MANAGEMENT BOARD

The ongoing international trend towards a comprehensive set of governance arrangements consisting of a management board provides a good starting point. Other government agencies have already moved down this path with some examples including the Reserve Bank, the Australian Prudential Regulation Authority (APRA) Risk Management and Audit Committee and Australian Securities and Investments Commission (ASIC).

The establishment of a management board will have number of positive influences in tax administration. It will bring a diverse mix of expertise and skills from across both public and private sector into the ATO in areas such as information technology, human resources, finance and communication. This is especially relevant given that the role and scale of the ATO's operations have grown substantially over the last twenty years. It will also help instil better project management skills and provide a new source of intelligence regarding business practices.

As listed by the IMF Working Paper, and drawing from the United States and the United Kingdom experience, the role and features of a management board could, amongst others:

- comprise private and public sector (including the Commissioner of Taxation) membership including non-executive directors representing the business community and other interests of government;
- provide advice on the management of the ATO including:
  - development and final approval of the ATO's overall strategy including performance indicators;
  - development and final approval of the ATO's communications strategy and sign off of significant ATO communications identified within it;
  - development and final approval of the culture and values objectives and strategies;
  - approval of the final sub-strategies for business lines and functions;
  - approval of final business plans (including the annual financial plan);
  - advising the Commissioner of Taxation on the appointment of senior executives; and

- ensuring the strength of the management team by participating in the appointment of and advising on the ongoing competence of board members, Executive Committee members and other key appointments;

- maintain the independence and authority of the Commissioner of Taxation by:
  - the board having no authority over the administration and enforcement of tax legislation and no access to confidential taxpayer information; and
  - the Commissioner of Taxation being responsible for the day-to-day operations of the ATO.

Along with the establishment of a management board, there would be considerable advantages in also establishing a number of committees to support the board in its functions and responsibilities. One possibility, along the lines of the United Kingdom approach, would be having an Audit and Risk Committee, the People Committee and the Ethics and Responsibilities Committee. Membership of these committees would be drawn exclusively from the non-executive directors. In addition, each committee would have its own terms of reference setting out its membership, responsibilities, reporting and information requirements. Particular senior ATO staff would have to attend committee meetings and provide relevant information, data and reports to allow an in-depth examination of ATO corporate performance.

RECENT GOVERNMENT ACTION

In 2009, the Government announced a review, *Australia's future tax system* (AFTS) and the IGT proposed to that review for consideration potential alternative ATO board structures.

Appendix 2 contains a diagrammatic representation of an example of a management board. It should be noted that the head of a centralised scrutineer agency (described below) would also be a member. The IGT believes that the appointment of the scrutineer agency head on the board provides an independence check and balance on the ATO's internal management as well a pro-active and real-time response to significant systemic issues.

Appendix 3 contains an example of a possible committee structure.

On 5 August 2010, the Government announced the establishment of a Tax System Advisory Board (the Board) to assist the Commissioner and the ATO Executive Committee on the general management and organisation of the ATO.

In January 2011, the Assistant Treasurer released a discussion paper setting out the design parameters for the Board and invited submissions on each of the three potential models for the Board.

In response to this discussion paper, the IGT has met with the Consultation Panel to discuss his views, in particular that the success of the Board will largely rely on the

Board not just being independent but also seen to be independent. The IGT also raised the need for options 2 and 3 (mentioned above and detailed further below) to be considered.

OPTION 2 — DIVERSIFICATION OF THE ATO EXECUTIVE COMMITTEE

The benefits of diversification

The IGT considers that there are broader benefits to be realised by the diversification of the ATO Executive Committee, in addition to the suggestions noted in option 1 above.

As Dr Ken Henry noted in his speech '*Confidence in the operation of the tax system*', a key difference between the ATO and a number of Australian regulators, including Australian Competition and Consumer Commission (ACCC), APRA and ASIC is that tax commissioners have largely been appointed from within the ranks of the ATO. This, he says, may have contributed to perceptions that the ATO could be more 'outward looking'.

