Australian Government

Inspector-General of Taxation

Follow up review into delayed or changed Australian Taxation Office views on significant issues

A report to the Assistant Treasurer

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July 2014

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17 July 2014

Senator the Hon Mathias Cormann
Acting Assistant Treasurer
Parliament House
Canberra ACT 2600

Dear Minister

Follow up review into delayed or changed Australian Taxation Office (ATO) views on significant issues

I am pleased to present you with my report of the above follow up review. The primary purpose of this review was to examine the ATO's implementation of agreed recommendations in my previous *Review into delayed or changed ATO views on significant issues* (the so-called 'U-turns' review).

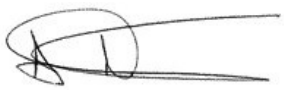
Overall, I have found that the ATO has implemented three out of four agreed recommendations and has partly implemented the other. The latter concerned the ATO's management of 'U-turns' in audits which was one of the main concerns raised by stakeholders in this follow up review.

The management of 'U-turns' in audits was also considered by the Full Federal Court in a case which was decided during the course of the review. This case raised some doubts regarding the ATO's ability to manage 'U-turns' administratively and the level of certainty provided by ATO practice statements more generally.

To alleviate the above concerns, I have made two new recommendations with which the ATO has agreed. There is a residual concern that legislative change may still be required to fully address 'U-turn' issues. However, I believe such a solution should only be pursued if issues continue to arise after the two new recommendations have been implemented.

I offer my thanks for the support and contribution of professional bodies, tax practitioners and taxpayers. I would also like to thank ATO officers for their professional cooperation and assistance in this review.

Yours faithfully,



Ali Noroozi
Inspector-General of Taxation

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EXECUTIVE SUMMARY

The Inspector-General of Taxation (IGT) undertook this follow up review to examine the Australian Taxation Office's (ATO) implementation of agreed recommendations contained in the earlier IGT *Review into delayed or changed Australian Taxation Office views on significant issues* (the so-called 'U-turns' review).

The 'U-turns' review made four recommendations to the ATO aimed at developing an administrative practice for managing 'U-turn' issues, applying this practice in compliance activities and improving community engagement to identify the main tax risks to be addressed (recommendations 2, 3, 4 and 5). The review also made one recommendation to the then Government that if concerns persist, it may wish to consider potential law changes to provide greater certainty for taxpayers in relation to changed ATO views (recommendation 1).

Following consideration of ATO materials and processes, the IGT concluded that the ATO had implemented three recommendations (namely, recommendations 2, 3 and 5) and partly implemented the other (recommendation 4).

Recommendation 4 concerned the application of the ATO's administrative process for managing 'U-turns' during ATO compliance activities as set out in *Practice Statement PSLA 2011/27*. Stakeholders had raised concern during this follow up review that 'U-turn' issues continued to persist in audits as ATO officers were not complying with the practice statement.

In addition, the ATO's management of 'U-turns' during audits was the subject of Federal Court litigation in *Macquarie Bank Limited v Commissioner of Taxation*. The Court's judgment, which was delivered during the course of this follow up review, raised some doubt regarding the ATO's administrative approach in this area as well as the taxpayer's ability to rely upon ATO practice statements more generally.

The IGT's examination of issues raised by stakeholders, and the Federal Court case, identified a number of areas for improvement. As a result, the IGT has made two new recommendations aimed at:

- ensuring ATO officers applied the administrative approach in *PSLA 2011/27* throughout the compliance process and during settlement negotiations;
- enhancing ATO officers' research and communication with taxpayers when considering 'U-turn' issues;
- implementing escalation processes for independent and objective reviews of 'U-turn' disputes; and
- publishing information regarding 'U-turn' matters.

The report also outlines support for an extension of the administrative approach set out in *PSLA 2011/27* to apply in appropriate single taxpayer cases.

There is a residual concern that legislative change may still be needed to address 'U-turn' matters. However, the IGT is of the view that a legislative solution should only be pursued if issues continue to arise after the above two recommendations have been implemented.

CHAPTER 1 — INTRODUCTION

1.1 This is a report of the Inspector-General of Taxation's (IGT) follow up review into the Australian Taxation Office's (ATO) implementation of agreed recommendations arising out of the *Review into delayed or changed Australian Taxation Office views on significant issues* (the so-called 'U-turns' review) which was publicly released by the Minister on 17 March 2010.

BACKGROUND TO THE 'U-TURNS' REVIEW

1.2 The 'U-turns' review was commenced on 10 March 2009, following a direction from the then Assistant Treasurer and in response to concerns raised by stakeholders on perceived ATO delayed or changed approaches on significant interpretative matters or past administrative practices.

1.3 The IGT found that, in certain circumstances, taxpayers were justified in their perceptions of changes in ATO views or practices at that time. Moreover, it was found that it was not the case that one binding ATO advice clearly changes another binding advice. The most common instance was disagreement between the ATO and taxpayers in relation to a previous ATO view or practice, or an industry view of which the ATO was aware and seemingly accepted, that was not in conformity with a subsequent ATO view.

1.4 The IGT observed that taxpayers were not as concerned with the perceived change as they were with its retrospective effect. Where the ATO is perceived to change or clarify its existing views with retrospective effect, taxpayers can incur significant unexpected costs. In some quarters, the IGT observed that this caused a substantial erosion of confidence in the ATO as a fair administrator and had driven a reluctance to work with the ATO on significant issues.

1.5 A number of recommendations were made which aimed to strike an appropriate balance between providing protection for taxpayers, where the ATO had facilitated or contributed to taxpayer views or practices inconsistent with subsequent ATO views, and preventing a laissez-faire situation where any position could arguably be justified in an area of uncertainty prior to the ATO releasing a formal view.

1.6 The IGT also found that underlying some of the concerns outlined above was the manner in which the ATO engaged with the taxpaying community while developing its views on technical issues. While there were many positive aspects of the ATO consultation processes, the IGT also identified significant scope for improvement in certain areas, particularly in relation to the use of technical discussion papers which, when properly framed and targeted, provide the ATO with a better understanding of arrangements and issues of concern to the community.

1.7 Accordingly, further recommendations were made to the ATO with the aim of:

- reducing delays in identifying compliance concerns and finalising its position on those concerns;
- improving the tone and manner of technical discussion papers on issues of compliance concern; and
- providing interim technical advice to both compliance/audit officers and taxpayers on issues where a final position may take some time in development.

1.8 Of the five recommendations made in the report, one was made to the previous Government for consideration (Recommendation 1) and four were directed to the ATO. The ATO agreed with all recommendations directed to it.

CONDUCT OF THE FOLLOW UP REVIEW

1.9 The IGT considers that it is important to assess the implementation of IGT recommendations to which the ATO has agreed. Historically, such assessments of the effectiveness of the ATO's implementation have been by way of follow up reviews. However, since November 2010, the IGT has worked with the ATO to develop a new process. The implementation of recommendations of all external scrutineer bodies with which the ATO has agreed are considered by the ATO's audit committee which reviews draft implementation plans and assures itself that the plans have been executed effectively. The audit committee is informed by quarterly updates from the relevant ATO business lines and its internal audit group through its reports as to the status of implementation. The first IGT review to be subject to this new oversight process was the *Review into the ATO's administration of private binding rulings*.[1]

1.10 As the 'U-turns' review predates the above oversight process, it is necessary for the IGT to undertake this follow up review to examine the effectiveness of the ATO's implementation of the agreed recommendations. This follow up review is conducted pursuant to subsection 8(1) of the *Inspector-General of Taxation Act 2003* (IGT Act 2003).

1.11 Throughout the follow up review, particular attention was given to:

- evidence of appropriate and effective implementation of agreed recommendations;
- ATO management policies, procedures, systems and reporting which support the implementation of these recommendations; and
- where relevant, the ATO's communication to taxpayers of the changes brought about by the implementation of the recommendations.

1.12 The IGT commenced the review by providing the ATO with an opportunity to first present materials that supported and evidenced the implementation of the agreed recommendations. The IGT reviewed the relevant materials, liaised with ATO senior officers

1 Inspector-General of Taxation (IGT), *Annual Report 2012–13* (2013) p 5; Australian Taxation Office (ATO), *Access, Accountability and Reporting* (22 January 2013) <https://www.ato.gov.au>.

and engaged with external stakeholders to gain a further understanding of the impacts of ATO improvements.

1.13 During the course of this review, taxpayers, tax practitioners and their representative bodies raised a range of ongoing concerns with tax administration in this area. Fresh concerns were also raised as a result of a court decision which brought into question the effectiveness of some of the implemented recommendations. As a result, this review is not purely a follow up review as it has had to address these concerns.

1.14 To assist with the IGT's consideration of issues, the IGT convened a working group comprising key taxpayers, tax practitioners and senior ATO officials (the Working Group), many of whom had assisted in the 'U-turns' review. The IGT greatly appreciates the generosity of the members of the Working Group in freely giving their time and expertise. Their involvement has significantly enhanced the outcomes of this follow up review.

1.15 The Working Group considered external stakeholders' concerns regarding the ATO's management of potential 'U-turn' issues and canvassed potential solutions in a frank and confidential manner. It should be noted, however, that the views expressed in this report are not necessarily those of individual members of the Working Group. The views were finalised by the IGT after much deliberation and based on input received and discussions with the ATO as well as external stakeholders.

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

CHAPTER 2 — AN ADMINISTRATIVE APPROACH TO ATO 'U-TURNS'

2.1 One of the key observations of the 'U-turns' review was that in the absence of binding advice the law allowed the ATO to apply any changed views retrospectively without protection against primary tax for taxpayers. The 'U-turns' report further noted that while the Commissioner may exercise his powers of general administration to not take compliance action for prior periods where taxpayers had relied upon a general administrative practice (GAP), there were significant difficulties for taxpayers in establishing the existence of a GAP.

2.2 The U-turns review sought to address the key concerns and findings regarding the impacts of retrospective application of changed ATO views through an integrated set of recommendations. The recommendations that interlink in this manner are 1, 2 and 4.

2.3 Recommendation 1 was made to the then Government for consideration to change the law so that changes to tax administration only operated prospectively particularly where taxpayers had relied on longstanding practices or GAPs, to provide greater transparency and certainty on changed or clarified ATO views.

2.4 However, at the time of the report's release, it was considered that if administrative changes directed to the ATO were appropriately implemented stakeholders' concerns would be significantly alleviated. Accordingly, an initial strategy was for the ATO to address stakeholders' concerns through Recommendation 2 which develops an administrative framework for managing potential 'U-turns' and Recommendation 4 as a corollary which applies to tax audits. Recommendation 1 was, therefore, effectively to be considered after a period of time had been afforded for the ATO's administrative approach to be implemented and assessed.

2.5 The public release of the IGT's report and the development of the ATO's administrative practice for managing potential 'U-turn' issues have yielded significant positive outcomes for both the taxpayer community and for the ATO. It has provided a basis upon which taxpayers and the ATO have been able to engage on potential 'U-turns' where previously this was difficult to initiate. Moreover, a number of positive examples have been brought to the IGT's attention regarding the practical outcomes which have emerged from the ATO applying its new approach when faced with a potential 'U-turn'. In recent years the IGT has also seen a number of examples of the ATO recognising the existence of prior practice in its public rulings and deciding to apply its view on a prospective basis only.[2]

2.6 Notwithstanding the positive feedback and outcomes of the 'U-turns' review and the resulting ATO administrative improvements, submissions made to the IGT during this follow up review suggested that some of the underlying issues continue to arise.

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2 ATO, Income tax: when a superannuation income stream commences and ceases, TR 2013/5, 31 July 2013, paras [45]-[49]; ATO, Income tax: capital allowances: treatment of open pit mine site improvements, TR 2012/7, 21 November 2012, paras [63]-[65]; ATO, Income tax: business related capital expenditure — section 40-880 of the Income Tax Assessment Act 1997 core issues, TR 2011/6, 30 November 2011, paras [57]-[58].

2.7 Furthermore, during the course of this follow up review, the Federal Court of Australia (Federal Court) handed down its judgment in *Macquarie Bank Limited v Commissioner of Taxation* (the *Macquarie* case),[3] which has brought into question some of the implemented recommendations of the 'U-turn' review. Some stakeholders have asserted that the *Macquarie* case may have broader implications particularly in relation to taxpayer reliance on practice statements more generally.

2.8 The remainder of this chapter will examine the ATO's implementation of Recommendations 2 and 4 and its administrative approach to 'U-turn' issues before discussing the persisting and new issues including the implications of the *Macquarie* case.

IMPLEMENTATION OF AGREED RECOMMENDATIONS

2.9 In assessing the implementation status of particular recommendations the IGT has used the following terms in this report:

- **Implemented** — the ATO has demonstrated that the particular agreed recommendation has been satisfactorily addressed.
- **Partly implemented** — the ATO has commenced implementation and made substantial progress toward completion.
- **Not implemented** — the ATO has not made satisfactory progress or falls well short of implementing the agreed recommendation.

2.10 In some cases the status of a recommendation may be determined to be implemented or partly implemented where certain work remains to be done, but only where there are detailed plans, actions and commitment to complete implementation within an appropriate timeframe.

RECOMMENDATION 1 OF THE IGT'S 'U-TURNS' REVIEW

The Government should consider whether the current legislative framework adequately provides effective transparency and certainty for taxpayers where the ATO retrospectively applies new, 'changed' or 'clarified' views.

2.11 Recommendation 1 was made to the then Government for consideration and therefore outside of the scope of the ATO's implementation. As noted above, Recommendation 1 was a longer-term consideration for the former Government which was conditional upon the effectiveness of the ATO's administrative processes for managing 'U-turns'.

3 [2013] FCA 887; See also Macquarie Bank Limited v Commissioner of Taxation [2013] FCAFC 119.

RECOMMENDATION 2 OF THE IGT'S 'U-TURNS' REVIEW

For the purpose of reducing the adverse impact of delayed or changed ATO views on significant issues, the ATO should within 12 months openly develop in collaboration with the taxpayer community, its administrative practice concerning the circumstances in which it seeks to apply its views retrospectively by incorporating the following process steps and considerations.

(a) Process steps

i. Before announcing any view, the ATO would conduct its own research to see whether its previous publications or conduct could have conveyed a different view. The Commissioner, based on this research, will then consider a number of criteria (set out below) to decide whether to take compliance action, in accordance with the new view, prospectively or retrospectively.

ii. Where the new view is contained in a public ruling or determination, the Ruling Panel, in addition to their substantive recommendations to the Commissioner would opine on whether to take retrospective or prospective compliance action. In addition, taxpayers, tax practitioners and relevant representative bodies would be invited to express views on this issue as part of the consultation process in developing the ruling or determination.

iii. In the final product the ATO would state whether compliance action would be on a go forward basis or not and would provide reasons for such a position.

iv. Where the actual product does not involve the Ruling Panel, for example, practice statements, audits, etc. the process would be the same except for the non-involvement of the Panel.

