Australian Government

Inspector-General of Taxation

Review into improving the self assessment system

A report to the Assistant Treasurer

Inspector-General of Taxation

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24 August 2012

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

Dear Minister

Review into Improving the Self Assessment System

I am pleased to present my report of the review into improving aspects of the income tax self assessment system.

This review arose largely due to an emerging global trend amongst revenue agencies to bring compliance activities forward and, in some cases, prior to lodgement of returns. It seems that the pendulum is swinging back from pure self assessment to a quasi-full assessment system, without many of the perceived benefits of the former regime. The review has focused on areas in need of most attention which were highlighted by a wide range of individual and business taxpayers, tax practitioners and their representative bodies.

Overall, I have made 33 recommendations directed at improving taxpayer certainty, reducing compliance costs and rebalancing taxpayer protections. Almost half of these are directed to the Government whilst the remainder are directed to the ATO.

A key area identified for improvement, amongst others, is the augmentation of existing public consultation processes with tripartite tax law design teams (comprising ATO and Treasury senior officials as well as paid external tax experts) who are engaged to provide advice on the proposed tax law, relevant explanatory memoranda and the nature and timing of ATO advice.

I have also made recommendations relating to key features of the current self assessment regime including, the penalties and interest regime, the Commissioner's administrative discretion, amendments periods and the ATO's advice framework.

The ATO has agreed, either in full, in part or in principle, with the vast majority of the recommendations made to it. The main disagreement, relating to declaring e-tax and a reinstated TaxPack as public rulings, gives rise to uncertainty particularly for individual taxpayers.

I offer my thanks to taxpayers, tax practitioners and their representative bodies for their time in preparing submissions and discussing issues with myself and my staff. I also thank the ATO and Treasury officers for their professional cooperation and assistance.

Yours faithfully

Ali Noroozi
Inspector General of Taxation

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EXECUTIVE SUMMARY

The Inspector-General of Taxation's (IGT) review into improving aspects of the income tax self assessment system arose from stakeholder concerns that recent administrative practices have swung the pendulum from a pure self assessment system back towards a quasi-full assessment system, without any of the previous benefits available from the former regime and with increased taxpayer costs. The areas in need of most attention were highlighted by a wide range of taxpayers, tax practitioners and their representative bodies. These areas included:

- the advice framework;
- the ATO's compliance approach regarding recent administrative requirements;
- the penalty and interest regimes; and
- tax law complexity and the ability to administer the law in a pragmatic manner.

Advice framework — Notwithstanding the outcome of previous reviews of the ATO's advice framework, taxpayers and their advisers claimed that they continued to experience examples of unnecessary delays, costs, perceived lack of sufficient objectivity and continuing uncertainty. The ATO faces considerable challenges in providing taxpayers with practical certainty on a timely basis. There is also a question as to whether the amount of binding advice produced is sufficient or provided in the areas of most need.

To address the above concerns, the IGT has made a range of recommendations including that the ATO be required to synchronise its advice with the enactment of substantial new laws and monitor that advice more closely following those laws' enactment. A number of other recommendations in this area are aimed at improving the provision of public binding advice, such as tailoring the scope of ATO public rulings to improve timeliness, improving issue identification for the public rulings program and providing a certain level of protection to taxpayers where there is no ATO advice or ATO guidance. A particular recommendation is directed at expanding the scope of protection afforded to e-tax and a reinstated TaxPack.

ATO compliance approaches — The IGT observed that the recent ATO risk based approach to compliance is aligned with broader international trends, particularly those aimed at shifting compliance activities upstream to address risks earlier. Such approaches raised the issue of whether ATO practices may be improved in order to reduce compliance costs and rebalance taxpayer protections without significantly affecting Government revenue.

In this respect, the IGT has made a number of recommendations aimed at addressing the impacts of its risk differentiation compliance approach including the reduction of costs arising from ATO information requests. The IGT has also recommended that taxpayer certainty can be improved by adjusting certain statutory periods of review such as:

- shortening the periods of review for micro and small businesses with relatively low annual turnovers; and
- reducing the periods of review for transfer pricing claims and losses.

A number of other areas for improvement in this area relate to specific ATO compliance activities, such as improving the delivery of Annual Compliance Arrangements and the transparency of pre-lodgement compliance reviews.

Penalties and interest regimes—These regimes were intended for a pure self-assessment model and require reconsideration in the light of recent changes to ATO compliance approaches. In this respect, the IGT has made a number of recommendations to Government for it to consider a number of matters, including that:

- the reasonably arguable position (RAP) penalty threshold be raised to $100,000 to relieve smaller taxpayers from incurring disproportionate compliance costs;
- the onus of proof for RAP penalties be placed on the ATO to impose a greater level of accountability for ATO penalty decisions; and
- interest be capped for ATO delays in the compliance assurance processes.

The IGT has also observed that significant numbers of unsustainable penalty decisions may have arisen because of a lack of ATO compliance officer discipline in dealing with evidentiary matters for the rate of penalty sought to be imposed. Recommendations for improvement have been made in other reviews in this regard and the ATO's administration of penalties more generally may be the subject of a future IGT review.

Tax law complexity and administering the law in a practical manner —Taxpayers face complexity arising from tax legislation, as well as the way that legislation is interpreted and administered by the ATO. As such, the ATO has a crucial role in developing the legislation that gives effect to policy and administering it in a practical manner that reduces costs and risks borne by taxpayers without significantly increasing the risk to the revenue.

In this respect, the IGT has recommended the augmentation of existing public consultation processes with tripartite tax law design teams, comprising ATO and Treasury senior officials as well as paid external tax experts, who are engaged to provide advice on the proposed law, relevant explanatory memoranda and the nature and timing of ATO advice.

The IGT is also of the view that there is merit in considering whether the Commissioner of Taxation's administrative discretion should be improved to facilitate relief to taxpayers facing unintended, anomalous, inequitable or impractical outcomes. Accordingly, The IGT has recommended that the Government consider providing the Commissioner with the power to not take compliance action in such circumstances for a period of three years whilst the Government takes any corrective action.

Overall, the report makes 33 recommendations directed at improving taxpayer certainty, reducing compliance costs and rebalancing taxpayer protections. Almost half of these recommendations are directed towards Government whilst the remainder are aimed at the ATO. The ATO has agreed, either in full, in part or in principle, with almost all the recommendations directed to it. The main disagreement relates to e-tax and a reinstated TaxPack having the status of a public ruling.

CHAPTER 1 — BACKGROUND

CONDUCT OF REVIEW

1.1 This report, the Inspector-General of Taxation's (IGT) review into improving the self assessment system, is produced pursuant to section 10 of the *Inspector-General of Taxation Act 2003* (the IGT Act 2003). In accordance with section 25 of the IGT Act 2003, the Commissioner of Taxation was provided with an opportunity to give submissions on any implied or actual criticisms contained in this report.

1.2 The review arose following concerns raised with the IGT by taxpayers, tax practitioners and their representatives. Generally these concerns focussed on taxpayers' ability to operate in an environment of ever-increasing tax complexity and risks. Whilst the benefits of the self assessment system were recognised, issues were raised with increasing costs of compliance with no abatement in the level of uncertainty.

1.3 The IGT started this review pursuant to subsection 8(1) of the IGT Act 2003 and announced terms of reference on 16 June 2011 (a copy is reproduced in Appendix 1). The IGT received a significant number of written submissions and also met with taxpayers, tax practitioners and their representative bodies to better understand the issues covered by this review.

1.4 Particular areas of focus were reviewed in more detail and discussed with key Australian Taxation Office (ATO) and Treasury staff.

1.5 It should be noted that Treasury undertook a detailed examination of the self assessment regime in 2004 (ROSA review)[1] and made significant recommendations to the Government and the ATO for improvements to the system. Overall, representations to this review expressed broad agreement with the overall aims of the ROSA review. However, many indicated that there was room for further improvement and questioned whether a number of the recommendations were implemented as intended. In particular, a number of issues were raised in relation to:

- the ATO's recent administration of the advice framework, such as whether the amount of binding advice produced was sufficient or provided in the areas of most need, whether ATO responses to adverse tribunal and judicial decisions provided sufficient clarity and whether taxpayers faced significant obstacles that hindered them in obtaining certainty about their tax risks in a timely and cost-effective manner;

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[1] See The Treasury (Cth), *Report on Aspects of Income Tax Self Assessment* (2004).