The IGT also agrees with stakeholder submissions that the majority of the ATO staff, including those in senior ranks and managerial positions, have limited experience in the private sector. As a consequence, the organisational culture and mindset is fashioned from a public sector perspective. Given that the ATO interfaces directly with business, there is a real need for both parties to 'speak the same language' and have shared expectations.

Stakeholders often contrast the Australian position with that of the United States, where it is much more common and culturally accepted for professional personnel to work both inside and outside of the government revenue collection agency, being the IRS.

To address the issues identified by business and tax professionals, a board, in isolation, may not be sufficient. The overall governance structure is likely to be enhanced by the diversification in the composition of the ATO Executive Committee. To this end, the IGT proposes the appointment of two additional Second Commissioners from the private sector to inject a wider range of experiences and perspectives into ATO management and provide intelligence and insight regarding trends in corporate governance and taxation risks.

The role and functions of the additional Second Commissioners

The additional Second Commissioners should be full-time roles. They would be both members of the ATO management executive and be part of the day-to-day management team.

These Second Commissioners may serve the system best by having specific responsibility for particularly critical or contentious areas of tax administration.

These areas may be those where the ATO's approaches, views and actions may be enhanced by having informed business perspectives and taxpayer experiences.

One such area is the ATO's objection and litigation sections. Stakeholders, by way of example, perceive that there is a lack of independent review where an ATO objection officer is located within the same business line as the original decision-maker, albeit a different section. The original decision-maker is perceived by taxpayers to have some kind of input or influence on the objection determination, either directly or indirectly, due to factors such as organisational, behavioural or social considerations.

The Joint Standing Committee of Public Accounts also reflected on this independence concern noting that it was difficult to characterise the objections process as an 'independent review' where objections officers were subject to the same culture, corporate goals and values as the rest of the ATO.[9]

The IGT's report into the *Underlying Causes and Management of Objections to Tax Office Decisions* found that in relatively simple matters, there was independent review but in larger, more complex, objections the line between the objections officer and original decision-maker was blurred. The IGT's report into *Large Business Audit and Risk reviews* considered similar concerns regarding the ATO's technical decision making review, where recommendation was made and accepted by the ATO for improvement.

An innovation, suggested by a wide range of stakeholders, is that the ATO should have a strong independent internal appeals or review area. The IGT sees considerable merit in this idea. While increasing the independence of review of original ATO decisions, the IGT believes that a separate appeals area would empower the ATO's in-house legal section to independently assess the evidence and prospects of a case before progressing the matter to litigation. The ATO's litigation arm would, like the Director of Public Prosecutions in criminal matters, have ultimate discretion as to which matters the ATO would litigate, which would be conceded and which should otherwise be settled. This would ensure that only genuine and fundamental disputes on interpretation or application of the law are litigated, resulting in cost savings for both government and taxpayers.

To achieve such an outcome, one of the additional Second Commissioners would head up this new appeals and review area, providing stakeholders with stronger assurance of independence.

The IGT notes that such a model currently exists in the IRS in the United States, with its Appeals area being empowered to separately and independently settle and pursue matters arising out of original IRS decisions.

It is appreciated that this approach may on occasions give rise to internal tensions within the ATO. The IGT considers that tensions of this nature are desirable in

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9 Joint Standing Committee of Public Accounts, above n 6, p. 325.

ensuring appropriate outcomes are achieved, thereby reducing the overall level of taxpayer disputes and the cost to the broader tax system.

In relation to the role of the other additional Second Commissioner, a number of options are available. For example, the appointment could be to a compliance role with responsibility for liaising with business, tax professionals and advisers where there is conflict or disagreement between the ATO and taxpayers. Other options may be for them to act as high level circuit-breakers within the ATO by being able to co-ordinate and drive the requisite ATO responses and be responsible for implementing changes to address identified shortcomings or to bring together key ATO decision-makers (for example, the Tax Counsel Network, centres of expertise and business lines compliance segments) where required to reach internal resolution of technical issues or disputes more quickly.