(b) The criteria to determine whether to apply new or clarified ATO views retrospectively or not should be based on fair and reasonable treatment and should strike a balance between:

- *protection for taxpayers where the ATO has facilitated or contributed to formation of views, by taxpayers, which are inconsistent with subsequent ATO views; and*
- *preventing a laissez-faire situation where any position could be arguably justified on a particular area of uncertainty before the ATO releases its formal view.*

(c) On the above basis, the criteria should be as follows:

i. the extent to which the ATO has facilitated or contributed to the taxpayer perception of the previous industry practice or position, including whether:

- *the ATO became aware of the previous industry practice or position (for example, through audits) but did not challenge it within a reasonable timeframe;*
- *the previous industry practice and position can be reasonably understood from ATO statements on how to administer the law;*
- *a general administrative practice supporting the previous industry practice or position can be deduced from other ATO conduct; and*
- *the time that has elapsed since the ATO's first awareness of the issue, publicly announcing it would challenge the previous practice and the time taken to finalise its new view.*

RECOMMENDATION 2 OF THE IGT'S 'U-TURNS' REVIEW (CONTINUED)

ii. the extent to which affected taxpayers had taken reasonable care in adopting the previous industry position or practice and whether such a position or practice is not devoid of legal merit;

iii. the extent to which the ATO has relied on material not available to taxpayers generally (for example Treasury files and discussions) with respect to its new/clarified view; and

iv. as an overriding qualification, the ATO would reserve its right to apply views retrospectively where there is fraud, evasion or tax avoidance (viz Part IVA of the Income Tax Assessment Act 1936 or section 165 of A New Tax System (Goods and Services Tax) Act 1999).

It should be noted that any of the above criteria, other than tax avoidance, may not be sufficient of themselves. They must be considered as a whole in making a determination.

2.12 The ATO agreed with Recommendation 2 but expressed reservations regarding the criterion in Recommendation 2(c)(iii).

2.13 In line with the recommendation above, the ATO consulted broadly with the taxpayer and tax practitioner community to develop a practice statement outlining its administrative approach to 'U-turns'. On 28 July 2011, the ATO issued Law Administration Practice Statement PSLA 2011/27 *Matters the Commissioner considers when determining whether the ATO view of the law should only be applied prospectively* (PSLA 2011/27).

2.14 The ATO considers PSLA 2011/27 to be a lawful direction to all staff who must adhere to its direction when performing relevant tasks.[4] References to PSLA 2011/27 are also embedded in a number of other relevant staff directions to reinforce awareness of its requirements.[5]

2.15 The criteria contained in Recommendation 2 were largely adopted in PSLA 2011/27. Set out in Table 1 below are these criteria together with the corresponding paragraphs in PSLA 2011/27 and the IGT's conclusion of the status of their implementation.

4 ATO, *Law Administration Practice Statements*, PSLA 1998/1, 19 December 2013, para [6]; See also *Public Service Act 1999* sub-s 13(5).

5 See for example: ATO, Income tax: consolidation: capital gains: does paragraph 40-880(5)(f) of the Income Tax Assessment Act 1997 prevent the deduction, under section 40-880 of that Act, of incidental costs described in subsection 110-35(2) of that Act that the head company of a consolidated group or MEC group incurs, in acquiring shares in an entity that becomes a subsidiary member of the group, after the entity joins the group?, TD 2011/9, 4 May 2011, paras [20], [29]; ATO, Self managed superannuation funds — notice of non-compliance, PSLA 2006/19, 15 November 2012, para [36]; ATO, Escalating a proposal requiring the exercise of the Commissioner's powers of general administration, PSLA 2009/4, 28 July 2011, para [22].

Table 1: Adoption of criteria in IGT Recommendation 2 in PSLA 2011/27 and implementation status

Recommendation criteria	Corresponding paragraph in PSLA 2011/27	Implementation status
2(a)(i)	24, 25	Implemented
2(a)(ii)	51	Implemented
2(a)(iii)	28, 29, 30	Implemented
2(a)(iv)	52	Implemented
2(b)	N/A	Implemented – discussed further below
2(c)(i)	36(a)	Implemented
2(c)(ii)	N/A	Not implemented — discussed further below
2(c)(iii)	N/A	Not implemented — discussed further below
2(c)(iv)	36(b), 36(c)	Implemented

2.16 It should be noted that PSLA 2011/27 does not include references to two of the criteria in the recommendation, namely the criteria set out in Recommendations 2(c)(ii) and 2(c)(iii).

Recommendation 2(c)(ii)

2.17 The ATO has advised that Recommendation 2(c)(ii), which was included in the draft version of PSLA 2011/27, was excised from the final version following comments received during the consultation process with external stakeholders, representative tax and accounting professional bodies and the Treasury. Specifically, it was suggested that even where the taxpayer adopted a position which was devoid of legal merit, if the ATO contributed to, or facilitated, the position being adopted then it should nonetheless apply its changed view prospectively.[6]

2.18 The IGT welcomes the ATO's consultation on this element of the recommendation, and notes that its excision from the final version of PSLA 2011/27 does not otherwise alter the overarching objective of the IGT's recommendation.

Recommendation 2(c)(iii)

2.19 The ATO undertook consultation on the possible inclusion of the criterion in Recommendation 2(c)(iii) in PSLA 2011/27. The feedback received from this consultation was that while the criterion may be relevant in determining whether the taxpayer took reasonable care or adopted a reasonably arguable position, it did not go to the heart of whether an ATO view should be applied prospectively.[7] This feedback resulted in Recommendation 2(c)(iii) not being included in the final version of PSLA 2011/27.

2.20 The IGT considers that, in line with the outcome of the ATO's consultation, the exclusion of criterion 2(c)(iii) from PSLA 2011/27 does not detract from its overriding objective of providing certainty for taxpayers.

6 ATO communication to the IGT on 14 May 2013.
7 ATO communication to the IGT on 14 May 2013.

Recommendation 2(b)

2.21 The ATO has advised that the principles contained in PSLA 2011/27, which largely align with the two points contained in Recommendation 2(b), are also integrated into various documents which guide officers in the development of an ATO view including taxation rulings, taxation determinations and other practice statements.[8] These documents seek to highlight the need to protect taxpayers who have acted in accordance with practices or views facilitated or contributed to by the ATO, and to prevent a situation in which any position may be arguably justified in areas of uncertainty prior to the ATO finalising its view. The ATO's guidance strikes this balance by referring to PSLA 2011/27 as well as directions for staff to escalate potentially affected matters to the Deputy Chief Tax Counsel for determination.

2.22 Accordingly, the IGT considers that while the text of Recommendation 2(b) was not included in PSLA 2011/27, these criteria and processes are outlined elsewhere in the ATO's guidance to its staff which, if followed, would go some way to addressing the systemic tax administration issue identified in the review.[9]

IGT conclusion — Implemented

2.23 Having regard to the preceding discussion on the ATO's publication of PSLA 2011/27, the IGT considers that this recommendation has been implemented.

RECOMMENDATION 4 OF THE IGT'S 'U-TURNS' REVIEW

Where:

- *the ATO comes across a taxpayer practice or view in a compliance activity, such as an audit or risk review;*
- *the ATO does not agree with that practice or view; and*
- *the taxpayer had acted in accordance with that practice or view because the taxpayer perceived that the practice or view was accepted by the ATO,*

the ATO should follow the process and criteria set out in recommendation 2 and deal with the compliance activity accordingly.

2.24 The ATO agreed with this recommendation. Following publication of PSLA 2011/27, the ATO published articles in its internal news publication urging staff to familiarise themselves with the practice statement's requirements. Moreover, the ATO's then Special Tax Adviser and Chief Tax Counsel released a video interview in which they discussed the purpose of the PSLA 2011/27 by 'more clearly articulating what [the ATO's]

8 See: ATO, *Public Rulings*, TR 2006/10, 4 October 2006, paras [60]-[70]; ATO, *Provision of advice and guidance by the ATO*, PSLA 2008/3, 28 February 2008, para [200]; ATO, *Precedential ATO view*, PSLA 2003/3, 8 June 2007, paras [9] and [13]; ATO, *Tax administration: what is a general administrative practice for the purposes of protection from administrative penalties and interest charges?*, TD 2011/19, 27 July 2011, paras [20], [29]; ATO, *Self managed superannuation funds – notice of non-compliance*, PSLA 2006/19, 15 November 2012, para [36]; and ATO, *Escalating a proposal requiring the exercise of the Commissioner's powers of general administration*, PSLA 2009/4, 21 May 2009, para [22].

9 Ibid.

practices are and how [it goes] about determining when [it] should only apply the view on a prospective basis.'[10]

2.25 The ATO has also advised that further guidance will be provided to staff on an issue by issue basis at appropriate business line technical conferences or technical leadership forums. Furthermore, if changes are made to existing case procedures as a result of these technical discussions then these changes would be publicised and so provide further opportunity to reiterate the requirements of PSLA 2011/27.

2.26 Moreover, the ATO has previously issued a minute to all its National Program Managers which outlines the purpose of PSLA 2011/27 and requested that it be disseminated to staff for their review. In addition, the IGT notes that material provided by the ATO suggests that the PSLA 2011/27 was also discussed at a number of ATO technical forums, and references to it were added to existing ATO compliance guidebooks and presentations.

2.27 Externally, the ATO has publicised the release of PSLA 2011/27 through general emails to members of the Large Business Advisory Group[11] and the National Tax Liaison Group (NTLG). Furthermore, articles and reference to the practice statement were published in the *TAXAGENT* magazine[12] and the *Large Business Bulletin*.[13] In addition, the ATO conducted information sessions with a number of tax practitioner stakeholders in which PSLA 2011/27 was discussed. The ATO has advised the IGT that while no further specific external guidance is planned, similar discussions with tax practitioners may be held in the future or as requested.

2.28 The ATO has also advised that a number of governance mechanisms are also in place to ensure that PSLA 2011/27 is being appropriately considered and applied by its staff. These mechanisms include:

- instructions to specifically consider PSLA 2011/27 in the creation of ATO interpretative decisions and public rulings;[14]
- guidance and procedures available on the ATO's Online Resource Centre for Law Administration (ORCLA), an internal repository of guidance for staff engaged in various advice work, which directly references PSLA 2011/27;
- review and approval phases built into Siebel, the ATO's enterprise case management system, which requires such approval only be given by an accredited officer[15] who has reviewed the advice or decision before they are issued to ensure compliance with ATO views including, where relevant, the requirements of PSLA 2011/27; and

10 ATO, Transcript for an interview with ATO Special Tax Adviser Kevin Fitzpatrick, internal ATO document, 1 August 2011.
11 The Large Business Advisory Group was renamed the Large Business Liaison Group during the course of this review.
12 ATO, *TAXAGENT*, October 2011, Issue 53.
13 ATO, *Large Business Bulletin*, September 2011, p 8.
14 See: ATO, *ATO Interpretative Decisions*, PSLA 2001/8, 2 May 2013; ATO, *Precedential ATO view*, PSLA 2003/3, 8 June 2007; ATO, 'Interpretative Decision Guidelines', internal ATO document; ATO, *Public Rulings*, TR 2006/10, 4 October 2006; ATO, 'Public Rulings Manual', 14 May 2014, internal ATO document.
15 ATO, *Authorisation of written binding advice*, PSLA 2002/13, 2 May 2014 [Withdrawn].

- the use of draft rulings and audit position papers which are provided to taxpayers to promote an opportunity for taxpayers to raise issues of potential inconsistency with PSLA 2011/27 prior to the final advice or decision being issued.

2.29 The ATO further notes that post-finalisation, a random sample of audit and ruling cases are subjected to assessment as part of its Integrated Quality Framework (IQF). Two relevant criteria under IQF are 'correctness' and 'transparency'. The former refers to compliance with the ATO view while the latter seeks to assess honest and open communication with taxpayers of reasons for decisions or actions taken. The ATO has advised that the IQF process has not unearthed any concerns with the application of PSLA 2011/27 in audits of large business taxpayers. The ATO has advised the IGT that from 1 July 2014, it will be making changes to the IQF process to better focus on case quality from the taxpayer perspective.

2.30 In addition to the IQF assessment information above, the ATO has also indicated to the IGT that it will review existing audit and private ruling processes with a view to augmenting the processes governing PSLA 2011/27. Specifically, the ATO notes that consultation with staff in the large business compliance area has commenced for the purpose of identifying what procedural, instructional or governance changes would be beneficial to interpretative assistance and compliance work in this area.[16]

2.31 One option being considered is the inclusion of a focussing question on industry practices in appropriate audit and ruling products. The ATO notes this option 'will not only enhance governance, but also raise awareness of PSLA 2011/27 by linking the procedures into mandated practices, bringing it to the fore at an early stage of compliance activities and enhancing the awareness of staff, taxpayers and advisers.'[17]

2.32 To further illustrate its implementation of Recommendation 4, the ATO has provided some examples of cases in which PSLA 2011/27 was considered and applied where the ATO had identified, or the taxpayer had brought to the ATO's attention, a possible 'U-turn'. The examples provided by the ATO included the following:[18]

- After the completion of an audit, the taxpayer lodged an objection on a number of grounds, including the question of whether ATO officers had properly considered the application of PSLA 2011/27. While the ATO advised the taxpayer that the application of PSLA 2011/27 was not a valid objection ground, it would nonetheless be considered in a process separate to the objection proper. The objection was disallowed and the taxpayer was advised that PSLA 2011/27 did not apply to their case. The taxpayer appealed the objection to the Federal Court but did not challenge the decision in relation to PSLA 2011/27.

- In a refundable tax offset audit case, the taxpayer made submission to the ATO that a 'U-turn' may have occurred in this case owing to the taxpayer's reliance upon the ATO's view in the then draft Practice Statement PSLA 3434. Following a series of consultations with senior ATO technical officers, as well as practitioners and representatives of the taxpayer, the ATO determined it would exercise the Commissioner's discretion to apply its view prospectively owing to the fact that the

16 ATO communication to the IGT, 25 January 2013.
17 ATO communication to the IGT, 25 January 2013.
18 ATO communication to the IGT, 15 February 2013.

ATO had been aware of the significance of the risk in the practice adopted by the taxpayer but had not taken timely action in response.

- A taxpayer relied upon an existing Taxation Ruling as well as correspondence in relation to a particular issue from the ATO Chief Tax Counsel, and continued to do so consistently up until 2008 when the ATO commenced compliance action. The ATO's audit report demonstrated consideration of the application of the PSLA 2011/27. In this case the ATO acknowledged that it had contributed to or facilitated the practice and would take no action in relation to the taxpayer's 2008 income tax return.

- A stakeholder had raised concerns with the ATO that its view concerning revenue expenditure to acquire or construct buildings was excluded and not considered 'research and development' under section 73B of the *Income Tax Assessment Act 1936* (ITAA 1936) represented a potential 'U-turn'. Information provided by the ATO indicates that it engaged with the stakeholders to discuss their concerns as early as 2010 and again in 2012 following the release of ATO Interpretative Decision 2012/5[19] on the issue. However, the ATO notes that no formal submissions or evidence were made to it to consider the application of PSLA 2011/27 and as such, the ATO has not specifically considered the issue as a 'U-turn'.