- the ATO's approach regarding recent administrative requirements, such as expanded returns with additional disclosure requirements and whether some of the ATO approaches were shifting the pendulum towards a quasi-full assessment system entailing increased taxpayer costs without any apparent commensurate reduction in risk; and

- the ATO's ability to administer the law in a practical manner that reduces costs and risks borne by taxpayers without significantly increasing the risk to the revenue.

1.6 During the review, the IGT established a working group comprising key tax practitioners and representatives. The participants were: Mark Bradford (Qantas), Michael Johnston (Consolidated Press Holdings Limited and the Group of 100), Alf Capito (Ernst & Young), Teresa Dyson (Law Council of Australia), Matthew Hayes (KPMG), Andrew Mills (Greenwood & Freehills), Professor Richard Vann (University of Sydney), Frank Brass (H&R Block), Darren Day (Woolworths), Chris Millett (Commonwealth Bank), Peter Poulous (Maddocks), Carlo Moretti (PKF Chartered Accountants and Business Advisers), Paul Suppree (BHP Billiton), as well as the ATO team led by Bruce Quigley, Second Commissioner—Compliance.

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

1.8 The working group met several times to identify and develop potential solutions to the systemic issues falling within the scope of this review. It should be noted, however, that the views and recommendations expressed in this report are not necessarily those of individual members of the working group. The views and recommendations were finalised by the IGT after much deliberation and based on input received from all stakeholders, including the ATO and Treasury.

1.9 In this report, the IGT has not discussed every aspect of the self assessment system. The focus has been on areas of most concern raised by stakeholders and those solutions most likely to provide the most benefit.

STRUCTURE OF REPORT

1.10 The report is divided into five main chapters.

1.11 Chapter 2 discusses the advice framework with particular focus on the ATO's role within Australia's system of self assessment and explores improvements which can be made.

1.12 Chapter 3 considers a number of specific aspects of the ATO's compliance assurance function. In particular, the chapter considers the impact of the ATO's recent trend of obtaining more information before or at the time of lodgement.

1.13 Compliance assurance can result in adjustments to tax liabilities, with the potential for added penalties and interest. Chapter 4 discusses the various issues raised

by submissions, particularly those in relation to the no reasonably arguable position and lack of reasonable care penalties.

1.14 Underlying the advice framework and the ATO's compliance assurance role is the complexity of the tax system itself. Factors which can affect this complexity include: the processes used in designing the law, measures aimed at the care and maintenance of that law, as well as the Commissioner's discretions. These issues are discussed in chapter 5.

1.15 Finally, the report outlines the recommendations arising from Treasury's ROSA review. It sets out the ATO's governance framework for their implementation and the ATO's progress towards that goal. The chapter also briefly refers to the IGT's submission to the Government's Tax Forum in relation to a proposed ATO appeals and review function.

CHAPTER 2 — ADVICE FRAMEWORK

BACKGROUND

2.1 The introduction of the self assessment system transferred to taxpayers the responsibility of applying the tax laws to their affairs. Under this system, an incorrect application of the law results in taxpayers being exposed to additional primary tax, penalties and interest. As such, the system relies on taxpayers having a good understanding of the tax laws so that they can fulfil this responsibility and avoid the potential adverse consequences.[2]

2.2 A key feature of the self assessment system is that it empowers the ATO to check taxpayers' application of the law to their affairs post-assessment and to retroactively amend their returns. As a result, taxpayers are compelled to accurately anticipate ATO views :

> [T]axpayers are more reliant upon the Tax Office to provide summarised, understandable statements that taxpayers may rely upon. In a system of self-assessment taxpayers expect that these statements will be timely, accurate and objective acknowledging court and tribunal decisions.[3]

2.3 Over time, the tax laws have also become increasing complex. This may be for a number of reasons, including as a response to increasingly complex business and personal affairs. As this complexity increases, taxpayers find it more difficult to ascertain how the tax laws apply to their affairs. Therefore, taxpayers may, at their own cost, seek the services of tax professionals to assist them.[4] However, there may also be circumstances in which advisers also consider it difficult to ascertain how the tax laws apply.

2.4 It is, therefore not surprising that the advent of the self assessment systems has led to the need for revenue authorities to play a stronger advisory role to support of taxpayers. The ATO can also influence or encourage compliance through its advice and therefore minimise the risk to revenue.

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[2] Peter White and Michael Walpole, 'Tax Forum: Manoeuvring the Maze — Self Assessment Post ROSA' (Paper presented at the Taxation Institute of Australia NSW Division, Sydney, 25 May 2007) p 4.

[3] David R Vos and Tasos Mihail, 'The Importance of Certainty and Fairness in a Self-Assessing Environment' (Speech delivered at the 7th International Tax Administration Conference, Coogee, 20–21 April 2006).

[4] Ern Chen Loo, Margaret McKerchar and Ann Hansford, 'An International Comparative Analysis of Self Assessment: What Lessons are there for Tax Administrators?' (2005) 20(4) *Australian Tax Forum* 669, p 696.

The ATO's advisory role

2.5 The ATO has no general legal obligation to assist taxpayers in understanding their responsibilities under the tax laws.[5] However, as already mentioned, many consider that the ATO should help taxpayers to make it as easy as possible to comply[6] as this engenders an environment conducive to high levels of compliance.[7] Some also consider that taxpayers have the right to know the manner in which the tax laws will be applied.[8]

2.6 The ATO itself understands the importance of this role and has committed to it in its *Taxpayers' Charter*:

> You can expect us to: …
>
> Help you to get things right …
>
> We aim to provide accurate, consistent and clear information to help you understand your rights and entitlements and meet your obligations.[9]

2.7 The ATO has previously expressed the aspiration to be a 'trusted authority on the law [and a] professional adviser and educator, ensuring that people have the information and support needed to meet their obligations under the law'.[10] More recently, however, the ATO has expressed its goal in terms of assisting taxpayers to understand their rights and responsibilities and enable them to fulfil their obligations easily at minimal cost. [11] In this respect:

> [the ATO] foresees a future where:
>
> - People are more engaged and willing to participate if they know what is expected of them and they are able to do this easily at minimum cost.
> - People are more likely to participate where they can obtain assistance and guidance on how they should participate. Practical assistance and ease of compliance often go hand in hand.[12]

2.8 Thus, the link between high levels of compliance with the tax laws and administrative assistance that is user-centric is strongly reflected in ATO material.

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[5] Provisions do exist in the *Taxation Administration Act 1953* to require the Commissioner to provide certain specific kinds of ATO advice in certain circumstances, such as those provisions relating to private rulings and oral rulings.

[6] See for example, Australia's Future Tax System (Ken Henry, chairperson), The Treasury (Cth), *Final Report*, (2009) Part 2 vol 2 p 649 <www.taxreview.treasury.gov.au>; Michael D'Ascenzo, 'Self Assessment: Priority Tasks (Speech delivered at the Joint Seminar of ATO/Institute of Chartered Accountants and Society of CPAs (ACT Division), 17 September 1991) <www.ato.gov.au>; see also, Joint Committee of Public Accounts and Audit, *Report 410 – Tax Administration* (2008) pp 98–99.

[7] Australia's Future Tax System, above n 6, part 2 vol 2 p 652.

[8] The Treasury, above n 1, p 23.

[9] Australian Taxation Office, *Taxpayers' Charter – What You Need to Know* (2010) pp 1, 9.

[10] Australian Taxation Office, *Strategic Statement 2003-05* (25 February 2005) <www.ato.gov.au>.

[11] Australian Taxation Office, *Strategic Statement 2010–15* (May 2011) <www.ato.gov.au>.

[12] Australian Taxation Office, *Making a Difference - The Intent Behind our Strategic statement 2010-15* (2010) p 6.

2.9 In furtherance of this user-centric objective, the ATO publishes a wide range of material, from highly technical legal analyses through to simple procedural step-by-step guidelines. An inclusive list of the different types of material is set out in appendix 3.

Two different levels of taxpayer protection

2.10 In terms of the extent to which ATO information can be relied upon, the tax laws provide varying levels of protection for ATO information that is incorrect or misleading and leads to an incorrect application of the law.[13]

2.11 Generally, there are two levels of protection:

- protection from additional primary tax, penalties and interest; and
- protection from penalties and interest.