OPTION 3 — CENTRALISED SCRUTINEER AGENCY

The IGT believes that a well-resourced and centralised ATO scrutineer function, incorporating best local and overseas practice, would better serve the Australian tax system.

Benefits of a well-resourced and centralised scrutineer agency

Under the proposed centralised model, the scrutineer would continue to play an important role in ensuring taxpayer rights are protected and would promote confidence in the integrity, transparency and accountability of the administrator. It would also provide a range of other benefits, including:

- a single port-of-call for considering taxpayers' administration issues and simplifying and improving access;
- a more holistic understanding of taxpayer issues arising in relation to their dealings with the tax system;
- prompt systemic issues identification that emerges from handling significant number of similar complaints;
- removal of overlap between the current scrutineer agencies;
- economies of scale and scope in centralising the separate scrutineer functions; and
- greater synergistic benefits for the ATO in only having a single tax administration scrutineer agency.

The centralisation provides a single port-of-call for taxpayer grievances, be they specific disputes or systemic issues. The investigation and resolution of specific taxpayer disputes would ensure the proposed central scrutineer agency has greater

opportunity to foresee likely systemic issues arising and would prevent unnecessary delay in their resolution.

In relation to the ATO, it would only be subject to one scrutineer as opposed to the current model in which it is required to respond to several agencies. The multiplicity and duplication of action by scrutineers sometimes requires multiple ATO responses to aspects of the same issue. It would also arguably enable the ATO to enhance its responsiveness and reduce the cost of scrutineer engagement.[10]

As foreshadowed above, it is also envisaged that the head of the scrutineer agency would participate at the proposed management board level of the ATO, allowing for the proactive and timely consideration of issues and concerns rather than the more reactive nature of current scrutiny which investigates or reviews taxpayer concerns after the event. It will also encourage the scrutineer agency to play a more supporting role in tax administration, not only through responding to taxpayer concerns and issues, but also providing input to ATO senior management in its strategies and approaches.

Operational structure of new scrutineer agency

The roles and responsibilities of the IGT and aspects of those of the Ombudsman and the ANAO (that is, those relating to tax administration) may be brought together into one statutory agency. The functions of this taxation administration scrutineering agency would include:

- assisting taxpayers in resolving complaints and problems with the ATO;
- identifying systemic issues in which taxpayers have problems in dealings with the ATO;
- recommending proposed improvements to the ATO's administrative systems and practices in mitigating systemic issues; and
- identifying tax administration policy issues, for legislative consideration, that seek to mitigate those systemic issues.

Similar to the activities of the Ombudsman relating to tax administration, this agency would consider and investigate specific taxpayer complaints from people or businesses who believe they have been treated unfairly or unreasonably by the ATO. The aim would be to resolve complaints impartially, informally and quickly or to suggest other avenues for resolving the matter. The handling of such complaints would assist in the identification of potential systemic issues, as a number of taxpayers raising similar concerns could suggest an underlying problem.

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10 Commissioner of Taxation, 'Sustaining Good Practice Tax Administration', Speech delivered to the Australasian Tax Teachers Association Conference, New Zealand on 20 January 2009. The Commissioner conservatively estimated that the cost of external scrutiny to the ATO had increased from $2,451,235 in 2005 to $4,157,488 in 2009.

Similar to the IGT, this agency would undertake reviews into systems established by the ATO to administer the tax laws or systems established by the tax laws and then make recommendations for the improvement of those systems.

Resourcing and Funding of the centralised scrutineer agency

The AFTS review raised the need for the existing scrutineering functions to be resourced appropriately beyond that of the current level of funding and made recommendation accordingly.[11] Analysis will be required to determine the appropriate level of resourcing that is required to operate the proposed centralised agency effectively.

Reporting

The centralised scrutineer agency reporting line would need to be considered. The reporting may be directly to Parliament and/or to Government.