- In consultation undertaken at the NTLG Goods and Services Tax (GST) sub-committee in relation to the different views expressed on GST tax invoice issues that involved the application of GST Ruling (GSTR) 2000/17 (alternative documents to be treated as tax invoices) and draft GSTR 2011/D1, the ATO acknowledged that GSTR 2000/17 facilitated a practice and, in applying PSLA 2011/27, agreed that documents created in line with GSTR 2000/17 would not be challenged or disputed by the ATO.[20]

- Other examples provided include the ATO applying its view on a prospective basis only that income should be treated as being derived within the electricity and gas industry once supply has commenced; deferring any compliance action on Harm Prevention Charities until March 2014 pending legislative change by the Government; and applying its changed view in Taxation Ruling TR 2013/2 on a prospective basis only.[21]

2.33 The ATO also consults on the intended date of effect of any new public ruling once it is released.[22] This assists taxpayers to determine whether it is necessary to raise any industry practice or other issues affecting compliance in relevant years. The ATO also notes that settlements which are agreed to or effected prior to the release of a public ruling are not otherwise disturbed by any potentially changed views.[23]

19 ATO, Income Tax Research and Development: building expenditure, ATO ID 2012/5, 2 January 2012.
20 ATO, National Tax Liaison Group GST Sub-Committee Minutes (June 2012) item 6.
21 ATO communication with the IGT, 20 December 2013.
22 See for example, ATO, Income tax: when a superannuation income stream commences and ceases, TR 2011/D3, 13 July 2011, para [40].
23 ATO, Product Stewardship (Oil) Benefit: the meaning of the expression 'goods produced from used oil' and the terms 'filtered', 'de-watered', and 'de-mineralised' for the purposes of the Product stewardship for oil benefit scheme, PGBR 2012/1, 12 September 2012.

IGT conclusion — Partly implemented

2.34 The IGT recognises that the ATO has made substantial progress in implementing this recommendation as described above. However, submissions made to the IGT during this review have raised ongoing concerns regarding the application of PSLA 2011/27, particularly in the course of active compliance activities. The examples raised in submissions, some of which are set out below, indicate that the ATO may not be applying PSLA 2011/27 during all audits and reviews.

2.35 The examples provided by stakeholders, which highlighted the breadth and complexity of potential 'U-turns' matters and the range affected taxpayers, include the following:

- Stakeholders were concerned that the ATO had disregarded a series of private rulings which had been issued that confirmed the ATO would not seek to apply Part IVA to securities and financial products issued under Division 974 of the *Income Tax Assessment Act 1997* (ITAA 1997). The IGT observed that the matter had been resolved following escalation to a senior executive within the ATO.

- An ATO 'U-turn' was perceived to have occurred by the ATO seeking to apply Part IVA during an audit to transactions involving two successive capital gains tax rollovers pursuant to sub-division 124-H of the ITAA 1997 which resulted in the taxpayers receiving a deferral of tax payable. It was contended that in applying Part IVA, the ATO had disregarded a range of prior private rulings with materially similar facts. Moreover, the IGT's investigation of the matter revealed that the audit officers did not appear to have regard to existing research undertaken by the ATO's risk assessment section which demonstrated the ATO's awareness of such transactions[24] and, in some cases, its 'tacit approval' which had been given to such arrangements.[25]

- The ATO was perceived to have retrospectively changed its view on general expense allocations in the Offshore Banking Unit (OBU) context. This issue is explored further below.

2.36 Having regard to the above examples, the IGT's observations in the OBU case study and feedback received from the Working Group (set out below), the IGT considers that the ATO has partly implemented Recommendation 4.

PERSISTING 'U-TURN' ISSUES

2.37 PSLA 2011/27 provides a structured process through which taxpayers may raise concerns regarding ATO views that potentially conflict with prior practice and to have those concerns investigated and resolved. However, the submissions which have been made by a range of stakeholders, including small and large taxpayers, tax practitioners and their representative bodies, indicate that certain issues which were sought to be addressed by the 'U-turns' review continue to arise.

24 ATO communication to the IGT, 8 August 2013.
25 ATO communication to the IGT, 5 July 2013.

2.38 In addition to the examples set out in the previous section which served to highlight some issues regarding the ATO's implementation of Recommendation 4, stakeholders have also raised some 'U-turn' examples outside of the active compliance context. Some of these examples included:

- The ATO holding a prior view that payments made, or property transferred, pursuant to an order of the Family Court of Australia under section 79 of the *Family Law Act 1975* are 'arms-length' transactions and therefore excluded from the operation of Division 7A of the ITAA 1936.[26] However, in a draft ruling issued in 2013, the ATO changed its view to regard such payments and transfers to not be 'arms-length' and therefore assessable as income in the hands of the receiver pursuant to section 44 of the ITAA 1936. While the IGT observed that the facts indicated that the ATO had performed a 'U-turn', the ATO's draft ruling accounts for this prior practice by confirming that it would only apply its changed view on a prospective basis which accords with the intent and purpose of PSLA 2011/27.

- An initial draft ruling relating to mobile home parks was perceived to constitute a 'U-turn' by stakeholders. The draft ruling deemed mobile home parks to not be 'commercial residential' premises and, therefore, operators of those parks would not be able to avail themselves of certain GST concessions.[27] The previous ATO view was to apply until the final ruling was issued after which time the new ATO view would apply 'both before and after the date of issue' except to 'the extent that it [conflicted] with the terms of settlement of a dispute agreed to before the date of issue' of the final ruling.[28] The ATO later updated the draft ruling to state that the final ruling would not apply retrospectively in relation to the supply of sites which had already been treated as long-term accommodation in commercial residential premises.[29]

2.39 A complete list of the examples raised with the IGT during the course of this review, together with relevant commentary, is set out in Appendix 1 for reference.

2.40 The two examples cited above serve to illustrate both positive and negative outcomes arising out of the ATO's administration of 'U-turns'. In the first case, the ATO's recognition of its prior practice aligns with the principles and processes contained in PSLA 2011/27. However, in the second example, the ATO did not appear to consider the implications of its prior position before issuing its original draft ruling in October 2013. However, the ATO did subsequently update the draft ruling to address these implications before withdrawing it altogether. These examples illustrate that the ongoing 'U-turn' issues may be due to a number of factors that need to be addressed. These factors include:

- the lack of ATO officer awareness of the purpose and requirements of PSLA 2011/27;

- issues in establishing industry practice and the quality of ATO officer research;

- issues affecting communication of ATO officer research to taxpayers;

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26 ATO, Income tax: matrimonial property proceedings and payments of money or transfers of property by a private company to a shareholder (or their associate), TR 2013/D6, 13 November 2013.

27 ATO, Goods and services tax: supplies made by an operator of a 'moveable home estate', GSTR 2013/D2, 30 October 2013.

28 Ibid, paras [32[and [33].

29 ATO, Goods and services tax: supplies made by an operator of a 'moveable home estate', GSTR 2013/D2, 19 November 2013, para [33].

- ATO officer objectivity and the need for independent dispute resolution mechanisms to address any disagreements which may arise; and

- the lack of public information regarding 'U-turns' which have been identified.

2.41 Having regard to the concerns raised, the numbers of submissions received and feedback from the Working Group, the IGT determined that it would be appropriate to examine the ATO's application of PSLA 2011/27 in an active compliance case to better understand the approach taken and the resulting taxpayer's experience in dealing with these issues.

2.42 Having considered the examples which were brought to the IGT's attention, the IGT identified the ATO's approach to OBU expense allocation as a suitable case study given the long history of the issue, as well as the nature of the material available within the ATO and the concerns raised. Moreover, impending litigation was progressing in the Federal Court at the time which brought the issues into the public domain and assisted to remove certain limitations on the IGT discussion of those issues having regard to privacy and secrecy considerations contained in the *IGT Act 2003*.[30]

2.43 As part of the case study, the IGT examined ATO documents on the administration of OBUs and engaged with senior ATO officers as well as OBU industry participants to better understand the relevant facts and underlying issues.

Case Study — Offshore Banking Unit expense allocation

2.44 Offshore banking broadly refers to the 'intermediation of a resident financial institution of financial transactions, between non-resident borrowers and non-resident lenders.'[31] An OBU is the unit within a bank, or appropriate financial institutions, which manages these transactions. Division 9A of the ITAA 1936, currently offers specific tax concessions to OBUs, including an exemption from Income Withholding Tax[32] and a tax rate of 10 per cent for 'taxable income derived from pure offshore banking (OB) transactions by an authorised OBU.'[33]

2.45 In addition to the concessional treatment afforded to OBUs, the regime requires specific allocation and classification of allowable deductions which are set out in section 121EF of the ITAA 1936. Where expenses can be characterised as exclusively OB or exclusively non-OB, the application of the provision is relatively straightforward.[34] The residual of deductions which cannot be classified as either exclusively OB or exclusively non-OB are considered 'general deductions' and required to be apportioned in accordance with sub-section 121EF(4) which states:

30 Inspector-General of Taxation Act 2003 s 23.
Explanatory Memorandum, House of Representatives, Taxation Laws Amendment Bill (No. 4) 1992.
32 This exemption was introduced in 1986.
33 Above n 31, p 19.
34 *Income Tax Assessment Act 1936* sub-ss 121EF(3) and 121EF(6).

> (4) A ***general OB deduction*** is so much of any deduction (other than a loss deduction, an apportionable deduction, an exclusive OB deduction or an exclusive non-OB deduction) allowable from the OBU's assessable income of the year of income as is calculated using the formula:
>
> $$Deduction \times \frac{Adjusted\ assessable\ OB\ income}{Adjusted\ total\ assessable\ income}$$

2.46 The OBU expense allocation issue which concerns the subject of the purported 'U-turn' involves taxpayers adopting particular methodologies to apportion general deductions which do not strictly apply the above statutory formula.

2.47 The OBU expense allocation issue had been raised by a representative industry body, the then International Banking and Securities Association (IBSA). The minutes of the ATO's meetings with IBSA members (the IBSA minutes) indicated that, as early as 1998, IBSA had raised some concerns with the ATO regarding the uncertainty and difficulties associated with the application of the above statutory formula.[35] Specifically, the ATO representatives were advised:

> … that OBUs did not always operate as separate profit centres, which made it difficult to allocate expenses on an in/out of OBU basis … [36]

2.48 In response, the IBSA members were advised:

> … that the ATO would accept an accounting allocation that gave a reasonable outcome. In particular, [the Deputy Commissioner for Large Business & International] said that the ATO would be satisfied that the expense allocation was in line with commercial practice, conducted at arm's length, sufficiently documented and applied consistently from year to year.[37]

2.49 After this meeting, the ATO identified that its examination of OBU compliance issues had been ad hoc and that the concessional treatment afforded to OBUs provided some incentive for taxpayers 'to contrive to have domestic banking (DB) income treated as OB income.' The ATO noted that 'the findings from several recent audits had reinforced the view that the regime posed some significant revenue risks.'[38] Therefore, during the 2002–2004 period, the ATO undertook a project to systemically review the compliance risks in the OBU industry (the 2002 OBU project).

2.50 Under the 2002 OBU project, the ATO initially sent questionnaires to the 17 taxpayer groups with the largest OBUs (OBU taxpayers) which together accounted for 95 per cent of all OBU activity.[39] The questionnaires consisted of twenty questions which sought details in relation to a range of OBU issues including:

- the number of full-time equivalent staff engaged in OB activities;

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35 International Banking and Securities Association (IBSA), IBSA/ATO Liaison Group Meeting, Minutes, 20 March 1998, p 7 [Unpublished].
36 Ibid.
37 Ibid.
38 ATO, 'Offshore Banking Unit (OBU) Project: Report for FSIG Executive', internal ATO document, November 2003, pp 3, 5-6.
39 Above n 38, p 3.

- the gross and net income from all OB activities for the relevant years;
- any areas in which the OBU believed that the 'provisions in the [ITAA 1936] do not operate as intended or create unnecessary practical problems, or on any other aspects of the operation and/or administration of the OBU regime';[40]
- policies and procedures in relation to identifying and recording OB activities;
- accounting procedures and internal controls to ensure that OB and DB activities are recorded in the relevant profit/cost centre's files and accounts; and
- internal review mechanisms to ensure that senior management are kept informed of OB activities and adherence to management policies, procedures and guidelines.

2.51 ATO officers also visited those OBU taxpayers to sight documents and gain a greater understanding of their businesses.[41] The ATO noted at the time that the 'expense allocation' issue was a 'big ticket item' for the 2002 OBU project.[42]

2.52 An internal ATO report on the 2002 OBU project was produced in November 2003. This report attached a summary of the methodologies adopted by 16 of the 17 OBU taxpayers surveyed to determine the level of general expenses.[43] The ATO's summary of these cases indicates that it had a reasonable understanding of the methodology adopted by the majority of OBU taxpayers and included commentary on whether the OBU taxpayer's methodology was consistent with sub-section 121EF(4) or 'accords with the spirit of the IBSA minutes.'[44]

2.53 Based on its findings, the report went on to identify five discrete issues with the operation of sub-section 121EF(4). In summary, these were:[45]

- the inequity of an arbitrary formula has led to a problematic 'search for a better way';
- the difficulty in deciding whether an expense is tainted by OBU operations;
- some accounting systems do not produce information needed for the general deduction formula;
- flaw in apportionment formula;[46] and
- misunderstanding as to the true economic cost of running the OB operations.

40 Ibid, appendix A, p 5.
41 Ibid, p 3.
42 IBSA, IBSA-ATO Liaison Group Meeting, Minutes, 17 December 2003, p 15 [Unpublished].
43 Above 38, appendix, general expenses.
44 Ibid.
45 Above n 38, pp 15-18.
46 The ATO has identified that where assessable OB income less interest results in a loss, the application of the formula results in a negative deduction which is irreconcilable with a common sense reading of the provision. See: Above n 38, p 17.