2.12 The level of protection applicable in any particular case depends upon:

- the type of ATO information issued or provided;
- the tax laws under which it relates; and
- the reason for the taxpayer's mistake.

Two general types of ATO information

2.13 The ATO categorises all of its information as either 'advice' or 'guidance'.

2.14 'ATO advice' is the ATO's opinion on the application of the law and is generally provided in the form of public, private and oral rulings.[14] Taxpayers are protected from additional primary tax, penalties and interest if they rely on such advice which may ultimately prove to be incorrect. In this way, it binds the ATO to that opinion. Effectively, binding advice allocates the risk of incorrect advice to the Government in return for taxpayer compliance with the ATO's opinion of the law.

2.15 A distinction needs to be drawn between ATO advice that is legally binding and ATO advice that is administratively binding. In the case of the former, it is the law that precludes the ATO from applying a view inconsistent with the legally binding advice. Whilst, in the case of the latter, it is the ATO who commits to not apply a view that is inconsistent with administratively binding advice. Although the ATO

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[13] Australian Taxation Office, *Taxpayers' Charter - Helping You to Get Things Right* (30 June 2010) <www.ato.gov.au>.

[14] Australian Taxation Office, *Taxation Treatment of Expenditure on Low Cost Items for Taxpayers Carrying On a Business*, PS LA 2008/3, 22 December 2011, para [12] <www.ato.gov.au>.

mayconsider itself bound, there have been instances where the ATO has argued publicly against administratively binding advice in litigation.[15]

2.16 The other category of ATO information is 'ATO guidance' which is provided to help taxpayers understand their obligations under the tax laws[16] — for example, fact sheets, calculators and brochures. However, taxpayers will not be protected from additional primary tax if the ATO guidance proves to be incorrect. In this sense it is not binding on the ATO. In contrast to ATO binding advice, taxpayers following non-binding ATO guidance effectively accept a greater portion of the risk of the adverse impacts of relying on incorrect ATO guidance.

2.17 Depending of the type of guidance, however, the tax laws may afford protection from penalties and interest, such as the ATO's law administrative practice statements and ATO interpretative decisions.[17]

2.18 There are also a number of ATO publications where no protection is offered under the existing advice framework — for example, edited versions of private binding rulings.

2.19 Appendix 3 reproduces part of the ATO's Practice Statement, *PSLA 2008/3*, which sets out the types of ATO information and the level of protection afforded.

Binding ATO advice is the ATO's view of the law, not the law

2.20 Binding ATO advice is the ATO's interpretation of the law and not the law. They assist the taxpayer to understand how the ATO considers the law applies.

2.21 It should be noted that the risks that taxpayers face are not only those in correctly applying the law. Taxpayers also face the risk of the administrator enforcing a different tax outcome to that expected. If taxpayers are to minimise this risk, they need to know the ATO's view of interpretational issues. In this sense, binding ATO advice provides taxpayers with a means for minimising this risk.

Main features of the current ATO advice system

2.22 The current ATO advice framework has a number of desirable features.

2.23 First, public, private and oral rulings can protect taxpayers from additional primary tax, penalties and interest, even if the ATO ruling is wrong. This provides taxpayers with certainty of the ATO's treatment of issues.

2.24 Second, the ATO view in private rulings can be subject to external review. However, this right may not provide a taxpayer with certainty of the ATO's treatment

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[15] See Michael Dirkis and Brett Bondfield, 'ROSA's Last Gasp: The Final Steps in Self Assessment's 21 Year Journey?' (2008) 3(2) *Journal of the Australasian Tax Teachers' Association* 202, p 204; *Bellinz Pty Ltd v FCT* (1998) 39 ATR 198.

[16] Australian Taxation Office, above n 14.

[17] Ibid paras [229]–[238].

of their affairs. The ATO may still audit the affairs to examine whether the ruling was implemented as stated. Any variance may provide room for further dispute.

2.25 Third, the ATO is not bound to any particular process in developing and issuing rulings. This has led to some successful innovations, such as class rulings, product rulings and determinations.

Aspects of the ATO advice framework reviewed previously and recommendations made

2.26 The history of the ATO providing advice can be traced back to the 1930s, a substantial period of time prior to the introduction of the self assessment system. A summary of that history and the key events impacting on the advice framework, such as external reviews, are set out in appendix 2.

2.27 One of the most important recent reviews of the advice framework was Treasury's 2004 ROSA review. In relation to the ATO advice framework, it recommended a number of changes to the ATO advice framework to make more of the ATO's advice legally binding, amongst other things. The Government and ATO agreed with all recommendations, and legislation and administrative changes were made.

2.28 This included the replacement of the provisions in the tax laws dealing with the rulings system. Overall the changes were aimed at:

- making advice in the form of rulings by the Commissioner available to many taxpayers on a wide range of matters;
- ensuring that the Commissioner provides rulings in a timely manner;
- enabling the Commissioner to obtain, and make rulings based on, relevant information;
- protecting taxpayers from increases in tax and from penalties and interest where they rely on rulings;
- limiting the ways the Commissioner can alter rulings to a taxpayer's detriment; and
- giving protection from interest charges where a taxpayer relies on other advice from the Commissioner, or on the Commissioner's general administrative practice.[18]

2.29 The ATO's approach to implementing the ROSA review's administrative recommendations is discussed in chapter 6.

2.30 Since that time other reviews have examined aspects of that framework and made a number of recommendations. These later reviews are also summarised in appendix 2, as referred to above.

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[18] Explanatory Memorandum, House of Representatives, Tax Law Amendments (Improvements to Self Assessment) Bill (No. 2) 2005, p 38 <www.comlaw.gov.au>.

2.31 Overall, four main underlying systemic issues recur in these later reviews, being delays, costs, lack of objectivity and uncertainty. Each of these issues is discussed in turn below.

Delays

2.32 A number of prior IGT reviews have noted substantial delays in issuing of binding advice. Although significant improvements have been made since those reviews, the most recent figures[19] indicate the timeframes for provision of binding advice continues to be outside of commercial expectations.

2.33 One possible reason for these delays is complexity, both in terms of the application of the law to factual arrangements and the law itself (including the policy objectives of that law).[20]

2.34 In addition to resolving the complexity of issues, the ATO also needs to consider the wider implications of interpretative positions, both for reasons of consistency and coherence of the tax laws.[21] The ATO has previously sought to deliver binding advice which minimises the potential for unintended application of that advice. Stakeholders observe that this appears to have driven an ATO desire to strive for perfection in broad scoping documents, motivated by an apparent fear of exposing the revenue to undeterminable risk. However, the ATO now has other means at its disposal to address the small number of cases that may seek to do this, such as the general anti-avoidance provisions, promoter penalty provisions, taxpayer alerts and reportable tax position schedules. The likelihood and consequences of this 'indeterminable risk' is much lower than what existed before these means were introduced.

2.35 Irrespective of the causes, delays are a major disincentive for taxpayers to obtain binding advice. Commercial and compliance imperatives force taxpayers to take positions within limited timeframes that are frequently much shorter than the timeframes within which the ATO takes to issue binding advice.

Costs

2.36 In the absence of public binding advice, taxpayers have no practical and inexpensive way of obtaining certainty from the ATO regarding the application of the law to their circumstances.[22] Both professional advice and private ruling applications impose substantial direct costs on taxpayers.

2.37 Also, a private ruling application will signal to the ATO a taxpayer's intention to enter a transaction. Although, this may not be of concern in and of itself, it may

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[19] Australian Taxation Office, *Commissioner of Taxation: Annual Report 2010–11* (2011) p 78.

[20] Michael D'Ascenzo, 'In Search of Solutions' (Speech delivered at the Obligation to Assist: Model Litigants in Administrative Appeals Tribunal Proceedings Seminar, Canberra, 26 August 2009 <www.ato.gov.au>.

[21] See for example, Kevin Fitzpatrick, 'A Long Innings — Valedictory Address by Kevin Fitzpatrick' (2012) 46(9) *Taxation in Australia* 394.

[22] Vos and Mihail, above n 3.

discourage taxpayers from seeking certainty on unsettled or 'borderline' areas of the law. This is because such applications may expose taxpayers to excessive costs as a result of the ATO increasing its scrutiny of these issues.[23] Some stakeholders have claimed that requests for private rulings can turn into mini-audits involving extensive and unnecessary information requests because the ATO may be trying to find a reason to give a negative response.