Where the scrutineer agency head is on the ATO management board, there may be scope to differentiate the agency's reporting. One possibility could be along the lines of the United States TAS, where the scrutineer agency is required to provide two annual reports that would be tabled in Parliament. One report would identify the priority issues that the scrutineer agency will address in the coming fiscal year and the other would set out:

- a summary of the most serious problems encountered by taxpayers;
- findings from specific reviews undertaken on systemic tax issues and recommendations for improving tax administration; and
- other efforts to improve taxpayer experience and reduce the compliance burden.

Lastly, and consistent with the AFTS' recommendation 118,[12] the centralised scrutineer agency reports may also be considered by the JCPAA. This ensures Parliament receives an independent and candid report of the problems taxpayers are experiencing and the scrutineer's opinion on their redress. These reports may then be used in the scrutiny of the ATO's performance in any parliamentary review process.

11 Treasury, Australia's future tax system—Report to the Treasurer, Canberra, 2009, recommendation 117 at pp. 663-4.

12 ibid., p. 664.

APPENDIX 1: EXCERPTS FROM IMF WORKING PAPER

ROLE OF THE MINISTER OF FINANCE

Control over the RA

The legislated role of the minister of finance with respect to the Revenue Authority (RA) has a major impact on the governance as well as the degree of autonomy from the executive level of government. Therefore, it is critical to set out the role of the minister in terms of the control and supervision of the RA (direct control and supervision in some cases, almost nil in others), the appointment of the chair and members of the board and the CEO, the approval of the budget, and so on. If too much authority is granted to the minister in these areas, the RA will de facto have a significantly reduced autonomy; if too little authority is granted to the minister, there is a danger that the RA may lose necessary sensitivity to its inherent public sector role.

Implications of corporate character

The role for the government in a more autonomous revenue authority will be much more limited than would be the case for a RA which was not a 'body corporate' and which was in effect directly subordinated to the minister of finance. For this kind of RA, a first consideration is in regard to the board. Clearly, the government is the 'shareholder' of the corporate body (the RA) and therefore needs to have a say in the appointment of those who will govern that body. There are two aspects to this: the appointment of the chair of the board and its members; and the appointment of the CEO.

Relationship to CEO

The position of CEO is one of the most important in the RA, and the CEO will in effect have a dual set of accountabilities. He or she will be subordinate to the board in terms of the management; however, he or she will also be directly accountable to the legislature and to the government for the execution of all the operational powers and functions assigned to the RA by virtue of the tax and customs laws.

Power of directive

Many government institutions that have been established as corporate bodies, including RAs, include a provision for the minister to issue a directive to that corporate body. This kind of provision allows the government as the effective shareholder to direct that some particular action be done. Any such direction requires maximum transparency, usually through publication in a country's official gazette. The argument in favour of these kinds of mechanisms is that they maintain a certain amount of executive level authority and accountability without materially affecting the autonomous nature of the RA, since the expectation is they would be rarely used.

Role of the board

RAs normally have a board whose functions and powers form an essential part of the organization's governance framework. Such boards can be advisory in nature, usually in cases where the minister has a strong role and autonomy is more limited, or they can be management boards with strong functions set out in legislation. Boards are almost always prohibited from involvement in the operational execution of the tax and customs laws, and from access to any information about individuals or corporations obtained as a result of the administration and enforcement of those laws. To do otherwise would place the (private sector) members of the board in an obvious and untenable potential conflict of interest situation.

Board functions

The role and functions of the board flow directly from the legislation. Board functions, again depending on degree of autonomy, could include the following: to oversee the administration, management, and organization of the RA; to oversee the management of resources, services, property, personnel, and contracts; to approve the strategic plans and the budget of the RA; to approve the annual report; to establish policies to be followed; to establish by-laws for the functioning and operations of the board. In general, the board will have the power to execute all the authorities of RA with respect to carrying out the board's mandate.

Board meetings

The chair will normally preside over the board's meetings and exercise the powers and functions as prescribed by by-laws established by the board under its legislated authority.