2.54 On the 'expense allocation' issue, the November 2003 report ultimately concluded that:

> The concern within industry is that the arbitrary allocation formula [the statutory formula] can lead to an unfair result. The ATO has signalled in the past a willingness in principle to accept a more economically realistic allocation. Our current concerns relate to how to achieve a fair outcome without confusing taxpayers and compromising the revenue. We have identified 5 discreet areas of concern within the expense allocation issue which we think need to be addressed. A series of ATO IDs would be a possible vehicle, although there is an argument that a "one stop shop TR" would be more useful, if supportable within the [Priority Technical Issues] framework.[47]

2.55 In March 2004, the ATO's Tax Counsel Network (TCN) issued internal advice on the operation of sub-section 121EF(4) and observed that:

> The threshold issue is whether section 121EF allows a loss or outgoing that relates to both OB and non-OB activities (eg. overhead expenses) to be apportioned, with each resulting component taken to be an 'exclusive OB deduction' and an 'exclusive non-OB deduction' respectively.[48]

2.56 On this issue, the TCN's view was that the statutory formula must be applied:

> Section 121EF does not allow a deduction that relates to both OB and non-OB activities to be apportioned on an economic/accounting basis and each component treated as an exclusive OB or exclusive non-OB deduction. Such a deduction is a 'general OB deduction' by definition and *must* be apportioned according to the formula contained in section 121EF(4).[49]

2.57 In July 2004, the ATO approached the Treasury to seek its support on its view of the operation of sub-section 121EF(4). In its minute to the Treasury, the ATO noted:

> The ATO view is that we are unable to read down the term "exclusively" as it is used within the definition of "exclusive OB deduction" (and "exclusive non OB deduction" for that matter). We believe that any such approach would render the statutory formula in sub-section 121EF(4) redundant, in addition to being contrary principles of statutory construction. High level advice from our Tax Counsel Network … has confirmed this overall view. That advice has stressed the clarity and strong sense of purpose which 121EF(4) provides. The ATO therefore considers that we are unable to consider alternative (contrary) methodology for calculating 'general expenses' within the OBU regime.[50]

2.58 The Treasury's response to the ATO noted that:

> … there are a range of possible methodologies (including the 'general expenses formula') that could provide outcomes consistent with the policy intention.
>
> It appears that the 'general expenses formula' was included in legislation because it provides a transparent, simple and reliable method for determining OBU deductions. This provides certainty for both taxpayers and administrators.

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47 Above n 38, p 3.
48 ATO communication to the IGT, 6 February 2013.
49 Ibid.
50 ATO communication to Treasury, 14 July 2004.

> As to whether the legislation itself allows taxpayers to use a method other than the 'general expenses formula', this is a matter of legal interpretation.[51]

2.59 After considering the TCN's view and the Treasury's response, it was decided that no ATO view would be published because 'the view was a straight forward application of the law'[52] and that the new view would only be communicated in a meeting with IBSA.[53]

2.60 In October 2004, the ATO met with members of IBSA and conveyed its position. The minutes of that meeting state:

> … the Commissioner has no discretion with respect to allowing an alternative or broadening the formula for OBU expense allocation. TCN has interpreted the legislation and Treasury consulted. IBSA may wish to seek policy relief with Treasury.[54]

2.61 According to the IGT's discussions with stakeholders and ATO officers, during the period starting from just after this meeting until 2010, no relevant ATO public statements were published on the 'expense allocation' issue.

2.62 In 2010, the ATO undertook a further project in relation to lower and medium risk OBU taxpayers within the large business market (the 2010 OBU project). In terms of the taxpayer population which comprised the new project, only five of the original seventeen OBU taxpayers who were subject of the 2002 OBU project were revisited.[55]

2.63 The report of the 2010 OBU project observed, amongst other things, that there were further ongoing concerns in relation to the formula to calculate general OB deductions:

> The statutory formula used to calculate the general OB deduction has caused angst among many taxpayers for a variety of reasons including the dilemma of a negative general OB amount and the methodology they use to determine what a general deduction is. In this regard, it is considered some blame may be attributable to the ATO for not providing guidance on the application of the OBU provisions that is detailed, clear and visible to taxpayers.
>
> Some taxpayers have found it difficult to comply with the statutory formula to calculate the general OB deduction. Some consider that the formula provides inappropriate allocations of expenses and have therefore substituted their own methodology to calculate their general OB deductions. Our policy has been to accept reasonable and supportable approaches to this allocation. This tacit approval has been given on an ad hoc basis where it is justifiable on the facts.[56]

2.64 Stakeholders and ATO staff indicate that the ATO has not made any further relevant public statements on its view concerning the OBU 'expense allocation' issue, with the exception of a position paper issued in May 2012 to a taxpayer subject to an audit. Stakeholders also claim that the ATO has not indicated in any other forums its intention to apply the statutory formula retrospectively. This is so, even in circumstances where the ATO

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51 Treasury communication to the ATO, 18 August 2004.
52 ATO communication to the IGT, 14 February 2013.
53 ATO communication to the IGT, 14 February 2013.
54 IBSA, IBSA-ATO Liaison Group Meeting, Minutes, 12 October 2004, p 5 [Unpublished].
55 ATO, Offshore Banking Units Project 2010 Tier 3 Project Closure Report, internal ATO document, 30 June 2011, p 8.
56 Above n 55, pp 8-9.

had previously made itself aware of the different practices and methodologies adopted by OBU taxpayers in relation to their OBU general expenses, and had taken no adverse action.

2.65 During an ATO audit of Macquarie Bank Limited, a point of disagreement arose as to what indeed was the ATO's practice in relation to OBU expense allocation. This disagreement led to litigation in the Federal Court.

2.66 Specifically, the case concerned Macquarie Bank's application pursuant to the *Administrative Decisions (Judicial Review) Act 1977* and section 39B of the *Judiciary Act 1903* for review of a decision by the Commissioner (and his authorised officers) not to apply a changed view of the law in relation to OBU expense allocation prospectively. In summarily dismissing Macquarie Bank's application, the Court noted:

> Just as no conduct on the part of the Commissioner could operate as an estoppel against the operation of the Acts,… it is trite that no practice statement could derogate from the Commissioner's duty to assess in accordance with the Acts.[57]…
>
> …Read with the references to the legal framework within which the Commissioner must operate, and obligations arising under the FMA Act [*Financial Management and Accountability Act 1997*], the references in PS LA 2011/27 at [21] and [23] to taking "action" (or "compliance action") are to be read as referring to circumstances where there are resource allocation decisions to be made — e.g. whether to initiate an audit or some other form of investigation. PS LA 2011/27 does not purport to require that, in assessing the tax due for past years or periods (e.g., at the completion of an audit), officers are to make a decision about whether to make that assessment on the basis of the ATO's current understanding of the law or on the basis of some other understanding.
>
> To the extent that any guideline or practice statement did purport to instruct an officer to act in that way, compliance with that instruction would be inconsistent with fundamental requirements of the Acts. The relevant guideline or practice statement would necessarily be read down accordingly.[58]

2.67 The judgment in the *Macquarie* case was subsequently approved by the Full Federal Court in refusing the taxpayer leave to appeal. The Full Court noted:

> Whatever the consequence of an alleged failure by the Commissioner to follow an earlier statement or position, it is not to bind him in law to act contrary to the provisions of the statute. To the extent that a reading of the practice statement suggests otherwise it should be withdrawn and rewritten. A declaration in favour of Macquarie that the Commissioner had acted contrary to the practice statement would be futile and would not alter the Commissioner's ability to re-assess Macquarie in accordance with his duty to apply the law.[59]

IGT observations

2.68 At a broad level, the IGT's examination of the OBU expense allocation example illustrates the complex and multifaceted nature of 'U-turn' issues and the longevity that can be associated with such matters. Moreover, it highlights the risks of inadequate communication where the ATO becomes aware of particular technical concerns within the community but does not take adequate action to provide administrative support and clarification on the issue. In these circumstances, the ATO was perceived to have tacitly accepted technically non-compliant positions on the basis that it provided a practical

57 Macquarie Bank Limited v Commissioner of Taxation [2013] FCA 887 at [69].
58 Macquarie Bank Limited v Commissioner of Taxation [2013] FCA 887 at [71] and [72].
59 Macquarie Bank Limited v Commissioner of Taxation [2013] FCAFC 119 at [12].

outcome to achieve the policy objective. As noted earlier, such technical application of the law could also lead to manifestly absurd outcomes such as negative deductions.

2.69 The judgments in the *Macquarie* case have raised questions regarding the status of ATO practice statements, generally, and the extent to which they may be relied upon by taxpayers and their advisers. Specifically relevant to this follow up review, are the Court's views that practice statements only empower the Commissioner to make 'resource allocation' decisions and do not operate to empower him to make decisions regarding whether to apply the law retrospectively.

The status of practice statements and 'resource allocation'

2.70 As is evident in the earlier discussion, the IGT's 'U-turns' report and the resulting PSLA 2011/27 are integral parts of the ATO's approach to managing 'U-turns'. In particular, the ATO considers that its practice statements are lawful directions by the Commissioner to his staff and that an officer's failure to comply with such statements can be grounds for disciplinary action. Such action may result in sanctions imposed under section 15 of the *Public Service Act 1999*, including termination of employment. As such, taxpayers have relied on practice statements as an authoritative statement by the Commissioner on the practices that ATO officers are required to follow in the course of their duties. However, the ATO states that practice statements do not empower the Commissioner to act contrary to the law.[60]

2.71 Following the Full Federal Court's judgment in the *Macquarie* case, the ATO issued a draft Decision Impact Statement (draft DIS), outlining its view of the administrative implications of the decision.[61] Specifically, the draft DIS states that PSLA 2011/27 only applies to the ATO's resource allocation decisions:

> The Full Court's decision confirms our understanding that when the Commissioner has formed the view that the tax law imposes a liability on a particular taxpayer, the Commissioner has a duty to assess the taxpayer in accordance with that view. This typically occurs, for example, when an audit is completed.
>
> As the Full Court's decision notes, we were conscious when drafting the Practice Statement of this obligation. We confirm that the Practice Statement applies only to resource allocation decisions, including resource allocation decisions made during the conduct of an audit.
>
> However, in light of the Full Court's comments that a reading of the Practice Statement could suggest otherwise, we will review the wording of the Practice Statement with a view to identifying any changes that should be made to clarify its intended operation. Any such changes are not expected to alter the practical operation of the Practice Statement.
>
> In the meantime, the Practice Statement continues to apply as an instruction to ATO staff about resource allocation decisions, with the intended practical effect of not disturbing assessments for years where the factors outlined in the Practice Statement are present. The

60 See for example, ATO, Matters the Commissioner considers when determining whether the ATO view of the law should only be applied prospectively, PSLA 2011/27, 13 January 2014, para [20].

61 ATO, *Macquarie Bank Limited v Commissioner of Taxation*, Draft Decision Impact Statement, 13 January 2014.

> ATO will seek to ensure that ATO officers carry out the research required by the Practice Statement at the earliest practical time.[62]

2.72 In discussions following its publication of the draft DIS on the *Macquarie* case, the ATO has advised the IGT that the term 'resource allocation' encompasses more than a narrow assessment of the economic efficiency in taking compliance-related actions. The ATO considers that 'resource allocation' decisions may also encompass broader considerations including particular benefits to the tax system of administering the law in a way which promotes certainty and fairness in practice. The ATO intends to reflect its understanding of 'resource allocation' in a revised version of PSLA 2011/27. This revised draft was the subject of specific comment by the IGT and the Working Group. It will also be the subject of community consultation before it is finally settled.

2.73 It ultimately remains to be seen whether the ATO's interpretation of 'resource allocation' is judicially challenged and, if so, whether a Court would agree with the scope of the ATO's interpretation. Notwithstanding this, the IGT recognises that the ATO is seeking to adopt an interpretation which may enable it to exercise its discretion more flexibly for the benefit of taxpayers.

2.74 In further discussions with the IGT, the ATO has also indicated that it considers 'resource allocation' decisions may only be made at the audit stage and before amended assessments are issued. However, the IGT considers that this limitation may result in taxpayers being prevented from escalating disagreements over the existence of potential 'U-turns' where an audit has finalised notwithstanding any deficiency in the ATO's consideration of the issue.

2.75 The ATO has advised the IGT that it would seek to ameliorate the impact of this limitation by allowing ATO officers to consider potential 'U-turn' issues as a factor in settlements with taxpayers. While the IGT notes the ATO's efforts to balance its approach under PSLA 2011/27 with what may be achieved in a broader settlement context, some concerns remain if ATO officers do not properly discharge their obligations during the audit phase. The inability to escalate the issues thereafter, save for settlement discussions, may lead to protracted disputes or additional costs, particularly where the working relationships are strained.

2.76 The IGT therefore considers that the ATO should not unduly limit the operation of PSLA 2011/27 and relevant ATO officers should be empowered to consider the application of PSLA 2011/27 throughout the compliance process and in settlement negotiations. In this respect, the IGT also considers that relevant ATO instructions to staff and settlement guidance materials, such as PSLA 2007/5 *Settlements* and the Code of Settlement Practice, are revised and reconciled to facilitate this outcome.

62 Above n 61.

RECOMMENDATION 2.1

The IGT recommends that the ATO update PSLA 2011/27 and relevant staff instructions and guidance materials, such as PSLA 2007/5 and the Code of Settlement, to ensure that 'U-turn' issues are considered by staff throughout the compliance process and as a relevant factor in settlement negotiations.

ATO Response

Agree.

Legislative change to empower the Commissioner

2.77 Notwithstanding the potential for a broader ATO interpretation of 'resource allocation', the Federal Court's judgments have resulted in a number of stakeholders raising concerns that ATO statements[63] regarding the circumstances in which it would not apply its changed view retrospectively may be untenable.

2.78 Moreover, concerns have been raised that whilst the ATO may specifically instruct its officers not to select certain issues for audit,[64] these issues may have to be considered, if a broader audit is underway and adjustments need to be made, to avoid arbitrary and inconsistent outcomes.

2.79 Accordingly, some stakeholders have asserted that, even if the ATO implements the above IGT recommendation appropriately, taxpayers are not sufficiently protected where ATO 'U-turns' arise with retrospective effect. These stakeholders have suggested that only legislative change to empower the Commissioner to apply delayed or changed views prospectively would provide the necessary protection. In addition, and in light of the *Macquarie* case, stakeholders have also noted that any such legislative power afforded to the Commissioner must include a right to seek external review by taxpayers.

2.80 While the IGT is generally supportive of a right of review for taxpayers, such a right must be balanced against the need to avoid frivolous or vexatious applications which may seek to delay or obstruct the efficient administration of the tax laws. Furthermore, the recommended administrative approach may be more expeditious and flexible than a legislative solution.

2.81 Therefore, while there are legitimate stakeholder concerns with the sustainability of the ATO's approach to 'resource allocation', the IGT believes that the recommended administrative improvements should be implemented in the first instance. If, after a

63 See for example: ATO, *Public Rulings*, TR 2006/10, 4 October 2006, paras [61] and [62].

64 See for example PSLA 2010/1 at [10] which states 'Because there had been considerable uncertainty before the decision in *Bamford* about the principles applicable to the operation of Division 6, it may be expected that some taxpayers will have lodged tax returns and / or administered their trusts on the basis of views that, with the benefit of the decision in *Bamford* , may be seen to be wrong. Accordingly, staff undertaking active compliance activities in respect of the 2009-10 and earlier income years should not select cases for active compliance just to correct such errors. However, if there is a deliberate attempt to exploit Division 6 (see paragraph 11 of the practice statement) or cases are selected for other reasons (for example, because there is a dispute about the quantum of the [tax] net income), and adjustments are to be made, the adjustments must be made on the basis of the law as explained in *Bamford*.'

reasonable period of time has elapsed, there is evidence that the administrative approach has not achieved the desired outcome, a legislative solution can then be pursued.