Lack of sufficient objectivity

2.38 Claims of lack of ATO objectivity or revenue bias have existed for a substantial period of time. This issue was considered in the IGT's *Review of the Potential Revenue Bias in Private Binding Rulings Involving Large Complex Matters.*[24] As summarised by the Joint Committee Of Public Accounts and Audit, this review:

> 4.35 … confirmed that there were significant perceptions of ATO bias in the tax community. Most stakeholders did not consider this bias to be undue. Rather, they thought it was the sort of approach to be expected of a revenue agency. The few examples given of undue bias occurred when the ATO was applying a legal interpretation that it thought best represented the policy intent of a law.[25]

2.39 Although that review examined an aspect of the private ruling framework, it should be noted that the review recommended a range of measures to improve objectivity on the ATO's interpretative framework that dealt with both private and public rulings, amongst others. The ATO agreed with most recommendations, but disagreed with the recommendation to publish Treasury advice to the ATO on interpretative matters. This IGT recommendation was later adopted in the Henry review.[26]

2.40 From time to time, suggestions have been made that binding advice should be issued or scrutinised by a body independent of the ATO to improve objectivity and accountability.[27] This approach, however, has not been recommended in a number of reviews of the tax administration system.[28]

2.41 The reasons that have been advanced for not doing so include that an independent body may give rise to increased delays,[29] reduced flexibility and responsiveness in exercising discretion in applying the laws to allow taxpayers to

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[23] Jennifer Batrouney, 'The Commissioner's Role in Interpreting Tax Law and Emerging Issues for Advisers' (Paper presented at the 46th Victorian State Convention: Feast of Delicacies, Lorne, 11–13 October 2007) p 14.

[24] Inspector-General of Taxation, *Review into the Implications of Any Delayed or Changed ATO Advice on Significant Issues* (2010) <www.igt.gov.au>; Inspector-General of Taxation, *Review of the Potential Revenue Bias in Private Binding Rulings Involving Large Complex Matters* (2008) <www.igt.gov.au>.

[25] Joint Committee of Public Accounts and Audit, above n 6, p 97.

[26] Australia's Future Tax System, above n 6, Part 2, vol 2, recommendation 114.

[27] See for example, See for example, Joint Committee of Public Accounts, *Report No 326 — An Assessment of Tax — A Report on an Inquiry into the Australian Taxation Office*, Canberra, 1993, p 104; Australia's Future Tax System, above n 6, Part 2 vol 2 p 659.

[28] Review of Business Taxation (J T Ralph, Chairperson), The Treasury (Cth), *A Tax System Redesigned: More Certain, Equitable and Certain* (AGPS, 1999) p 95 Recommendation 3.6; Australia's Future Tax System, above n 6, Part 2 vol 2 p 659; Note also, no mention was made of this proposal in The Treasury, above n 1.

[29] Review of Business Taxation, above n 28, p 145.

comply, such that its interpretative views may be detached from practical consequences. The Henry review examined these reasons and, notwithstanding considering that these problems could be overcome, concluded that uncertainty for taxpayers may effectively increase:

> While the rulings function could be moved to an independent body, the ATO would still have to interpret the law in order to fulfil its administrative role. In the absence of the ATO's 'in-house' binding rulings regime, taxpayers would have a reduced understanding of the ATO's view of the law and a reduced capacity to bind the ATO to those of its views that were known. Even if the independent body had issued a ruling that bound the ATO, there could be doubt about the ATO's view on whether or not it applied in a given case.[30]

2.42 In addition to the recommendations made in prior IGT reviews,[31] the Henry review also considered that objectivity would be improved by more explicitly stating the policy objectives of the law in the text of the law.[32]

Uncertainty

2.43 As discussed above, minimising uncertainty for taxpayers as to how to apply the law to their affairs as well as how the ATO may administer those laws is critical. In examining the degree of uncertainty in the Australian tax administration system, there are a number of indicators that should be explored.

2.44 First, the Australian tax system has one of the highest users of tax advisers in the developed world, notwithstanding the endeavours of the ATO.[33] A recent Organisation for Economic Co-operation and Development (OECD) comparative survey report indicates that for the 2009 year, 73 per cent of all personal income tax returns were lodged by tax professionals. This exceeds figures reported for New Zealand (50 per cent), the USA (40 per cent), the UK (67 per cent) and Canada (39 per cent).[34] The ATO reports that for the 2009–10 year over 95 per cent of business taxpayers and 72 per cent of individual taxpayers lodged their returns through a tax agent.[35]

2.45 Second, a large number of the ATO's compliance activities, such as data matching programs that identify omitted interest, dividends and salary, detect accounting, transposition and governance errors. The remainder of the ATO's compliance activities may involve greater analysis of factual arrangements, the tax

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[30] Australia's Future Tax System, above n 6, Part 2 vol 2 Recommendation 112.

[31] Inspector-General of Taxation, Implications of Delayed or Changed ATO Advice, above n 24; Inspector-General of Taxation, Potential Revenue Bias in Private Binding Rulings, above n 24.

[32] Joint Committee of Public Accounts and Audit, above n 6, p 97.

[33] Loo, McKerchar and Hansford, above n 4, p 696; P Niemirowski, S Baldwin and A Wearing, 'Thirty Years of Tax Compliance Research: Of What Value is it to the ATO' in Michael Walpole and Chris Evans (eds), *Tax Administration in the 21st Century* (Prospect Media, 2001) pp 199-213.

[34] Centre for Tax Policy and Administration, Organisation for Economic Co-operation and Development (OECD), *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2010)* (2011) p 188 <www.oecd.org>. A complete table of available data is contained in the report at pp 188–189.

[35] Australian Taxation Office, *Compliance Program 2010-11* (2010) <www.ato.gov.au>.

laws and the application of those laws to the facts. Only a small number of such ATO compliance activities result in adjustment involving the application of culpability penalties that indicate taxpayers knew their obligations but failed to fulfil them (or were reckless to those obligations). This infers that the ATO advice framework has not been effective in the majority of those cases where no egregious culpability was found but which nonetheless resulted in an adjustment to the taxpayer's self assessment. The implications, therefore, are that a key objective for the ATO should be to focus on minimising taxpayer uncertainty, both in terms of the interpretation of the tax laws and the administrator's application of those laws.

2.46 Since 2010–11, the ATO has adopted as a corporate key performance indicator to 'reduce legal risks and increase certainty through ATO views by issuing advice and practical guidance that assists people to meet their obligations'.[36]

2.47 This is an encouraging step and further work should be conducted to ensure that the metrics used to evidence this indicator are more than merely the amount of guidance and advice provided, and the number of cases litigated. Such metrics could include the percentage of ATO compliance activities resulting in adjustments that had misstatement penalties of 50 per cent or more applied. Invariably, this aim of increasing taxpayer certainty should be achieved with minimal taxpayer compliance costs.

RECOMMENDATION 2.1

The ATO should expand the range of indicators it uses to publicly report on the level of certainty that it provides with minimal compliance cost to taxpayers.

ATO response: Agree.

The ATO agrees that there is benefit in publishing information about progress towards achieving greater certainty.

The ATO will discuss with the Inspector-General of Taxation and consult with the community, through appropriate consultative forums, to explore options that may be feasible and to identify what additional information might be usefully published.

SUBMISSIONS TO THIS REVIEW

2.48 An underlying theme from submissions to this review was that, under the self assessment system, the risk of adverse consequences arising from uncertainty primarily rested with the taxpayer. In this respect, they supported the aims of the Treasury ROSA's recommendations — that is, the main role of the advice framework was to minimise the adverse effects, or harm, of uncertainty.

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[36] Australian Taxation Office, above n 19, p 79.

2.49 The overwhelming conclusion drawn in most submissions was that public binding advice is most effective where it is targeted at the areas of greatest taxpayer concern or uncertainty and, critically, that it is published in a timely manner. In these circumstances taxpayers are able to use advice at the time they are self-assessing in order to reduce the costs and impacts of uncertainty. However, notwithstanding the outcome of previous reviews of the ATO's advice framework, taxpayers and their advisers claimed that they continued to experience examples of unnecessary delays, costs, perceived lack of sufficient objectivity and continuing uncertainty. This gave rise to substantial shortcomings in providing taxpayers with practical certainty of the administrator's view.