Ex-officio members

A board has many duties and functions to perform and requires a mixture of skills and experiences in order to be effective. As a RA remains a government institution, it is often considered advisable to include certain government representatives on the board. In order to ensure autonomy at the same time, these positions are usually based on the notion of fixed ex-officio, or non-voting, appointments. This will respect the principle that all (voting) members of the board are required to act strictly in the best interests of the organisation, and not represent the interests of some other constituency.

The CEO

In the context of corporate governance, there is a debate as to whether the CEO should also be a member of the board. The CEO of the RA has a critical role to play and has an important relationship with the board, as well as with the minister of finance in terms of the revenue laws. Careful consideration needs to be given to the most effective role for the CEO on the board.

Selection of board members

In the interest of ensuring sufficient capacity on the board, the legislation should clearly indicate that all members of the board must have the experience and knowledge required for discharging their functions, normally in finance, accounting, taxation, public administration, law, or some other related field.

Size of the board

Considerable debate has also taken place concerning the optimum size for corporate boards. It would appear from the literature that boards of 7 to 12 members are now being considered optimal in terms of the efficient and effective functioning of corporate boards. Larger boards than this are considered unwieldy; smaller ones are felt to be too narrow and tending to lack comprehensive skills.

Role of the CEO

Powers vested in CEO. The CEO is generally responsible for supervising and managing the day-to-day operations of the RA. The management authority of the organization is embodied in the board, and in that respect the CEO, even though possibly a member of the board, is subordinated to it. However, the RA also has the mandate for the execution and enforcement of the revenue legislation, and the board will be prohibited from involvement in these areas. It is possible, then, to have an RA where the CEO only has responsibility over the areas where the board has a mandate, and where the heads of the revenue departments retain their powers and functions directly from the respective legislation.

At issue here is the extent to which all the powers and obligations related to the revenue laws (such as the power to assess taxes, make a customs determination, issue interpretations, impose or waive penalties, and so on) are actually given to the CEO through the enabling legislation of the revenue authority, who in turn delegates them to other senior officials and staff, or whether they are still given directly to the departmental heads, which serves to exclude the CEO from operations (this was a feature of some early RAs).

Accountability to the government

Although RAs are intended to have independence from the public sector, it is important that they retain accountability to the government as a public institution. After all, an RA, despite its independence, continues to perform critical public sector functions. It is thus essential to establish appropriate accountability mechanisms that reflect the desired degree of autonomy for the organization. It is generally felt that the greater the autonomy of the RA from the public service, the greater the need for unique, structured, and transparent accountability mechanisms in the legislation.

In the government context, laws assign responsibility and authority to organizations and individuals within them, and these organizations and individuals are held accountable for the effective and efficient performance of their responsibilities according to the governance framework established for them. Many of the aspects discussed earlier in this paper constitute in effect accountability mechanisms to serve this purpose.