Further opportunities to improve ATO management of 'U-turns'

2.82 In response to this follow up review, stakeholders have raised a number of further opportunities to improve the ATO's management of 'U-turns'. These are discussed further below.

Awareness and understanding of the purpose and intent of PSLA 2011/27

2.83 Stakeholders had expressed concern regarding a perceived 'education' gap, both for the ATO and for some taxpayers. In particular, they noted a lack of awareness and understanding of the purpose and intent of PSLA 2011/27, particularly during the conduct of audits. For example, stakeholders recounted circumstances in which the ATO's audit teams were either unaware of PSLA 2011/27 and their associated responsibilities under it or otherwise expressing a reluctance to concede that it applied to audit activities. While it was observed that escalation channels to senior executives generally worked well, it was suggested that stronger governance mechanisms were needed to ensure ATO officers are both aware of, and adhered to, the requirements under PSLA 2011/27 at first instance. Moreover, stakeholders raised concerns that where ATO officers did consider 'U-turn' issues, they adopted an unnecessarily legalistic approach to the words of PSLA 2011/27 without regard to the intent and purpose of the practice statement.

2.84 The ATO has acknowledged that improvements can be made in relation to staff knowledge and education, particularly when issues of uncertainty emerge in the course of compliance activities. The ATO has agreed that ongoing education and reinforcement of the requirement to adhere to all PSLAs were appropriate. To this end, the ATO has advised the IGT that:[65]

> Work is already underway across compliance to improve our implementation of PSLA 2011/27. This includes a plan to increase awareness of the practice statement at the initiate phase of audit products:
>
> - internally through incorporating trigger points where an ATO officer would consider the practice statement; and
> - externally through informing taxpayers that the ATO has guidelines for circumstances where they perceive, and have evidence that the ATO view has changed or been delayed.
>
> If research by the ATO officer reveals evidence that may reasonably be perceived by the taxpayer as a u-turn, there may be an opportunity at the initiate stage for the ATO to share their research and findings with taxpayers (as much as they can under secrecy and privacy law) and for taxpayers to raise any concerns they may have. This will allow any potential u-turn issue to be resolved early and will guard against this process being used for frivolous claims at the later stages of a review or audit.

2.85 The IGT considers that increased awareness and education on the purpose and requirements of PSLA 2011/27 would be beneficial for both ATO officers engaged in compliance activities as well as taxpayers and advisers seeking to raise potential 'U-turn'

65 ATO communication to the IGT, 28 August 2013.

issues and that as part of the revision of PSLA 2011/27, the ATO should consider communication strategies to instil greater understanding of the ATO's administrative approach to 'U-turns'.

Establishing industry practice and the quality of ATO officer research

2.86 The IGT's examination of purported 'U-turn' issues has revealed practical difficulties in identifying and evidencing industry practices and the ATO's facilitation or contribution to those practices.

2.87 It was generally assumed by stakeholders that the ATO has access to all taxpayer information within an industry, as well as an understanding of common practices through its stakeholder consultation and compliance activities. However, in practice, this may not always be the case as the ATO may not review all taxpayers' arrangements or all aspects of taxpayer practices. Even in those cases where the ATO does so, the extent of the ATO's knowledge is dependent on the retention and dissemination of corporate knowledge of such practices, which generally relies on ATO officers' memories, ATO record-keeping systems and its appropriate use by ATO officers.

2.88 Similarly, some ATO officers appeared to assume that taxpayers are alive to the taxation practices within their industry. However, this may not always be the case. Competition between taxpayers and commercial in-confidence practices means approaches adopted by others within the same industry are often guarded and not generally known. Furthermore, for tax advisers, the requirement to maintain client confidentiality and legal professional privilege may operate to prevent advisers from disclosing evidence of potential industry practices with their clients. Furthermore, taxpayers and advisers may be reluctant to raise evidence of industry practice with the ATO out of concern that doing so may result in increased compliance costs in dealing with ATO inquiries and active compliance activities.

2.89 There is also a lack of clarity on what constitutes an 'industry practice'. For example, does an 'industry practice' necessarily require industry participants to adopt practices which are materially similar to each other, or is it enough that industry participants adopt different practices but not the one which the ATO considered to be correct? The ATO encountered these questions in its industry-wide reviews of OBUs referred to above.[66] As noted earlier, those industry reviews identified instances where the ATO had previously given tacit approval to taxpayer practices which were not consistent across the industry and which did not align with the ATO's view of the law.[67]

2.90 In addition to establishing the industry practice itself, stakeholders have also advised the IGT that evidencing the role played by the ATO in contributing to or facilitating said practice can also be difficult. This is especially true in cases where there are few or no ATO public pronouncements on certain issues. In these instances, taxpayers may seek to rely on discussions or public comments made by ATO officers, such as at conferences, other public forums or during the course of previous audits. For example, in relation to the OBU expense allocation issue, the IGT observed that taxpayers sought to use discussions and comments made by senior ATO officers at an industry forum to evidence the ATO's awareness and acceptance of a particular practice. Similarly, the IGT also observed that the ATO sought to use other statements made at the same forum to outline its view of the law.

66 Above n 38; Above n 55.
67 Above n 55, p 9.

2.91 The use of external forums to convey ATO approaches or views of the law may be problematic for two reasons. First, not all industry participants are members of such forums. Although, it may be argued that while not all participants are members, discussions at such forums may reach other industry participants through common members, business discussions or through advisers familiar with these forums. However, it cannot be asserted that all stakeholders would be accurately informed of all relevant matters.

2.92 Secondly, where forum minutes and discussions are sought to be relied upon as evidence of the ATO communicating acceptance of a particular practice, difficulties may be encountered where seemingly contradictory statements are subsequently made. Such difficulties are compounded where subsequent ATO activities may be interpreted as 'tacit acceptance' of the original positions.

2.93 The above practical difficulties are similar to those identified by the IGT in the 'U-turns' review in relation to establishing GAP.[68] Recommendation 2 of the 'U-turns' review sought to address these practical difficulties by placing the onus on ATO officers to conduct research on these issues before applying any potentially changed views. Stakeholders also commented that they are heavily reliant on ATO officers to undertake sufficient research to determine whether any action by the ATO, or its officers, contributed to or facilitated an industry practice.

2.94 Notwithstanding this obligation on ATO officers, stakeholders expressed concern that the level of research undertaken in accordance with PSLA 2011/27 was, in some instances, insufficient. Such concerns may be justified as the IGT found certain instances in which ATO officers did not identify either the relevant ATO record indicating awareness of certain taxpayer arrangements or the ATO's response or view of those arrangements. For example in the examination of the OBU expense allocation issue, the IGT found that the research required by PSLA 2011/27 did not uncover ATO records which set out the ATO's understanding of different taxpayer methodologies, the previously expressed ATO view on the taxpayers' compliance with the law or previous ATO public statements.

2.95 Moreover, stakeholders were concerned that when ATO officers undertook appropriate research, they may have given undue weight to matters that favour the ATO position while ignoring others supporting taxpayers' positions. For example, a taxpayer in one case noted that in respect of certain transactions, it had identified more than ten private rulings issued by the ATO over a number of years on the matter. However, the taxpayer noted that the ATO officers' research appeared to rely on general comments made in speeches by ATO senior officers and failed to give due weight to the private rulings cited by the taxpayer.

2.96 The IGT recognises that some difficulties may arise for individual ATO auditors, or audit teams, in identifying evidence relevant to an industry practice. At present, these ATO officers may discharge their research obligations under PSLA 2011/27 by reviewing internal ATO databases, such as views expressed on ATOlaw and external public guidance. However, there are limitations on the extent to which ATO officers are able to identify the actual action taken by the ATO, whether in specific private rulings, audits of materially similar cases or industry-wide risk assessments.

68 IGT, Review into delayed or changed Australian Taxation Office views on significant issues (17 March 2010) p 15.

2.97 In discussions with the ATO, the IGT has observed that the ATO's risk assessment sections, which are not part of audit teams, appear to undertake more comprehensive research of particular risk areas when developing the ATO's risk treatment strategies. This process involves research undertaken to assess the breadth and severity of perceived risks to the tax system and revenue. To this end, the ATO's risk assessment sections not only draw on broad data and database searches, but also have authority to obtain qualitative case-specific information and outcomes in a range of ATO activities to examine the risks in detail and what action the ATO took in audit and review cases. The findings and recommendations of this process assist the ATO to determine whether compliance activities should be conducted on the issue or whether other treatment, such as issuing advice and guidance, may be more appropriate.

2.98 Some ATO officers and audit teams may be able to access risk assessment information. However, most ATO officers do not have access to such information. In addition to the databases mentioned earlier, they are limited in their reach to personal and professional networks within the ATO. Ideally they should all have access to a consolidated searchable database of the ATO actions taken in case work. However, establishing such as database represents a high standard of ATO data and information management which is unlikely to be realised in the short term.

2.99 As a result of discussions with the IGT during this follow up review, the ATO has proposed to implement internal design improvements to ensure that, in appropriate cases, ATO audit officers have access to a wider network of corporate knowledge on risk issues, treatments and outcomes which may inform their audit conduct. In doing so, the ATO is mindful of the need to guard against possible vexatious or frivolous attacks on the ATO's processes. Specifically, it has advised the IGT that the research of the risk assessment area on relevant risks will be made available to auditors when they commence compliance activities in relation to those risks:[69]

> The ATO considers that there are two avenues through which the application of PSLA 2011/27 might arise in compliance: one is issue-specific and arises during an audit; the other is risk assessment specific and can be dealt with by documenting in summary form the research we already carry out in testing the risk hypothesis…
>
> The ATO considers that the outcome of applying PSLA 2011/27 can appropriately be reflected in the risk treatment strategy that follows from a risk assessment. If a risk assessment indicates that treatment to reduce the incidence of risky behaviour is necessary, and the weight of evidence on balance, supports giving serious consideration to applying the practice statement, it follows that it is likely the decision will only be applied prospectively. In these circumstances treatment will tend towards publication of the ATO view and an education campaign to ensure taxpayers are aware of this changed view. If applying the practice statement the weight of evidence does not support there has been a change to the ATO view, or no ATO facilitation or contribution to the development of particular views by taxpayers generally or an industry practice, then it follows that the treatment strategy can be applied retrospectively, including audits of prior years to ensure compliance with the law. As the risk assessment and management process is mandated corporately, a template could be developed such as a checklist of sources, a brief summary of contents and references where necessary.
>
> If the treatment strategy includes compliance action, the risk assessment's application of PSLA 2011/27 to the risk hypothesis will provide a starting point for the auditor's own

69 ATO communication to the IGT, 28 August 2013.

case-specific research. Applying the practice statement at the risk assessment stage will increase the quality of the risk assessment and any resulting recommendation for treatment. It will also more clearly define the risk to be examined, providing more certainty for case officers and laying the foundations for their communications with taxpayers about PSLA 2011/27.

2.100 Furthermore, where ATO staff seek to rely on draft rulings in the conduct of active compliance activities, the ATO provides the contact details of the ATO officers who drafted the rulings so they can be used as reference points in relation to determining the research undertaken on any existing industry practice. ATO compliance officers may also directly contact rulings officers to discuss any risk concerns which may emerge during audit activities. The ATO considers that would assist to reduce duplication of research under PSLA 2011/27 while increasing confidence for officers seeking to rely on draft rulings.

2.101 The IGT considers that broadening ATO officer access to information and research relevant to PSLA 2011/27 would assist to enhance the quality of research pursuant to PSLA 2011/27. The ATO could also seek to reduce the perceptions of inadequate or potentially biased research by ensuring that ATO officers document their research including steps they have taken and evidence on which they have relied. Such documentation demonstrates that they have discharged their obligations under PSLA 2011/27 and could be shared with taxpayers and their advisers where necessary.

The communication of ATO research to taxpayers and their advisers

2.102 An issue related to ATO officer research is the adequacy of the ATO's communication to the taxpayer of the research undertaken. Where the ATO does not provide sufficient information to assure taxpayers of the research taken under PSLA 2011/27, taxpayers and their advisers may perceive that the ATO's research is inadequate or not in accordance with the requirements of PSLA 2011/27.

2.103 It could be argued that communication of ATO research would be tantamount to issuing a formal statement of reasons and PSLA 2011/27 does not presently require such a statement to be prepared.

2.104 The IGT does not consider that formal statements of reasons need to be issued. Indeed, where the ATO has consulted with taxpayers throughout the audit or in the development of a ruling, it is unlikely that any written communication be necessary beyond reflecting the substance of the parties' discussions. However, absent such engagement and where taxpayers have continued to allege the existence of a 'U-turn', the lack of sufficient communication may leave taxpayers to question whether the ATO has undertaken the requisite research. Moreover, it creates difficulties for taxpayers seeking to assess the adequacy of the ATO's research and to determine whether there is any other pertinent information which they could provide to assist the ATO.

2.105 The IGT recognises that communication in this regard may pose some difficulties for the ATO where statutory confidentiality and privacy obligations prohibit the ATO from disclosing details of contrary practices adopted by other taxpayers. However, providing taxpayers with details of the steps taken by ATO officers and sharing the evidence, to the extent possible, would instil some trust and confidence in ATO processes and minimise any perception of bias.

Objectivity, independence and escalation processes

2.106 Stakeholders were concerned that ATO audit officers who were responsible for applying PSLA 2011/27 would not be able to isolate the consideration of potential 'U-turns' from the substantive considerations of the audit and that there was a risk that their considerations would be affected by an unconscious bias. This may be exacerbated where audits are long-running or concerned potentially contentious issues.

2.107 Stakeholders further noted that where they had concerns in this regard, there were limited avenues of redress beyond escalating matters to audit team leaders. However, it was clear from stakeholder submissions that they had little confidence in this process as it was perceived that audit team leaders only received briefings on relevant issues from their officers rather than considering afresh the concerns raised by taxpayers. Where this occurs, taxpayers may need to turn to other escalation points within the ATO, such as senior officers with whom they or their advisers have had prior contact.

2.108 In the past, the IGT has noted that such an informal approach to escalating concerns was problematic as it favoured taxpayers or advisers with personal contacts rather than progressing matters through formal channels.[70] This may constrain opportunities to progress matters of concern toward resolution or otherwise require advisers with these contacts to be engaged in seeking to resolve their issue.

2.109 The IGT considers that such issues of independence and objectivity can be addressed by having a senior officer outside of the Compliance Group review any disputes or disagreements over potential 'U-turn' issues. The ATO has informed the IGT that it proposes to include additional text in an updated version of PSLA 2011/27 to provide review of 'U-turn' decisions by senior officers within the Law Design and Practice Group. The exact wording of such a change will be the subject of broad community consultation before a final updated version of the PSLA is released.

2.110 The IGT welcomes the ATO's approach in this regard, noting that it is likely to enhance the actual and perceived independence and objectivity of the ATO's 'U-turn' decision making process and further instil community confidence in the ATO's administration.