2.50 Overall, these submissions considered that the ATO's administration of the advice framework had not fulfilled the ROSA review's aims, but appeared to be directed towards minimising the risk to the consolidated revenue at the expense of increasing administrative costs and taxpayers' uncertainty.

2.51 Submissions highlighted certain ATO behaviours as substantially contributing to these views, including:

- an ATO emphasis on directing taxpayers to private rulings over providing public rulings; and
- an ATO preference in issuing non-binding guidance rather than public rulings.

2.52 These perceived behaviours are discussed below.

Emphasis on directing taxpayers to private rulings

2.53 Submissions observed an ATO emphasis on directing taxpayers to private rulings notwithstanding the increased costs and delays in such a process in comparison with public rulings. Submissions claimed that, in contrast to public rulings which are principles based, private rulings are primarily used by the ATO as a risk management tool whereby the ATO seeks to quantify the revenue impacts of specific arrangements and therefore provides an unexpressed basis for the ATO to reject or manage out arrangements. These factors contribute to the basis for perceptions of ATO revenue bias in private rulings.

2.54 As an example, submissions argued that the ATO was reluctant to provide public binding advice in resolving certain areas of uncertainty in relation to share capital tainting rules, instead directing taxpayers to private rulings:

> In 2007, in response to external calls for guidance on share capital tainting rules, the ATO agreed to release a fact sheet. The fact sheet, however, did not cover the application of the share capital tainting rules to equity based remuneration arrangements. Public binding advice was requested on the topic. The ATO response was that because of the wide range of circumstances that may arise commercially and such diversity of facts, it was more appropriate to deal with questions of this nature through the private rulings process, including the issue of an ATO Interpretative Decision covering a specific set of facts (ATO ID 2009/76).

> [Four years later] The topic was accepted by the National Tax Liaison Group [NTLG] Public Rulings Steering Committee as a potential new ruling on 18 March 2011, and forwarded to the main NTLG for consideration. The ATO agreed to issue a ruling if external stakeholders could supply real factual circumstances to be used in that ruling. Share capital tainting: consequences of employee share schemes was added to the Rulings Program on 20 September 2011 with the draft TR [Taxation Ruling] due to issue on 11 January 2012.
>
> … The draft TR was reviewed by the Public Rulings Panel on 25 November 2011, with agreement among members that reasoning for the decision was too liberal and that further work was needed to address this. The draft TR was to go back to the panel with panel comments due 30 January 2012. Consequently, the issue date for the draft TR was deferred until 29 February 2012. Further issues have been raised that require consultation with Treasury, which is likely to further delay the issue of the draft.

2.55 In the IGT's view, the ATO reaction in this example may be characterised as a cautious attempt to limit the risk to consolidated revenue because of a lack of knowledge of the types of business arrangements to which the advice may potentially apply. Also there may be a variety of complex factual scenarios to which the advice may apply, such that it may be difficult or unwieldy for the ATO to address all of them in one document.

2.56 However, the example also indicates room for improvement in the ATO's engagement with the private sector in resolving issues of technical complexity. Such an issue was also discussed in the IGT's *Review into the Implications of any Delayed or Changed ATO Advice on Significant Issues*, the so-called 'u-turns' review.[37] Recommendation 3 of that review was aimed at securing improvements by ensuring that all ATO staff adhere to an improved framework for taxpayer engagement in developing technical views. The improved framework included using the most appropriate vehicle to engage the community on community issues (such as technical discussion papers) and provide interim guidance to the extent it can and minimise delays.

2.57 It is clear that the ATO's recent general response to taxpayer calls for increased certainty is for the taxpayer to seek a private ruling.[38] However, as stated above this is not always possible or an attractive option for taxpayers due to delays and costs that may arise in seeking a private ruling.

2.58 Nevertheless, the ATO has had some success in realising these improvements by implementing the recommendations of previous IGT reviews. One such area is in relation to more widely adopting the key principles of the priority ruling process in relation to large business private rulings.[39] The ATO redeveloped its work practices to

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[37] Inspector-General of Taxation, Implications of Delayed or Changed ATO Advice, above n 24.

[38] For example Australian Taxation Office, above n 14, para [207]; see also Bruce Quigley, 'We Can See Clearly Now: Growing Transparency with Large Businesses' (Speech delivered at the Corporate Tax Association Convention, Melbourne, 7 June 2011.

[39] Inspector-General of Taxation, Potential Revenue Bias in Private Binding Rulings, above n 24, Recommendation 4; Inspector-General of Taxation, *Review of Aspects of the Australian Taxation Office's Administration of Private Binding Rulings* (2010) Recommendation 3 <www.igt.gov.au>.

improve the management of private ruling work. The pilots of this work indicate an approximately halving of the timeframes for rulings. A summary of that work is provided in appendix 5.

Private rulings — requesting evidence of facts and resulting costs and delay

2.59 As stated earlier, some submissions to this review also claimed that a private ruling request can turn into a mini-audit resulting in unnecessary costs and delay. In particular, it is claimed that the ATO sometimes requests evidence of facts presented in a ruling request — for example, asking for copies of the accounts to support a taxpayer-presented fact of a particular accounting treatment.

2.60 Reasons for these ATO requests may include the ATO seeking to address issues outside the scope of the application or the taxpayer not providing enough facts. These particular issues have been considered in other IGT reviews. However, the issue of requiring evidence of facts presented in a private ruling application can amount to an inquisitorial type of engagement, more akin to an audit, bringing with it additional delays and compliance costs.

2.61 The ATO agrees that the information gathering process undertaken for a private ruling should not become a de-facto audit. However, the ATO advises that it may be concerned that particular facts presented by the taxpayer may not be an accurate representation of the evidence, or a 'gloss'. If this is the case, the ATO may engage with the taxpayer to discuss these concerns. If legitimate concerns still remain unaddressed, more investigatory process may be more appropriately dealt with outside of the private ruling process.

2.62 Additionally, it has been suggested that if the taxpayer does not wish to provide more information, the ATO may use assumptions in the private ruling. If these assumptions materially differ to the actual facts, they effectively invalidate the protection of the ruling. In this respect, the Commissioner must give the applicant a reasonable opportunity to respond where he proposes to make assumptions in a private ruling.[40]

2.63 The ATO, however, holds the view that the use of assumptions in these circumstances may be constrained because it considers that the law requires the Commissioner to ask for more information where further information is required to make the private ruling:

> (1) If the Commissioner considers that further information is required to make a *private ruling or an *oral ruling, the Commissioner must request the applicant to give that information to him or her.

[40] *Taxation Administration Act 1953* sch 1 s 357-110(2).

> (2) The Commissioner may decline to make the ruling if the applicant does not give the information to the Commissioner within a reasonable time.[41]

2.64 The ATO's practice statement, *PSLA 2008/5*, indicates that the ATO will not use assumptions where the applicant should be able to provide the information:

> 21. Generally, where a ruling cannot be made on the facts available, the Commissioner will decline to rule. He will only make assumptions about unknown facts such as future events, and where an assumption is made it must be one that the Commissioner reasonably expects to eventuate. Assumptions must not be made where the applicant should be able to provide the required information, or the information can be readily obtained from another source. Staff who are unsure about assumptions, and when to use them, should refer to ORCLA [Online Resource Centre for Law Administration — the ATO's internal staff instructions].[42]

2.65 The ATO's internal staff instructions (ORCLA) make it clear that, in these circumstances, the ATO considers that the use of assumptions will be rare:

> Making assumptions in Division 359 – private rulings
>
> While section 357-110 of Sch 1 to the TAA gives us the power to make assumptions, we are not obliged to do so.
>
> You must not make assumptions if the applicant can provide the required information, or the information can be readily obtained from another source under section 357-120 of the TAA.
>
> Generally, if you cannot make a ruling on the facts available or readily obtainable, you should decline to rule. Also, if the correctness of the private ruling relies on assumptions about a future event or other matter, you can decline to rule.
>
> The decision to rule based on an assumption should be rare, and you should consider it with great care. Any assumption you do decide to make must be one that we can reasonably expect to eventuate.
>
> If you request further information to clarify the facts of a case and the applicant fails to respond, do not make assumptions about the missing information, but follow the process outlined in 'Additional Information not provided within the specified time to finalise the advice'.
>
> If you propose to make assumptions, tell the applicant about the assumptions before making the ruling, and give them a reasonable opportunity to respond (see Law Administration Practice Statement PS LA 2008/5 for further information). Notifying the applicant of our assumptions extends the usual 60-day period for making a ruling under

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[41] *Taxation Administration Act 1953* sch 1 s 357-105.