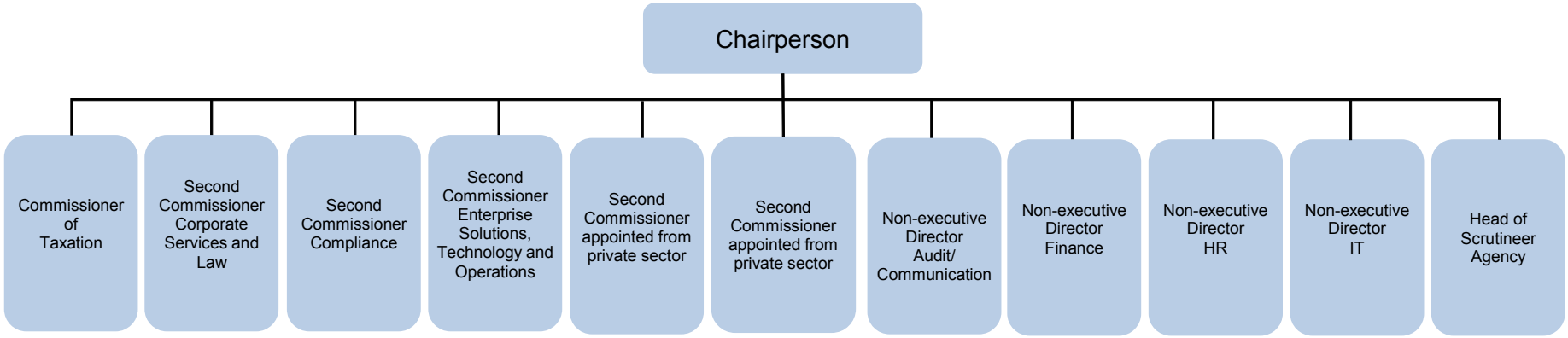
Internal and external audit

A first element concerns the issue of auditing, both internal and external. As for internal audit, it is generally accepted that boards of RAs will have an active role in reviewing the outputs of internal audit (including internal affairs) in order to be able to exercise their management responsibilities, and that the organization should have an independent internal audit function reporting directly to the CEO (there is some current debate as to whether internal audit should report to the board). An RA must also have external audit. There are two choices for external audit—either the board appoints the external auditor, or the auditor general of the country, which reports to parliament, is named the external auditor for the RA.