2.111 It has been suggested that where 'U-turn' decisions are to be made, they ought to be made by the relevant Second Commissioner. The IGT acknowledges that decisions in respect of 'U-turns' are significant and have the potential to affect a broad class of taxpayers. However, the IGT also recognises that escalation of all matters in which 'U-turn' allegations are made to the Second Commissioner may not be desirable as it may result in lengthy delays and protraction of matters needing to be addressed. In the IGT's view, effective and efficient resolution of 'U-turn' issues should be favoured and the Second Commissioner should be notified of cases in which disputes remain unresolved by the Law Design and Practice Group.

70 IGT, Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution (2012) p 72.

Publicising identified 'U-turns'

2.112 An ancillary issue concerning the transparency of the ATO's processes, is the extent to which instances in which PSLA 2011/27 was considered and/or applied are made publicly available. At present the ATO does not publish such data.

2.113 The IGT considers that it would be beneficial for the ATO to publish information and statistics relating to instances of the application of PSLA 2011/27. This would enhance both the transparency and effectiveness of the ATO's administration of 'U-turns' in accordance with PSLA 2011/27 as well as instilling greater community confidence.

RECOMMENDATION 2.2

The IGT recommends that the ATO:

(a) enhance the effectiveness of its officers' research pursuant to PSLA 2011/27 by, for example, providing compliance officers with access to the research of the ATO's risk assessment section at the commencement of compliance activities;

(b) instruct ATO officers to document research undertaken pursuant to PSLA 2011/27;

(c) where there is a dispute in relation to a 'U-turn':

(i) to the extent permissible by law, provide details of the research undertaken pursuant to PSLA 2011/27 to the taxpayer or their adviser and engage in further discussion with a view to resolving the dispute;

(ii) if the dispute persists after the sharing of research and further engagement envisaged at (c)(i), refer the matter for review to an independent senior officer from the Law Design and Practice Group;

(iii) notify the Second Commissioner if the dispute persists after the independent senior officer review mentioned at (c)(ii);

(d) publish information regarding the ATO's administration of PSLA 2011/27, including:

(i) the number of cases in which taxpayers have alleged an ATO 'U-turn';

(ii) the number of cases in which PSLA 2011/27 was applied and ATO acceptance of a 'U-turn'; and

(iii) descriptions of accepted 'U-turns'.

ATO Response

Agree.

Where the ATO contributes to or facilitates a practice adopted by a single taxpayer

2.114 While it was not the subject of the 'U-turns' review, stakeholders have raised instances where the ATO contributed to or facilitated a practice adopted by a single taxpayer. For example, where a taxpayer had been the subject of audits in prior years, the action or inaction of the ATO auditors may have led that taxpayer to adopt, or continue to apply, existing practices. In such cases, stakeholders contend that the ATO auditors' actions or inaction indicates to the taxpayer that there is no compliance risk concern and that approval had been given, at least tacitly, for the taxpayer to continue to adopt these practices.

2.115 It should also be noted that it is not always possible to identify an industry practice in the above instances. For example, the taxpayer's activities may be unique or the taxpayer may constitute the entire industry.

2.116 Having regard to the above matters, stakeholders have suggested that the ATO should consider whether there is scope to apply its views prospectively in respect of a single taxpayer where, by action or inaction, the ATO has contributed to or facilitated a particular practice being adopted by that taxpayer. These stakeholders suggest that such an approach would align with the ATO's intent to administer the law in a manner which promotes certainty and fairness.

2.117 The IGT considers that, as a matter of equity and fairness, the prospective application of changed ATO views to a single taxpayer also raises a need to revisit the tax affairs of other taxpayers with materially similar circumstances. However, difficulties may arise where those taxpayers have previously been the subject of finalised audits, settlements and amended assessments may have been issued.

2.118 The IGT is of the view that issues of equity and fairness may be addressed in two ways. First, the prospective application of changed views to a single taxpayer requires consideration of the tax issues, facts and circumstances of a particular taxpayer. Accordingly, any decisions rendered would be specific to the circumstances of the taxpayer and considerations as to whether it is possible to revisit past audits or assessments may be accommodated within the broader 'U-turns' process, taking into account relevant matters such as statutory limitations on amendments. Secondly, the ATO's implementation of escalation processes for the resolution of disputes as well as the publication of accepted 'U-turns' would assist to ensure that the number of 'U-turns' cases raised after audits have been finalised should be reduced.

2.119 Accordingly, the IGT is of the view that a single taxpayer should have the benefit of a changed ATO view applied prospectively, if the ATO contributed to or facilitated that taxpayer adopting a prior inconsistent practice. When approaching such considerations, the IGT considers that the criteria and processes contained within PSLA 2011/27 are germane. Where such considerations cannot be accommodated within the scope of PSLA 2011/27, then the ATO should identify an appropriate channel through which it can instruct its staff to consider these issues at the earliest possible point in time during the compliance verification process.

2.120 The ATO has acknowledged that there may be instances in which the principles of PSLA 2011/27 may be applicable to a single taxpayer. In this regard, the ATO is of the view that an objective test should be applied to determine whether a reasonable person in the

taxpayer's position would have formed the impression that the ATO had agreed with the taxpayer's view based on a pattern of ATO action or inaction.

2.121 Where the ATO observes multiple taxpayers raising materially similar issues, it would be appropriate for the ATO to consider the possible existence of an industry practice and apply PSLA 2011/27 accordingly.

CHAPTER 3 — ENGAGEMENT WITH STAKEHOLDERS ON TECHNICAL ISSUES

3.1 The 'U-turns' review noted that there were many positive aspects regarding the manner in which the ATO engages with the taxpaying community while developing its views on technical issues. However, the report also identified scope for improvement in certain areas.

3.2 The IGT observed that there were a range of vehicles for the ATO to engage with the community in the development of its views and that determining the right vehicle may be a difficult matter. In particular, the IGT noted that the use of technical discussion papers:

> … can better inform technical decisions through impartial discussions on issues. Developing an ATO technical view that involves open consultation with relevant parties ensures that the ATO correctly understands the arrangements and their context and that alternative views are robustly considered before the ATO finalises its view. There is potential to use technical discussion papers to gain knowledge (if approached in an impartial manner) and arrive (in a collegiate manner) at a robust view based on a sound understanding of the relevant arrangements and implications.[71]

3.3 However, the IGT also observed that the examples raised during the 'U-turns' review showed that the use of technical discussion papers within the broader consultation framework may not be well articulated or understood. The IGT also noted the stakeholder perceptions that technical discussion papers were used to promote a particular ATO view rather than impartial discussions of technical issues.[72] These perceptions may lead to adverse reactions from taxpayers and their advisers and result in the adoption of defensive positions which hinders effective discussion of the issues.

3.4 Other areas for improvement identified by the IGT included the need for the ATO to more quickly identify and resolve issues involving significant revenue risk and providing interim guidance where finalisation of the ATO view may be delayed.

3.5 Accordingly, and as noted earlier in Chapter 1, Recommendations 3 and 5 were aimed at:

- reducing ATO delays in identifying compliance concerns and finalising its position in relation to those concerns;
- improving the tone and manner of technical discussion papers on issues of compliance concern; and
- providing interim guidance (to both taxpayers and ATO compliance officers), to the extent it can, for those issues where a final position may take some time to develop.

71 Above n 68, p 34.
72 Ibid, p 35.

IMPLEMENTATION OF AGREED IGT RECOMMENDATIONS

3.6 The IGT's assessment of the implementation of these recommendations uses the same terminology set out and defined at the start of Chapter 2.

RECOMMENDATION 3 OF THE IGT'S 'U-TURNS' REVIEW

The ATO should, in collaboration with the taxpayer community, improve its framework for taxpayer engagement in developing its technical views and ensures that all staff adhere to the improved framework. The following should be incorporated into the improved framework:

i. Use the most appropriate vehicle in the circumstances to engage the taxpayer community on technical issues.

ii. Engage and be seen to be engaged impartially on matters of uncertainty and in particular, ensure that any ATO technical discussion paper has been independently reviewed by an appropriate peer in the law sub-plan before public release.

iii. Alert taxpayers to ATO compliance concerns as soon as practicable, but not in a manner that alarms them before such concerns are substantiated and ensure that its alerts are sufficiently targeted towards the issue of specific concern.

iv. Engage with taxpayers in an appropriate tone and manner, including informal engagement with the taxpayer community on issues of compliance concern before formal engagement commences.

v. In relation to any consultation process (including where any technical discussion paper is issued), develop a project plan and adhere to that plan without sacrificing the quality of process.

vi. In relation to any consultation process (including where any technical discussion paper is issued), provide interim guidance (to compliance staff as well as taxpayers) to the extent the ATO can. If it cannot, it should explain why not and give an indication of the timeframe in which it could expect to do so.

vii. Use circuit-breakers for impasses on technical issues and involve Treasury where advice regarding the purpose or object of the relevant provisions would be helpful.

viii. Ensure that delays in developing and finalising ATO technical views are minimised, and reasons are given for those delays.

3.7 The ATO agreed with this recommendation. During the follow up review, the ATO advised that it had undertaken a range of actions to implement this recommendation. The ATO's PSLA 2010/5 *Technical discussion papers*[73] adopts most of the matters outlined in Recommendation 3 while the remainder are reflected in other ATO policy and guidance documents. Table 2 below sets out the matters in Recommendation 3 together with cross-references to corresponding paragraphs in PSLA 2010/5 or relevant parts of other

73 ATO, *Technical Discussion Papers*, PSLA 2010/5, 2 December 2010.

policy and guidance documents. The IGT's conclusions on their implementation status are also set out in the table below.

Table 2: Adoption of Recommendation 3 PSLA 2010/5 and other ATO policy or guidance and the IGT's conclusion on status of implementation

Recommendation	Corresponding paragraph in PSLA 2010/5 or other ATO policy and guidance	Implementation status
3(i)	3, 5	Implemented
3(ii)	1, 18	Implemented
3(iii)	PSLA 2008/15 — Discussed further below	Implemented
3(iv)	17	Implemented
3(v)	10, 11, 12	Implemented
3(vi)	ATO public rulings program — Discussed further below	Implemented
3(vii)	ATO's Transforming Tax Technical Decision Making Project and ATO-Treasury Protocol — Discussed further below	Implemented
3(viii)	ATO public rulings program — Discussed further below	Implemented

3.8 PSLA 2010/5 requires ATO officers to consider less formal strategies to engage with the community on technical issues, while acknowledging that technical discussion papers may be used in appropriate instances.[74] Specifically, it notes that technical discussion papers may be issued:[75]

- where there is significant uncertainty as to the view or approach that the ATO should take on an issue;
- where there is a need to seek formal input on the nature of commercial arrangements relevant to the application of the law; or
- where private sector input is appropriate for the implementation of new law.

3.9 Moreover, PSLA 2010/5 also provides guidance for ATO staff when developing technical discussion papers. The guidance includes that:[76]

- Technical discussion papers must be published for the purpose of undertaking genuine community consultation and to seek open dialogue on the issue under consideration. Their content and tone should reflect these purposes. A technical discussion paper therefore should not promote a particular precedential ATO view. Where it is appropriate to outline a 'preferred' view, this should be done in an impartial manner, to make it clear that genuine community comment is sought, and to ensure discussion of alternative views.
- The particular issues on which comments are sought should be clearly expressed, and questions to the community clearly articulated.

74 Above n 73, para [3].
75 Ibid, para [4].
76 Ibid, para [17].

- The date of effect of the application of the potential precedential ATO view that may flow from the issues raised in the paper must be clearly articulated and canvassed. This might be done by proposing a date of effect and seeking comment on that date, or by simply seeking comment on what the date of effect of the potential precedential ATO view should be.

- Where it is appropriate, the particular audience from whom comments are sought can be indicated.

3.10 In addition to PSLA 2010/5, the ATO has noted that engagement with taxpayers when developing its technical views is also built into a number of other ATO policies and processes. These include the ATO's practice statement on management of high risk technical issues,[77] its Public Rulings Manual[78] and general procedural guidance on ORCLA.[79]

Recommendation 3(iii)

3.11 The ATO publishes Taxpayer Alerts to provide information on emerging compliance issues of concern and give guidance on the avenues through which taxpayers may obtain ATO advice on a particular issue.[80]

3.12 The Taxpayer Alert process is initiated where an ATO officer or an area of the ATO identifies an arrangement which may constitute aggressive tax planning. To assist ATO officers in identifying such arrangements, PSLA 2008/15 outlines a range of indicative factors and elements[81] and directs staff that 'it is **mandatory** to escalate the issue for consideration as to whether a Taxpayer Alert should be published.'[82]

3.13 Discussions concerning the appropriateness of issuing a Taxpayer Alert on the identified issue are conducted between the relevant business line representative and a senior executive from the Aggressive Tax Planning (ATP) business line. Once approved, relevant drafts of the Taxpayer Alert are provided and signed off by the ATO's Tax Counsel Network, the Deputy Commissioner in the ATP business line, the ATO Second Commissioner – Compliance and the Commissioner before publication.[83]

3.14 Given the inherent differences between issues, the period of time taken to publish a Taxpayer Alert will vary. However, the ATO has set itself an aspirational timeframe of 52 days to publish Taxpayer Alerts following a decision that the identified issue should be publicly communicated as an Alert.[84]

3.15 PSLA 2008/15 emphasises that the role of Taxpayer Alerts is to inform taxpayers and tax agents of 'new and emerging higher risk tax planning and superannuation issues'.[85] The ATO has communicated to external bodies that Taxpayer Alerts are not intended to

77 ATO, Management of high risk technical issues and engagement of officers in the Tax Counsel Network, PSLA 2012/1, 11 October 2013.
78 ATO, 'Public Rulings Manual', Above n 14, section 7.3.
79 ATO, 'Working Together and sharing information', internal ATO document, 11 April 2014; ATO, 'Engage with the Taxpayer', internal ATO document, 10 October 2013.
80 ATO, *Taxpayer Alerts*, PSLA 2008/15, 27 June 2013.
81 Ibid, para [27].
82 Ibid, para [14].
83 Ibid, para [24].
84 ATO, 'Taxpayer Alerts', internal ATO document, undated.
85 Ibid, para [7].

alarm the community.[86] Notwithstanding this, the IGT identified an example of a Taxpayer Alert which was issued after the 'U-turn' report was released which created significant levels of industry concern. Specifically, TA 2010/2 alerted taxpayers to the use clauses in superannuation trust deeds to limit contributions as an attempt to circumvent the imposition of the excess contributions tax. The alert resulted in industry concerns being raised regarding the ATO's characterisation of the arrangements and the lack of clarity on the mischief sought to be addressed.[87] The ATO subsequently withdrew the alert in response to concerns raised by stakeholders.

Recommendation 3(vii)

3.16 The ATO notes that since responding to the IGT's recommendation in 2010, a number of key events have occurred that have had an impact upon implementation of this recommendation.