[42] Australian Taxation Office, *Written Binding Advice (Private) - Requests for Further Information, Notification of Assumptions and Intended use of Information from Sources Other than the Applicant,* PS LA 2008/5, 2010 <www.ato.gov.au>.

> section 359-50 of Sch1 to the TAA. The extension starts on the day we tell the applicant about the assumptions, and ends on the day the applicant responds.
>
> State your assumptions clearly in the notice of private ruling, as they help define the scheme being ruled upon.[43]

2.66 Section 357-110 was inserted by the *Taxation Laws Amendment (Improvements to Self Assessment) No. 2 Act 2005*. The explanatory memorandum to the relevant amendments states:

> 3.38 To make a private or oral ruling, the Commissioner may require further information. The Commissioner must first ask for that information from the taxpayer. The Commissioner may also obtain information necessary for a ruling in other ways, but is not obliged to do so. While the Commissioner cannot refuse to rule simply because insufficient information was provided with the initial application, where the Commissioner asks the applicant for additional information, but it is not provided within a reasonable time, the Commissioner may decline to rule. …
>
> 3.40 Issuing a ruling may depend on an assumption about an unknown fact, such as a future event. If the Commissioner considers that correctly making a private or oral ruling would depend on an assumption, the Commissioner may make the assumption and tell the applicant about it, giving a reasonable time for their response, or may decline to make the ruling.

2.67 On one hand, it could be argued that the law requires the Commissioner to ask for information before using assumptions. On the other hand, it could be argued that in light of the context of the relevant provisions use of assumptions was intended to enhance the provision of timely private rulings and the requirement to ask for additional information was aimed at preventing the Commissioner from declining to rule without first attempting to remedy deficiencies in the facts presented in the application.

2.68 In the IGT's view, the Commissioner should be empowered to broadly align his approach with the approach taken by private sector advisers: i.e. a recital of material facts on which the advice is based and, where there are concerns with the facts presented, make critical assumptions that are prominently marked and clearly brought to the taxpayer's attention. Using such assumptions will also help minimise delays caused by additional ATO information requests. In this respect, the IGT notes that the Commissioner's instruction to staff may be too restrictive.

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[43] Australian Taxation Office, 'Online Resource Centre for Law Administration: Making Assumptions in Division 359 – Private Rulings', 25 June 2012.

RECOMMENDATION 2.2

(a) The Commissioner should amend PSLA 2008/5 to allow ATO staff to make assumptions of fact in private rulings, in a broader range of circumstances, without being required to request additional information. In these circumstances, the taxpayer should be given a reasonable opportunity to review the assumptions and be required to confirm that the assumptions are correct.

(b) If the Commissioner considers that he is not empowered to implement (a) above, the Government should consider amending the law to provide the Commissioner with such power.

ATO response: Matter for Government.

The current law does not support an amendment of PSLA 2008/5 along the lines recommended – it would require a change in legislation. Section 357-105 of Schedule 1 to the Taxation Administration Act 1953 provides that where further information is required to make a private ruling, the Commissioner must request the applicant to provide that information. This approach has been confirmed by the Courts (see for example CTC Resources NL v FC of T 94 ATC 4072).

Comparative costs — private rulings and public rulings

2.69 Notwithstanding improvements in delivery, private rulings will always come at a cost to taxpayers. Individuals and smaller businesses do not have the same level of resources of large businesses. Some of the technical issues arising for small businesses are as complex (if not more so) as for large businesses. Inaccessibility of private rulings will tend to have a greater impact for them, than for large business taxpayers. Due to the costs of seeking professional advice, individuals and small businesses are much more reliant on public binding advice in order to mitigate the impacts of uncertainty.

2.70 In comparison to private rulings, public binding advice is relatively inexpensive for taxpayers to find and apply (where it exists). The unavailability of simple public binding advice puts these taxpayers at a greater disadvantage as they are less able to bear the underlying costs of uncertainty and the direct costs of administrative compliance, including advice costs.

2.71 The IGT also considers that there may be a more effective approach in dealing with the public versus private ruling dichotomy. If the ATO is able to better address the cost and practical access to private rulings and enhance some of their benefits, as well as improving stakeholder perceptions of cost and benefit, private rulings are likely to become more widely used by taxpayers. The end result will be reduced taxpayer uncertainty, as well as an improvement to ATO information gathering regarding those specific areas.

Reconsidering ATO technical resource allocation

2.72 The ATO currently seeks to allocate the most complex technical tax law issues to the most highly skilled and experienced ATO technical officers in the Tax Counsel Network and Centres of Expertise. Up until recently,[44] the ATO determined which issues were of greater importance through its Priority Technical Issues process. This process sought to achieve, among other things:

> [the] correct identification and prioritisation of technical issues with systemic implications that cross taxpayer markets, industry segments or revenue line boundaries.[45]

2.73 Issues concerning the ATO's technical decision making processes and procedures have been raised in many IGT reports historically. The IGT raised such concerns from as early as 2005 in both review and annual reports.[46] Others have suggested expanding the extent of resources through a user-pays system. However, this suggestion has been rejected on propriety grounds.[47] This raises the question of how the ATO can more effectively deploy its technical resources and whether there is scope for improved technical decision making processes and procedures.

2.74 In line with these concerns, the ATO has embarked on a number of initiatives to deliver more effective and efficient use of tax technical resources through earlier engagement of tax technical expertise.

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

- Bolster technical networks within the business/service lines - Work with Compliance and Operations to provide early engagement for Active Compliance, Interpretative Advice and Operations staff dealing with technical matters.
- Investigate and establish early engagement mechanisms - including Tax Counsel Network/Centres of Expertise Consultants, tax clinics etc, to help deliver timely, quality decisions for the community and build technical capability in the business/service lines, and ensure less difficult or risky cases are not escalated to Law.

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[44] See the ATO's replacement of Australian Taxation Office, *Taxation Treatment of Expenditure on Low Cost Items for Taxpayers Carrying on a Business,* PS LA 2003/8, 2007 with Australian Taxation Office, *Management of High Risk Technical Issues and Engagement of Tax Technical Officers in Law and Practice,* PS LA 2012/1, 2012 <www.ato.gov.au> on 10 April 2012.

[45] Australian Taxation Office, *Management of Priority Technical Issues,* PS LA 2003/10, 2005, para [3] <www.ato.gov.au>.

[46] See for example: Inspector-General of Taxation, *New IGT Work Program 2011-12* (4 April 2011) <www.igt.gov.au>; Inspector-General of Taxation, *Annual Report 2009-10*, 2010, pp 11-12 <www.igt.gov.au>; Inspector-General of Taxation, Delayed or Changed Australian Taxation Office Views, above n 24, pp 42-43.

[47] The Treasury, above n 1, p 23.

- Change the basis of escalation to Centres of Expertise and Tax Counsel Network to one based on a formal risk assessment, with 'precedential' one of several criteria to be considered.

- Design and implement a practice management function in Law, to manage the activities of our highest level experts and best meet the expectations of the community and ATO business/service lines.

- Design and implement a review process at sub-plan level to align law interpretative advice priorities with corporate and sub-plan priorities. This should be a two way process, with Law advising on emerging issues and risks the sub-plans should consider and where further risk assessment is required.[48]

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

2.77 The improvements should also align the ATO's efforts with the Joint Committee of Public Accounts' (JCPA) recommendation made in 1993 that the ATO 'commit itself to providing decisions to taxpayers which are final and supportable in the first instance'.[49]

2.78 The ATO has conducted a number of pilots as part of the T-project. The recommendations resulting from the pilots have now been adopted by ATO management and are in the process of being implemented. Accordingly, it would be more appropriate for the IGT to consider reviewing this area once these changes are implemented and bedded down.

2.79 Given the reallocation of its technical resources, it is therefore also important that the ATO concentrate its efforts on providing sufficient public binding advice, in a timely manner, for those areas where uncertainty has its most significant impacts.

2.80 Providing public binding advice would also help to address perceptions of revenue bias because ATO interpretative decisions would be made on a principle basis without full knowledge of the revenue implications (as is the case with private rulings).