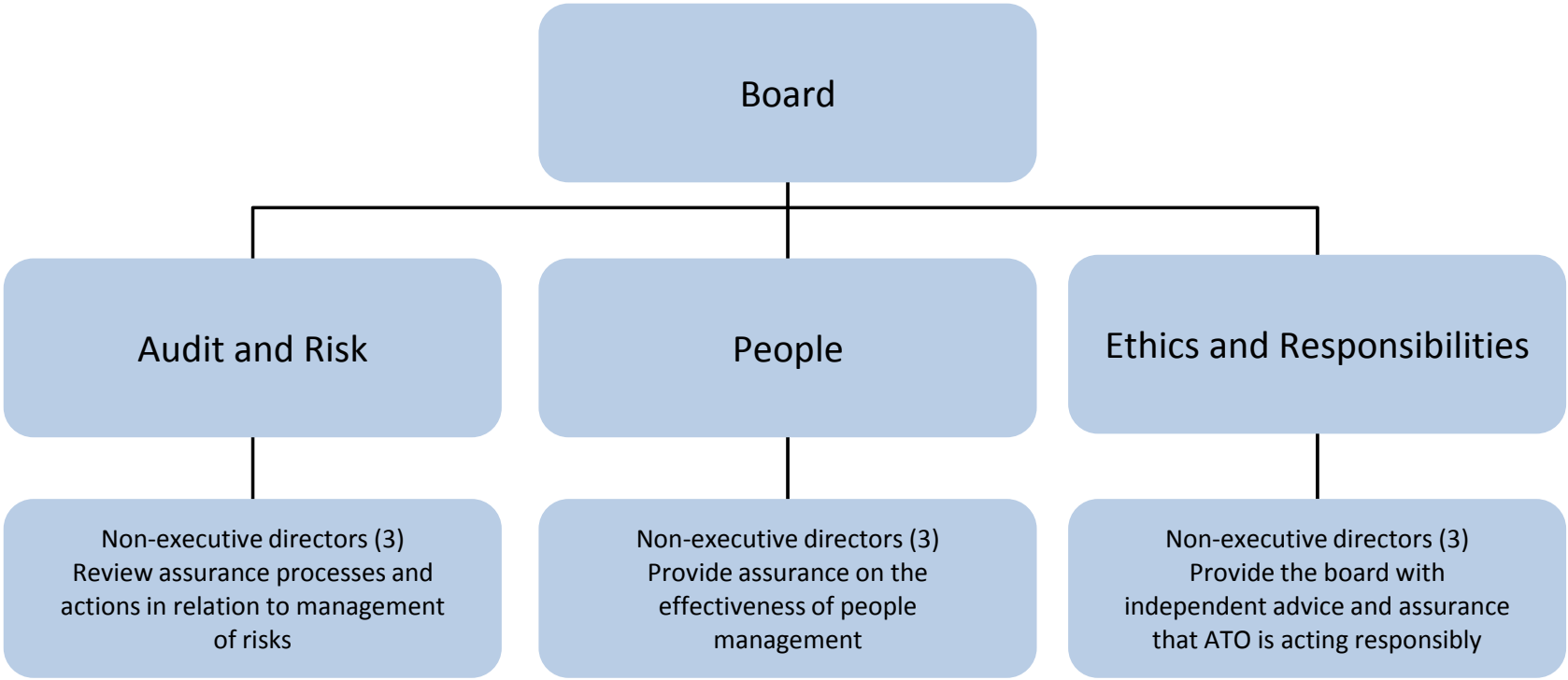
Reporting to parliament

Providing formal reports to parliament is another means of ensuring accountability to both the parliament and the executive. The two most common forms of reporting are through the annual corporate plan and budget (a look ahead at what the RA plans to do in the coming year) and the annual report (a look back at what was accomplished in the year past). Such documents provide valuable information to the government and the parliament, to ensure transparency.

APPENDIX 2: EXAMPLE OF A MANAGEMENT BOARD STRUCTURE



APPENDIX 3: EXAMPLE OF COMMITTEE STRUCTURE



APPENDIX 3 — ATO RESPONSE

Australian Government
Australian Taxation Office

SECOND COMMISSIONER OF TAXATION

Mr Ali Noroozi
Inspector-General of Taxation
GPO Box 551
SYDNEY ACT 2001

24 May 2012

Dear Mr Noroozi

RE: INSPECTOR-GENERAL OF TAXATION'S REVIEW INTO THE ATO'S USE OF EARLY AND ALTERNATIVE DISPUTE RESOLUTION

Thank you for the opportunity to provide comments on your report on the ATO's use of Early and Alternative Dispute Resolution (ADR).

As your report acknowledges, in Chapter 2, the ATO is already doing an extensive amount of work to encourage the use of dispute resolution processes. This work has also been favourably commented upon by numerous external bodies that have recognised that the ATO is a leading agency in the Commonwealth on encouraging ADR.

We also think it is important to place this work in the context that the overwhelming majority of taxpayers do not dispute their tax liability. There were 434,000 audits and reviews in 2010-11 that resulted in liability adjustments and only 24,000 objections in the same year. About 17,400 of these objections were to income tax assessments and represent a tiny fraction of the 15.6 million income tax returns that were lodged last financial year. We think this shows for Australia's self assessment system good compliance by taxpayers and good risk identification that most adjustments are not disputed.

We agree with your comments that early efforts to resolve disputes and formal ADR techniques can both play effective roles in resolving tax and superannuation disputes. We believe that for most disputes the most appropriate use of their and our resources is to focus on minimising and resolving disputes as early as possible by direct communication with taxpayers, before considering whether it is necessary to engage a 3rd party ADR practitioner to assist. This is supported by our analysis published in *Your Case Matters* that shows most objections are resolved at that stage and only a small proportion go on to litigation and in turn most of these are finalised prior to hearing (61% in 2010-11).

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Your review has identified some opportunities for us to improve our processes, reporting, and publications (such as the Taxpayer's Charter and PS 2007/23). It also provides us with an opportunity to remind our staff of the importance of ongoing communication with taxpayers, particularly those who have disputed their tax liability and the importance of ensuring such taxpayers remain engaged in the tax and superannuation system.

Attached is the ATO response to recommendations (Annexure 1). The ATO accepts either fully, in principle or in part 20 of the 22 recommendations in the report. We also note that 1 of the remaining 2 recommendations is a matter for Government.

If you require further information on this matter, please contact Debbie Hastings on 02 9374 2233.

Finally I would like to acknowledge the efforts of all involved in the undertaking of the review.

Yours sincerely

Jennie Granger
Second Commissioner of Taxation

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[To minimise space, the appendix to the ATO's response has not been reproduced here, but has been inserted into the text of this report underneath each of the recommendations to which that text relates.]