3.17 First, the ATO has completed the rollout of its Transforming Tax Technical Decision Making (TTTDM) project which, in part, seeks to abolish the previous formal escalation model and adopt a model that engages ATO technical decision makers as early as practicable. The ATO has advised that 'the main benefit of the project relates to improving tax technical decision making to provide a better experience for the community and staff.'[88]

3.18 The ATO has further advised that the concept of circuit breakers is inherent within the TTTDM project. As the IGT observed in the *Review into the ATO's use of early and Alternative Dispute Resolution*, '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.'[89]

3.19 Secondly, an ATO-Treasury Protocol (the Protocol) has been established that, amongst other things, institutes quality assurance processes for new laws with the aim of fostering collaboration between the ATO, the Treasury and external stakeholders in the development and administration of new or changed tax and superannuation laws.[90] Such collaboration was envisaged in the IGT's *Review into improving the self assessment system* (the IGT's self assessment review).[91]

3.20 Circuit breakers are also contained within the Protocol. Disputes are to be escalated first to the Tax Policy Co-ordination Committee, comprising senior ATO and Treasury officials and, if they cannot be otherwise resolved, to the relevant Minister's officers.[92]

86 Taxpayers Australia, *Taxpayer alerts (not taxpayer alarms)* (9 August 2013) < http://www.taxpayersassociation.com.au>.
87 ATO, NTLG Superannuation Technical Subgroup Minutes, June 2010, item 7; Law Council of Australia, Letter to the Australian Taxation Office (1 April 2010) <www.lawcouncil.asn.au>
88 ATO, 'Talkbook Transforming Tax Technical Decision Making (TTTDM)', internal ATO document, July 2012.
89 Above n 70, p 19.
90 ATO, Treasury and the Australian Taxation Office — Tax and Superannuation Protocol (2012) Annexure A.
91 IGT, Review into improving the self assessment system (2013) pp 127-130.
92 Above n 90.

Recommendation 3(vi) and 3(viii)

3.21 In response to the Recommendations 3(vi) and 3(viii), the ATO has provided evidence of reduced timeframes for issuing public rulings as well as those instances in which it has issued interim advice.

3.22 In the Commissioner's *Annual Report 2012–13*, it was noted that the ATO had significantly improved the timeliness of its public rulings, with 86 per cent of all public rulings issuing on time,[93] being within six months for draft rulings and twelve months for final rulings. The ATO observes that this is above its targeted benchmark of 78 per cent and the 76 per cent which was achieved in 2011–12.[94] Information provided by the ATO also indicates that in 2012–13 the average number of days taken to issue a final ruling was 261 days, down from 314 in 2011–12. For draft rulings, it has advised that the average number of days taken was 158, down from 190 in 2011–12.[95]

3.23 The ATO's Public Rulings Program (which is updated monthly) outlines all rulings' planned issue dates and often provides some details on the status of the ruling including any potential delays, such as a ruling being held pending legislative change or further consultation.[96]

3.24 The ATO has provided a list of rulings which were on hand as at 30 June 2012, and remain on hand as at 14 January 2013 and noted the reasons for delays in issuing these rulings as well as any interim guidance which has been provided. In five of the eight cases, the ATO has provided interim advice by way of draft Taxation Determinations, while in the remaining cases, the ATO has noted that interim advice is not necessary as the purpose of the ruling was to change the ATO view and until the ruling is finalised, the existing ATO view continues to operate.[97]

IGT conclusion — Implemented

3.25 The ATO's PSLA 2010/5 addresses most of the matters contained in Recommendation 3, including when technical discussion papers may be used and the need to observe tone and content of such papers to promote an impartial consultation. Those matters which are not included in PSLA 2010/5, specifically Recommendations 3(iii), 3(vi), 3(vii) and 3(viii), are included in the ATO's framework for taxpayer engagement in developing its technical views in other ATO guidance mentioned above.

3.26 Accordingly, the IGT recognises that the ATO has developed an improved framework for the use of technical discussion papers when engaging with external stakeholders to develop its technical views. However, the IGT also observes that since the publication of PSLA 2010/5 in December 2010, the ATO has only made use of such papers sparingly. The IGT's investigation indicated that only one technical discussion paper was issued by the ATO in each of 2011–12[98] and 2012–13[99].

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93 Commissioner of Taxation, *Annual Report 2012-13* (2013) p 29.
94 Ibid. The ATO did not report any significant reduction in the number of public rulings issued between 2011–12 (214 public rulings issued) and 2012–13 (213 public rulings issued).
95 ATO communication to the IGT, 12 February 2014; ATO communication to the IGT, 15 February 2013.
96 ATO, *Public Rulings Program*, 12 June 2014, < https://www.ato.gov.au>
97 ATO communication to the IGT, 15 February 2013.
98 ATO, *Securitisation and TOFA*, TDP 2011/1, 31 August 2011.

3.27 The Public Rulings Program information which the ATO has provided in support of its implementation of Recommendations 3(vi) and 3(viii) does not include any public details on the interim guidance which the ATO has issued. Accordingly, while the ATO is issuing interim guidance in some cases,[100] such guidance is not readily available or accessible to taxpayers and tax practitioners. While the IGT's recommendation did not strictly require the ATO to centrally publish a list of interim guidance, the IGT considers that such a list, where linked to pending public rulings, would significantly assist taxpayers and their advisers.

3.28 It should be noted, however, that the IGT has identified some examples in which the ATO has provided interim guidance to taxpayers following significant Federal Court decisions. For example, following the decision in *MBI Properties Pty Ltd v Commissioner of Taxation*,[101] the ATO published an interim DIS to advise taxpayers that they may continue to rely on GSTR 2002/5, GSTR 2012/1 and GSTR 2012/2 until the matter is finally resolved.[102] Similar guidance was also issued by the ATO in relation to the *ATS Pacific Pty Ltd v Commissioner of Taxation*[103] and *AP Group Limited v Commissioner of Taxation*[104] cases.

3.29 In this regard, the IGT observes that the ATO has made good progress on its provision of interim guidance for taxpayers when final views are likely to be delayed. The IGT encourages the ATO to consider wider use of interim guidance in appropriate cases.

3.30 The IGT has also observed that updates and discussions of relevant pending public rulings may occur at consultation forums, such as some sub-committees of the NTLG.[105] However, during the course of this follow up review, the ATO announced a new approach to its community consultation, consisting of four liaison groups and four advisory groups.[106] These groups replaced the previous ATO consultative forums and are supplemented by technical and special focus working groups 'to consider matters that have the potential to significantly affect the community's willing participation in the tax and superannuation systems' and are established and maintained on a needs basis.[107]

3.31 Through the above streamlining process, the ATO aims to develop 'a consultative process that is responsive and agile — one that takes a holistic view of the entire interaction with people'[108] and to ensure that effective consultation is undertaken on a 'project basis rather than via static, longstanding committees.'[109] Given these new arrangements, some time will be needed to assess the effectiveness of these new forums to disseminate relevant updates and information on pending public rulings.

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99 ATO, GST treatment of recovered dishonoured payment costs, TDP 2012/1, 1 August 2012.

100 See for example ATO, Income tax: when a superannuation income stream commences and ceases, TR 2011/D3, 13 July 2011; ATO, Income tax: Employee share schemes: If a share in a 'no goodwill' professional practice company is acquired by a practitioner-shareholder (or a new practitioner-shareholder), will the Commissioner accept, for the purposes of determining whether that acquisition was at a discount within the meaning of subsection 83A-20(1) of the Income Tax Assessment Act 1997, that the goodwill of the company can be taken to have no value?, TR 2011/D9, 26 October 2011.

101 [2013] FCAFC 112.

102 ATO, *MBI Properties Pty Ltd v Commissioner of Taxation*, Interim Decision Impact Statement, 21 November 2013.

103 [2013] FCAFC 105; ATO, *AP Group Limited v Commissioner of Taxation*, Decision Impact Statement, 4 April 2014.

104 [2013] FCA 341; ATO, *ATS Pacific Pty Ltd v Commissioner of Taxation*, Interim Decision Impact Statement, 6 September 2013.

105 See for example ATO, NTLG Fringe Benefits Tax sub-committee, Minutes, 16 May 2013, item 4.

106 ATO, *ATO Consultation Framework* (12 June 2014) <http://www.ato.gov.au>.

107 Ibid; ATO, *ATO Website limited life working group* (23 October 2013) <http://www.ato.gov.au>.

108 Chris Jordan, *Tax, the way ahead* (Speech delivered to the Tax Institute 28th Annual Convention, 14 March 2013).

109 Chris Jordan, *Reinventing the ATO — building trust in Australia's tax administration* (Speech delivered at the ATAX 11th International Tax Administration Conference, 14 April 2014).

3.32 The IGT considers that with some exceptions such as the TA 2010/2 discussed above, the use of Taxpayer Alerts, as guided by PSLA 2008/15, largely aligns with the intent of Recommendation 3(iii) in providing information to taxpayers on emerging compliance issues of concern.

RECOMMENDATION 5 OF THE IGT'S 'U-TURNS' REVIEW

To reduce the timeframes elapsing between industry practices developing and the ATO becoming aware of its compliance concerns (i.e. concerns with practices that are perceived to be incorrect at law), the ATO should be more proactive in identifying areas of compliance concern as early as possible, including:

(a) supplementing existing consultative forums with technical issues forums (for example, core workshops on sensitive areas and technical discussions with externals with particular expertise in the relevant area); and

(b) in relation to developing guidance on new law, making better use of ATO and industry knowledge learned from the development of the relevant legislative provisions.

3.33 The ATO agreed with this recommendation, noting that it should be proactive in identifying areas of uncertainty or compliance risks through engagement with taxpayers and their representatives. The ATO has also advised that the Chief Tax Counsel, Deputy Chief Tax Counsel and senior technical officers continue to meet with tax practitioners and legal practitioners to discuss emerging technical issues and other matters of concern.

3.34 Furthermore, the ATO has established consultative groups with specific focus of better understanding the risks associated with taxpayer arrangements. For example, in September 2011, the ATO's Financial Products Taskforce engaged with members of the financial product industry on widely offered wholesale and retail financial products to assess the risks and to determine whether taxpayers should be alerted to certain tax features of products.[110]

3.35 The ATO has also provided a number of other examples to the IGT to illustrate its public consultation efforts and the outcomes arising from consultations with external stakeholders, including the following:

- Illegal early release of superannuation benefits by self-managed super funds (SMSF) — the ATO engaged with SMSF administrators, industry associations, the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission. Arising out of this consultation, a differentiated registrations process was established to enable the manual review of 'high risk' SMSF registrations, a new member verification service through the ATO Business Portal, a new Super Fund Look Up website to assist taxpayers determine the validity and status of an SMSF and a coordinated guidance note drafted by the ATO and issued by APRA relating to specific checks to be conducted before a rollover is progressed.

110 See for example, ATO, Structured financial products that exploit franking credits and other tax benefits, TA 2012/3, 14 June 2012.

- GST and foreign currency exchange — as a result of consultations with banking and finance industry representatives, the ATO and industry identified implications arising from the High Court's decision in *Travelex Ltd v Commissioner of Taxation*[111] and sought to address them by issuing GST Determinations[112] and addenda to existing GST Rulings.[113]

- Life insurance assets — an industry body raised concern with the ATO that the proposed application of Division 320 of the ITAA 1997 to the acquisition and disposal of assets held in segregated classes of life insurance companies may potentially be a 'U-turn' and the ATO has advised that its process will seek to address the concerns.

3.36 The ATO has also advised that it is in the process of developing a communication strategy to support the Office of the Chief Tax Counsel (OCTC) in its informal technical discussions with key external stakeholders. The current objectives and approach of the strategy include the following:

> Informal technical discussions need to be an open and candid exchange of views.
>
> We are seeking to draw out early information about taxpayer and industry practices or views that we are presently unaware of (our unknown unknowns). However, to create an appropriate environment and to encourage the external parties to speak freely, this needs to be a two way conversation.
>
> Therefore, we will also need to bring emerging issues (our known unknowns) to the discussions. The intention would be to explore these issues further in the conversations. These issues could be identified by staff from OCTC or from the Compliance business lines via technical networks, requests for curbside advice, tax clinics — or the issues may relate to the imminent implementation of new law or a public ruling.[114]

3.37 Furthermore, the ATO has developed guidelines for such discussions and noted that the purpose and approach are as follows:

> The purpose of informal technical discussions between the ATO and leading legal and accounting firms is to:
>
> - proactively identify and surface areas of emerging technical uncertainty or compliance risks to improve the timely mitigation of technical risks;
> - create an environment where stakeholders can proactively bring technical issues to the ATO's attention and engage in open discussions on such issues; and
> - gain a mutual understanding of respective positions through a candid exchange of views.[115]

The ATO also states:

> For the discussions to achieve the stated objectives, two way conversations are required where participants feel free to raise issues and explore them by openly contributing to the discussion. To enable an open exchange of views, the conversations should operate under the following principles / mutual expectations:

111 [2010] HCA 33.
112 ATO, Acquisition-supply in Travelex Scenario, GSTD 2012/5, 6 June 2012.
113 See for example, ATO, Goods and services tax: GST treatment of financial supplies and related supplies and acquisitions, GSTR 2002/2A6, 16 May 2012; ATO, Goods and services tax: supply of rights for use outside Australia — subsection 38-190(1), item 4, paragraph (a) and subsection 38-190(2), GSTR 2003/8A2, 21 December 2011.
114 ATO, 'Draft Communication Strategy', internal ATO document, 21 September 2012
115 ATO, 'Guidelines for informal technical discussions', internal ATO document, September 2012, p 1.

- minutes are not taken;
- issues raised or comments made are not attributed to individuals;
- individual taxpayer details are not disclosed; and
- information arising from the discussions can be used for further exploration but should not be attributed or taken as formal organisational views.[116]

3.38 The ATO has advised the strategy will be reviewed to assess the effectiveness and ongoing viability.

3.39 Lastly, the ATO Law and Practice business line's 2012–13 Line Plan,[117] emphasises the need for ongoing active early engagement with the Treasury, practitioners and the community generally in identifying and advising on areas of uncertainty or areas of the law which were not operating as intended or with which compliance may be difficult.[118]

IGT conclusion — Implemented

3.40 Recommendation 5, which deals with effective early identification and response to areas of uncertainty and risks, is critical in addressing stakeholders' concern with the ATO's risk-based approach to compliance. Generally speaking, the approach seeks to target the ATO's available resources to those areas involving the greatest perceived risk to revenue and results in lower risk cases having a lighter touch. However, these taxpayers may be exposed to potential adverse ATO views, with retrospective effect, where the ATO recalibrates its view of certain risks in later years, such as where lower risk cases accumulate to form a higher risk.[119]

3.41 In addressing Recommendation 5(a), the ATO has provided details regarding its approach to informal technical discussions with external stakeholders which emphasises proactive identification of emerging technical issues and areas of uncertainty. The ATO has also provided material to the IGT that demonstrates positive outcomes emerging from the implementation of this recommendation.

3.42 Accordingly, the IGT considers that Recommendation 5(a) is implemented, noting that due to the ATO's recent restructured consultation arrangements, referred to earlier, it is too early to assess whether these arrangements will result in earlier and better identification of areas of uncertainty and compliance risks.