ATO preference for issuing non-binding guidance

2.81 As discussed above, submissions considered the ATO's administration of the advice framework had not fulfilled the ROSA review's aims and highlighted certain ATO behaviours as contributing to this view. One of these ATO behaviours was said to be an ATO preference for issuing non-binding guidance.

2.82 In providing information to taxpayers, the ATO advises that it aims to allocate resources in a manner that delivers the most effective response to specific issues.[50] In this respect, the ATO takes a graduated approach that 'steps up' the level of taxpayer

[48] Australian Taxation Office, *NTLG Minutes September 2011* (9 December 2011) Item 11 <www.ato.gov.au>.
[49] Joint Committee of Public Accounts, *Report 326: An Assessment of Tax* (1993) p 270.
[50] Australian Taxation Office, Communication to the Inspector-General of Taxation, 12 December 2011.

protection. The first step may be for the ATO to provide a form of non-binding guidance. If taxpayers want more certainty they can apply for a private ruling.[51] Also where the ATO identifies a pattern of facts from audits and private rulings it will consider whether it should issue public binding advice to apply its view more broadly.[52] Where matters of this nature are not issued in public binding advice form, increased uncertainty remains for those affected in the greater community.

2.83 Submissions to this review observed an ATO preference for issuing non-binding guidance and a reluctance to issue public binding rulings. In the absence of public binding advice, many taxpayers may seek to rely on relevant non-binding ATO guidance, thereby exposing them to the risk of retrospective change of treatment by the ATO.

2.84 As such, taxpayers prefer binding advice over non-binding advice because it gives taxpayers greater protection against uncertainty of the administrator's application of the law, and therefore more effective in minimising the potential harm caused by this uncertainty.

2.85 In addition to the stakeholder concerns above the ATO raised the following propositions:

- there has been an increase in the proportion of public rulings and determinations issued; [53]
- ATO guidance is effectively binding;[54] and
- legally binding advice cannot be simple and practical.[55]

2.86 These propositions are further outlined below.

Increase in proportion of public rulings and determinations issued

2.87 In any one year, the ATO may produce far less ATO advice than ATO guidance. In the 2010–11 financial year, the ATO provided 9285 pieces of ATO advice and 27,292 pieces of ATO guidance.[56] The ATO reports that it released 9075 private binding rulings in this year, compared with 10,946 in the 2009–10 financial year.[57]

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[51] For example, Australian Taxation Office, above n 14, para [207].
[52] See for example, the ATO's response to tax practitioner calls for a public ruling in relation to guarantee fees and transfer pricing: Transfer Pricing Sub-Committee, *Meeting Minutes 1 December 2005*, NTLG (1 December 2005) Item 5 <www.ato.gov.au>.
[53] Australian Taxation Office, Communication to the Inspector-General of Taxation, 22 December 2011.
[54] Australian Taxation Office, Communication to the Inspector-General of Taxation, 15 December 2011.
[55] Australian Taxation Office, Communication to the Inspector-General of Taxation, 27 March 2009 in Inspector-General of Taxation, *Review of the Tax Office's Administration of Public Binding Advice*, 2009, p 55 <www.igt.gov.au>.
[56] Australian Taxation Office, above n 19, pp 76–77.
[57] Ibid 77.

2.88 An examination of the numbers of particular types of ATO advice products (public rulings and determinations) and ATO guidance products (ATO Interpretative Decisions (ATOIDs) and Law Administration Practice Statements (LAPS)) reveals that over an eleven year period far more public non-binding guidance has been published and maintained than public binding advice (see table 2.1 below). However, this of itself does not necessarily confirm that the ATO has a 'preference' for providing non-binding guidance over binding advice.

Table 2.1: Numbers of particular ATO advice and ATO guidance products over the 2001–2011 calendar years

Published Public ATO Advice and ATO Guidance Products	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Cumulative
Public Rulings and Determinations												
Released	303	285	222	378	313	392	269	207	167	138	163	2837
Withdrawn	247	221	152	231	210	248	35	14	13	5	2	1378
Current	56	64	70	147	103	144	234	193	154	133	161	1459
ATOIDs												
Released	805	1116	1200	982	368	341	226	166	161	228	99	5692
Withdrawn	581	669	605	421	141	88	35	22	15	6	6	2589
Current	224	447	595	561	227	253	191	144	146	222	93	3103
LAPS												
Released	15	20	13	19	28	22	26	23	9	5	30	210
Withdrawn	9	10	2	4	8	5	8	2	1	0	0	49
Current	6	10	11	15	20	17	18	21	8	5	30	161
Total Products												
Released	1123	1421	1435	1379	709	755	521	396	337	371	292	8739
Withdrawn	837	900	759	656	359	341	78	38	29	11	8	4016
Current	286	521	676	723	350	414	443	358	308	360	284	4723

Source: Australian Taxation Office
Notes:
1. Source for this set of statistics is ATOLAW which is provided by calendar year.
2. The numbers for withdrawns indicate the numbers which were released in the given year, which have subsequently been withdrawn. They may have been withdrawn in that year or later.
3. In addition to public rulings and interpretative decisions, the precedential ATO view is expressed in documents listed on the Schedule of documents containing the precedential ATO view. The precedential ATO view is the Tax Office's documented interpretation of any of the laws administered by the Commissioner in relation to a particular interpretative issue. As at 15 December 2011, there were 84 documents listed on the schedule, 23 of which are current and 61 relate to prior income years.

2.89 The ATO analysis of these figures note that the information indicates the following trends:

1. 1.74 per cent decrease in total products released from the 2001 to 2011 calendar years (1123 - 292).

2. 88 per cent decrease in ATOIDs released from 2001 to 2011 calendar years (805 - 99) cf. 46 per cent decrease in Public Rulings and Determinations released over same period (303 - 163).

> 3. 46 per cent of all products released in the 11 year period have been subsequently withdrawn (4016/8739).
>
> 4. Public Rulings and Determinations as a per cent of total products released has increased from 27 per cent in 2001 to 56 per cent in 2011.[58]

2.90 These figures clearly show an increase in the proportion of public ATO advice, compared to certain types of public ATO guidance. The ATO also produces other forms of binding advice and non-binding public guidance, such as private rulings and fact sheets, which have not been captured.

2.91 Additionally, the figures are indicative of the relationship between binding advice and non-binding guidance, showing that a greater proportion of ATO material is non-binding in nature.

ATO guidance is 'effectively' binding

2.92 Another proposition raised by the ATO was that notwithstanding ATO guidance may not legally bind the ATO it may be difficult for the ATO to 'walk away' from such material.[59]

2.93 The ATO has also suggested that ATO guidance is derived from ATO views set out in ATO advice documents, such as rulings or determinations.[60] Furthermore, where ATO guidance is prepared on an issue where there is no precedential ATO view, ATO advice will also be prepared for publication in conjunction with it. In this way, the ATO considers that ATO guidance guides taxpayers towards ATO advice.

2.94 The IGT, however, has reported in other reviews certain circumstances in which the ATO has not stood by ATO guidance. For example, in the IGT's *Review into delayed or changed Australian Taxation Office views on significant issues* (the so-called 'u-turns' review) an ATO webpage, 'most frequently asked questions and answers to Division 7A', from 1999 to 2007 stated that Division 7A would not apply where the trustee retains an unpaid present entitlement on trust. However, in 2009 as set out in the IGT's report:

> A senior ATO official commented publicly that unpaid present entitlements could be treated as loans under Division 7A of the ITAA 1936. This is of concern to tax practitioners as this was contrary to information published on the ATO's website over the years in relation to unpaid present entitlements. They are unsure in what situations unpaid present entitlements will be treated as loans under Division 7A. In particular they would like to know if the ATO is seeking to apply its views generally and retrospectively.[61]

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[58] Australian Taxation Office, Communication to the Inspector-General of Taxation, 22 December 2011.
[59] Australian Taxation Office, Communication to the Inspector-General of Taxation, 15 December 2011.
[60] Ibid.
[61] Inspector-General of Taxation, *Review into Delayed or Changed Australian Taxation Office Views on Significant Issues*, Sydney, 2010, p 62 Issue number 21, referring to Deputy Commissioner, Australian Taxation Office,

2.95 In the example, further consultation with the tax profession indicated that the ATO may have been unaware of its prior views. The ATO agreed with recommendation 2 in the IGT's report, which was designed to reduce the adverse impact of delayed or changed ATO views on significant issues by including the following process step:

> 24. Before applying any product, position, opinion or view of the law, tax officers are required to determine whether there are circumstances which would make it appropriate to take action to apply the ATO view of the law only on a prospective basis.
>
> 25. To do this tax officers must:
>
> (a) undertake research to form an opinion whether any ATO publication, product or evidence of ATO conduct could have reasonably conveyed a different view of the law on a particular issue, to taxpayers generally, or to a particular class or industry group.[62]

2.96 Although the ATO may endeavour to base non-binding products on binding advice and give taxpayers the option of relying on simple guidance or more complex binding advice, stakeholders provided a number of examples where the ATO was prepared to publish non-binding guidance (such as a fact sheet or practice statement), however, was not prepared to provide public binding advice at that point in time.