3.43 With respect to Recommendation 5(b), the IGT considers that this recommendation is now incorporated within the broader recommendation 2.3 of the subsequent IGT's self assessment review which provides: [120]

> Where the tripartite tax law design teams consider that certain details are more effectively addressed in ATO public binding advice (see recommendation 5.1), the Government should consider requiring the ATO to synchronise its public binding advice with the enactment of substantial new tax law. Whether any particular new tax law requires synchronised ATO public binding advice, and what matters such advice must cover, should be subject of consultation on the development of that law. After enactment of the new laws, the advice

116 Ibid.
117 The Law and Practice business line is now Review and Dispute Resolution.
118 ATO, *Law and Practice Line Plan 2012-13* (2013) internal ATO document, pp 1, 3 and 4.
119 IGT, Annual Report 2004–05 (2005) p 6.
120 Above n 91, p 40.

should be monitored and where necessary updated with those changes having prospective effect.

3.44 The then Government agreed in principle to this recommendation and noted that: [121]

> The Government is committed to improving the level of interaction between Government and stakeholders. As part of this commitment, Treasury with the ATO, is continuing to undertake work in the areas of law development, consultation and communication with stakeholders.
>
> As part of the Government's commitment to continually improve its consultation processes, the Government has adopted a tailored consultation approach for tax issues. In this regard, where matters are new and complex or entail major reforms, early ATO involvement in all relevant processes so that it can synchronise the development of its advice will enhance certainty for the community.

3.45 Furthermore, on 10 October 2013 the ATO published PSLA 2013/4 *The ATO's role in tax law design and expressing ATO views as part of the law design process* (PSLA 2013/4) to outline its role in the tax law design process.[122] While PSLA 2013/4 notes that the ATO cannot provide binding advice on legal interpretation until after enactment[123] it will provide 'advice to Treasury on the administrative and interpretative aspects of proposed tax laws.'[124] Specifically, staff are instructed that they 'can, and should, provide preliminary views about how the ATO would interpret the draft law.'[125]

3.46 The ATO's early consideration of administrative and interpretative issues through consultation as part of the design process aligns with Recommendation 5(b) and recommendation 2.3 in the IGT's self assessment review such that early consideration should enable the ATO to develop and provide binding advice in a timely manner. Accordingly, the IGT considers that the ATO has implemented Recommendation 5(b).

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121 David Bradbury, *Inspector-General of Taxation review into improving the self assessment system*, Media Release 13 February 2013, <assistant.treasuer.gov.au>.

122 ATO, The ATO's role in tax law design and expressing ATO views as part of the law design process, PSLA 2013/4, 10 April 2014.

123 Ibid, para [20]; ATO, The ATO role in providing information or advice on the potential application of announced changes to the tax law, or where legislative change is contemplated but not announced, PSLA 2004/6, 2 July 2012.

124 Above n 122, para [11].

125 Ibid, para [18].

APPENDIX 1 — STAKEHOLDER EXAMPLES OF POTENTIAL 'U-TURNS'

Number	Issue	Summary
1	Sub-section 73B(1) of the ITAA 1936 — Certain expenditure on research and development activities [now repealed] ATO ID 2012/5: Income Tax: Research and Development: Building Expenditure	Stakeholders are of the view that the ATO's prior practice, as illustrated in a letter from the ATO to a taxpayer, was that expenses incurred in the acquisition or construction of a building for research and development purposes was deductible pursuant to subsection 73B(1) of the ITAA 1936. However, in a subsequent view set out in ATOID 2012/5, the ATO has outlined its view that such expenditure was not deductible and is excluded under subsection 73B(1) of the ITAA 1936. Stakeholders allege that this represents a 'U-turn' from prior practice and the ATO has not had due regard to PSLA 2011/27. The stakeholder has provided the IGT with a copy of a letter issued by the ATO to a taxpayer referred to above. The stakeholder informs the IGT that it is continuing to engage with the ATO on this issue, and will be formally requesting the matter be investigated as a potential 'U-turn' having regard to the letter.
2	Section 121EF of the ITAA 1936 — Definitions relating to allowable deductions of an OBU	Stakeholders consider that the ATO has performed a 'U-turn' on whether taxpayers are able to substitute alternate expense allocation methodologies in respect of general OBU expenses in place of the statutory formula in section 121EF(4) of the ITAA 1936. Stakeholders contend that the prior ATO view was that alternate methodologies which yielded reasonable outcomes were acceptable. This was subsequently changed following advice from the ATO's Tax Counsel Network that the law did not allow for any alternative methodologies and that the statutory formula in sub-section 121EF(4) must be used. This was the basis of the case study discussed in Chapter 2 of this report.
3	Subdivision 124-H of the ITAA 1997 — Exchange of units in a unit trust for shares in a company Two successive CGT rollovers	The issues concerned whether the ATO should apply Part IVA to transactions involving two successive CGT rollovers which results in the taxpayer achieving a tax deferral. The IGT was informed that such transactions were routine and the ATO had been aware of this fact for many years. Moreover, the IGT was referred to pointed to a number of private rulings which dealt with similar (though not identical arrangements) in which Part IVA was not applied. As such, it was contended that the ATO's application of Part IVA to their transaction represents a U-turn from prior practice. The IGT sought additional information from the ATO on this issue and noted that an early draft risk assessment report suggested that the ATO was aware of transactions of this kind and had been 'tacitly approved' in some instances. The IGT notes that prior private rulings did not specifically rule on the application of Part IVA in those cases. Accordingly, while the additional information received from the ATO suggested that it may be aware of these issues, it was not determinative that the ATO had committed a 'U-turn' by seeking to apply Part IVA to certain transactions.
4	The application of section Part IVA of the ITAA 1997 to securities and products issued under Division 974 of the ITAA 1997	Stakeholders advised the IGT that previously the ATO had issued a series of private rulings confirming that it would not apply Part IVA to certain securities and products issued by the taxpayer pursuant to Division 974. The stakeholder contends that in more recent transactions, the ATO had performed a 'U-turn' by attempting to apply Part IVA to similar securities and products in direct contravention to prior private rulings. The stakeholder used this case study to highlight perceived deficiencies in the ATO's research pursuant to PSLA 2011/27 and noted that the matter had already been escalated and resolved.
5	ATOID 2012/31 — Income Tax Thin Capitalisation: exemption — certain special purpose entities [Withdrawn] Draft Taxation Determination (TD) 2012/D11 — Income tax: does sub-section 820-39(3) of the *Income Tax Assessment Act 1997* only	The ATO had previously, through a series of private binding rulings, confirmed that certain special purpose entities and insolvency-remote special purpose entities are exempt from the thin capitalisation rules in Division 820 of the ITAA 1997 by virtue of the operation of section 820-39 of the ITAA 1997. However, stakeholders contend that the ATO's narrow interpretation that the only entities which qualify for exemption under section 820-39 of the ITAA 1997 are special purpose entities that have been established for the purpose of carrying on securitisation activity represents a 'U-turn' from prior

Number	Issue	Summary
	apply to special purpose entities that have been established for the purpose of carrying on securitisation activity? [Withdrawn]	practice and the position in earlier private rulings. The IGT notes that both ATOID 2012/31 and draft TD 2012/D11 have been withdrawn.
6	Draft GSTR 2013/D2 — Goods and services tax: supplies made by an operator of a 'moveable home estate' [Withdrawn]	Stakeholders advised the IGT that the prior ATO view was that mobile home parks (or moveable home estates) were 'commercial residential' premises and therefore operators of such parks had access to GST concessions. The ATO changed its view in draft GSTR 2013/D2 to no longer consider mobile home parks to be 'commercial residential' premises and therefore, operators would no longer have access to GST concessions previously available. Following feedback received through community submissions, as well as comments from a number of members of Parliament, the ATO has withdrawn the draft ruling and, accordingly, the prior position remains in force.
7	Draft TR 2014/D1 — Income tax: employee remuneration trust (ERT) arrangements	Stakeholders allege that the ATO's position that employers may only deduct contributions made to employee remuneration trusts where the employee disposes their shares within a period of five years is a 'U-turn' where previously no such timeframe was imposed. The draft ruling states, at paragraph 163, that 'the Commissioner has issued a large body of private rulings in the past which evidence a more favourable prior GAP in respect of the deductibility to employers of contributions made to the trustee of an ERT than some of the views contained in this draft Ruling. Accordingly, the Commissioner will not undertake compliance activities to apply the views expressed in this draft Ruling in this regard to those contributions made prior to this draft Ruling issuing that would have been accepted as being deductible under this prior practice. However, if the Commissioner is asked or required to state a view (for example in a private ruling or in submissions in a litigation matter), the Commissioner will do so consistently with the views set out in this draft Ruling.' The ATO's recognition of a prior GAP is consistent with the intent and application of PSLA 2011/27 for the Commissioner to not take compliance action in prior years against taxpayers who have relied upon the GAP.
8	Section 109J of the ITAA 1936 — Payments discharging pecuniary obligations not treated as dividends Draft TR 2013/D6 — Income tax: matrimonial property proceedings and payments of money or transfers of property by a private company to a shareholder (or their associate)	The issue is whether monies paid, or property transferred, pursuant to section 79 of the *Family Law Act 1975* is exempt from the operation of Division 7A (as payments of dividends) by operation of section 109J. The ATO considers that where such a payment or transfer is effected to the shareholder of a private company, this forms part of the shareholder's assessable income under section 44 of the ITAA 1936. Similarly, where the payment or transfer is made to an associate of the shareholder, this is considered to be a payment for the purposes of sub-section 109C(3) of the ITAA 1936. Stakeholders allege that the ATO's view in draft TR 2013/D6 that such payments are not 'arm's length' is directly contrary to the view it had expressed previously in a series of private rulings. The ATO recognises the prior practice. At paragraphs 37 and 38 of the draft ruling, the ATO recognises the existence of a prior general administrative practice contrary to the view stated in the draft ruling. Accordingly, it notes: 'ATO Interpretative Decision ATO ID 2004/462 correctly explains that section 109J of the ITAA 1936 will only apply to prevent a payment by a private company giving rise to a deemed dividend under section 109C of the ITAA 1936 where, amongst other things, that payment discharges an obligation of the private company. The ATO ID explains that no relevant obligation can arise as a result of an order under section 79 of the FLA 1975, where that order does not bind the private company (for example, where the private company is not a party to the relevant proceedings). The ATO ID is silent on the role of section 109J of the ITAA 1936 where orders under section 79 of the FLA 1975 do bind the private company (as can now be the case). A significant body of private rulings issued subsequent to this ATO ID have proceeded on the basis that an order made under section 79 of the FLA 1975 which does give rise to an obligation for a private company to pay money to an associate of a shareholder, will attract the protection of section 109J of the ITAA 1936.' … 'The body of private rulings referred to in paragraph 37 of this draft Ruling evidence a prior general administrative practice contrary to the view, set out in paragraph 6 of this draft Ruling that orders made (directly) to a private company under section 79 of the FLA 1975, to pay money to an associate of a shareholder of that company, will result in a deemed dividend arising under Division 7A. Example 5 (at paragraphs 20 to 23 of this draft Ruling) goes on to illustrate that view. In any case where the view set out in paragraph 6 and/or Example 5 of this draft Ruling is less favourable to a taxpayer than the

Number	Issue	Summary
		Commissioner's previous practice in respect of such orders against a private company, the Commissioner proposes not to undertake active compliance activities so as to apply that view in respect of any such orders made before the date the final Ruling is issued. However, if the Commissioner is asked or required to state a view in respect of such orders (for example in a private ruling or in submissions in a litigation matter), the Commissioner will do so consistent with the views set out in this draft Ruling (including paragraph 6).' The ATO's recognition of a prior GAP and the ATO's decision not to take any active compliance activity to apply the new view to past years is consistent with the approach set out in PSLA 2011/27.
9	Draft TR 2014/D2 — Income tax: the application of the foreign income tax offset limit under section 770-75 of the ITAA 1997 to foreign currency hedging transactions	The Commissioner's view that the source of foreign currency hedging gains for income tax purposes is where the contract is formed represents a potential 'U-turn' from prior advice in some private rulings that the source of these gains is where essential decisions giving rise to the gain are made. The ATO has recognised these contrary views and at paragraph 52 of the draft ruling states "in view of the fact that some private rulings expressing contrary views to those in this draft Ruling have been made in respect of the issue of the source of foreign currency hedging gains, submissions are sought on whether the final Ruling should apply only from a certain date, and, if so, what that date should be." The ATO's research which identified prior ATO advice with a contrary view is consistent with the intent and purpose for which PSLA 2011/27 was developed.
10	Miscellaneous	A number of other issues were also raised with the IGT as having the potential to become 'U-turns' but stakeholders who raised those issues noted that the ATO had not yet undertaken any action to change earlier published advice. Accordingly, the IGT did not investigate these issues. For completeness, these are set out below: - concern was expressed that the ATO may performing a 'U-turn' on its position as set out in TR 95/36 — *Income tax: characterisation of expenditure incurred in establishing and extending a mine*; - concern was expressed that the ATO may performing a 'U-turn' on its position as set out in TR 98/23 — *Income tax: mining exploration and prospecting expenditure*; - a stakeholder posited that the ATO could perform a 'U-turn' and apply section 99B of the ITAA 1936 more broadly beyond non-resident trusts (this example was raised by the stakeholder as a hypothetical scenario only); - the types of acquisitions that qualify as exploration deductions under section 40-80 of the ITAA 1997 and whether this may change in light of the decision in *Mitsui & Co (Australia) Ltd v Commissioner of Taxation* [2012] FCAFC 109; - the then proposed Division 36 to the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) and the now enacted Division 142 GST Act to replace section 105-65 of Schedule 1 to the *Taxation Administration Act 1953* were considered by some stakeholders to be 'U-turns'. However, this issue turns on legislative change and not ATO action and therefore falls outside the scope of PSLA 2011/27; and - stakeholders raised concern that the ATO appeared to be seeking to re-litigate matters relating to inter-branch funds transfers, matters of which are currently dealt with by taxation ruling TR 2005/11: *Income tax: branch funding for multinational banks.*

APPENDIX 2 — ATO RESPONSE

Australian Government
Australian Taxation Office

Second Commissioner of Taxation

Mr Ali Noroozi
Inspector-General of Taxation
GPO Box 551
SYDNEY NSW 2001

Dear Ali

Follow up review into the ATO's implementation of agreed recommendations included in the review into delayed or changed ATO views on significant issues

Thank you for the opportunity to comment on the final draft of your report on the follow up review into the ATO's implementation of agreed recommendations included in the review into delayed or changed ATO views on significant issues.

Following discussions with your office, we agree with both recommendations 2.1 and 2.2 and welcome your feedback on the implementation of recommendations from the 2010 report.

I would like to acknowledge the efforts of everyone involved in undertaking this follow-up review.

If you require further information on our response, please contact Jonathan Woodger [redacted]

Yours sincerely

Andrew Mills
Second Commissioner
Australian Taxation Office

9 July 2014

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