2.97 Furthermore, if the ATO considers it will stand by non-binding guidance which is based on binding advice, it can be perplexing why the ATO does not declare that information binding and increase the level of certainty for taxpayers.

2.98 In the IGT's view where a non-binding product expresses or applies an interpretative view, it is appropriate for the ATO to publish that view in a binding form whereby taxpayers could rely on it. In the absence of any clear reasons as to why the interpretative view should not be binding, it should work towards providing that view publicly in a binding form. This would enhance taxpayer understanding of the ATO's position and provide protection from the adverse consequences, thereby minimising the harm caused by uncertainty.

ATO advice cannot be simple and practical

2.99 One particular area strongly voiced by submissions was that the ATO has not given full effect to the ROSA recommendations in relation to making ATO advice more accessible, timely and binding in a wider range of cases. They considered the ATO's approach to advice as being 'limited, cautious and conditional'.[63]

'Is the Tax Office Widening its Crackdown on Lawyers and Accountants?' (Speech delivered at the presentation to the Tax Institute of Australia, Canberra, 31 March 2009) <www.ato.gov.au>.

[62] Australian Taxation Office, *Debt Relief*, PS LA 2011/17, 2011 <www.ato.gov.au>.

[63] See also Inspector-General of Taxation, above n 55, p 9 <www.igt.gov.au>; The Treasury (Cth), 'Review of Aspects of Income Tax Self Assessment' (Discussion Paper, March 2004) p 26.

2.100 In its ROSA review, the Treasury explained that one way to reduce uncertainty would be for taxpayers to be confident that they are assessing their liabilities in accordance with the ATO's interpretation of the law.[64]

2.101 It articulated the general principle that all ATO advice should provide a level of protection (depending on the type of advice) to those who reasonably rely on it in good faith and that if such advice turns out to be wrong:

> Such consequences should properly be borne by the community as a whole. Although this will not be a great cost (as Tax Office advice will be correct in the great majority of cases), it will relieve a major source of uncertainty for taxpayers.[65]

2.102 The ROSA review concluded that taxpayer certainty would be improved by providing a better framework for ATO advice and making ATO advice more accessible, timely and binding in a wider range of cases.[66]

2.103 In making ATO advice more accessible to the general public, the ROSA report recommended that all ATO written advice, including public rulings, should use plain language with a minimum of qualifying statements. This implies that rulings should be clear and succinct:

> Some submissions noted that advice provided by the Tax Office is not always easy to understand. These submissions proposed that advice should be written in a plainer and simpler style. However, submissions also recognised the balance that needs to be struck between providing advice that is clear and succinct, and ensuring that advice is accurate. They acknowledged that, depending on the taxpayer and the advice sought, varying degrees of technical language may be required or appreciated. Moreover, some taxpayers and practitioners have said that they would prefer a longer explanation in order to gain a better understanding of how the Tax Office might approach similar cases.
>
> Nevertheless, the Tax Office is not in the business of being a paid tax adviser to individuals and it should not feel obligated to provide its general advice in a way that only suits a minority. The main purpose of Tax Office advice is to inform the public about how it will interpret the law and act in a given situation. If that advice is written like some legal opinions, in complex language with caveats or qualifying statements, what is stated to be public advice, may not in fact be accessible by the general public.
>
> The Review therefore encourages the Tax Office to provide general advice in a style that is as simple and easy to understand as possible. Some rulings with a potentially limited readership may need to be tailored to the special needs of the target audience.

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[64] The Treasury, above n 1, p. 3–4.
[65] Ibid p 9.
[66] Ibid Foreword p i.

Recommendation 2.8

Wherever possible, Tax Office general written advice, including public rulings, should be written in plain language, with a minimum of qualifying statements so that it is accessible to the general public.[67]

2.104 The IGT has previously reviewed concerns with the implementation of the 2006 ROSA legislative changes on the ATO's advice framework in his *Review of the Tax Office's administration of public binding advice.*[68] In summary, that IGT review concluded that although the ATO had taken positive steps to implement the ROSA changes, the ATO had also not given full effect to those changes. Amongst other things,[69] this was because the ATO's advice 'has become … more limited, cautious and conditional'.[70] The review formed this conclusion on the basis that:

- the number of (non-binding) practice statements issued had generally increased each year;
- the ATO had not made significant parts of TaxPack or *e-tax* legally binding (further developments in this regard are discussed later in this chapter)
- the ATO had replaced binding material with non-binding material;
- the ATO had not instituted a systematic process for reviewing the level of protection for pre-2006 rulings stating that they are not binding; and
- in 2007, the ATO withdrew statements made in a 2003 practice statement which clearly indicated that it considered ATO precedential views (such as ATOIDs) as representing its general administrative practice.[71]

2.105 In its response, the ATO strongly disagreed with these findings, explaining:

> Providing advice and guidance on the application of the laws administered by the Commissioner is central to the role of the Tax Office. It enables taxpayers to understand and meet their obligations and to be aware of their rights and entitlements in a self-assessment system. However, the assistance provided must be relevant to the intended audience. Plainly, the community is quite diverse when it comes to its need for assistance on taxation matters. Our experience is that most taxpayers, especially individuals and small businesses, are looking for guidance that is simply expressed and provides practical step by step assistance. This guidance does not readily lend itself to be legally binding. 'Binding' means that if the Commissioner provides favourable advice that is wrong, taxpayers who rely on that guidance are advantaged relatively to those that comply with the law. That is, errors made by the Commissioner in binding material exact a high price on the community, which must forgo the relevant revenue.

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[67] The Treasury, above n 1, p 14.
[68] Inspector-General of Taxation, above n 55.
[69] Other issues were also raised in that review, such as the ATO's approach to 'general administrative practice'. These have been considered in other IGT reviews, such as the so-called 'u-turns' review.
[70] Inspector-General of Taxation, above n 55, p 9.
[71] Ibid pp 9–11.

> Because of this risk, binding advice needs to be prepared rigorously and needs to be expressed in precise, often legalistic terms. While the Tax Office public and private rulings provide this type of advice, they often do not meet the needs of those taxpayers seeking simply expressed guidance referred to above. Of course, as you know, any taxpayer who wants a private ruling can seek one.[72]

2.106 Clearly, under the ATO's approach to administering the advice framework to date, the ATO finds it a continual challenge to provide technically accurate advice in a manner that is simple and practical to a wide range of taxpayers. This indicates a need to reconsider the approach in administering the advice framework.

2.107 Having considered the main stakeholder and ATO views on the relevant factors, potential solutions to concerns need to be considered.

LEGISLATIVE IMPERATIVE TO MINIMISE UNCERTAINTY

2.108 Given the role that the advice framework plays in harm minimisation for the productivity of the economy and confidence in the tax system, it has been strongly argued that there should be a legislative imperative to provide binding advice. Such advice would minimise the extent of uncertainty, especially in relation to those self assessing taxpayers who do not have practical access to private rulings.

2.109 In considering the issue of a legislative imperative a number of threshold questions need to be considered. First, should all ATO guidance be binding on the ATO?

Should all ATO information be binding on the ATO?

2.110 The issue of whether all ATO information should be made binding was considered during Treasury's ROSA review. However, no such recommendation was made. In the discussion paper to that review, Treasury stated that there was a risk that if such an obligation was placed on the ATO, then the ATO's advice may become 'more limited, cautious and conditional'.[73] Additionally, it may also result in the ATO producing less information.

2.111 Relevantly, the Government has also recently acted on the Board of Taxation's recommendations to enact a legal framework for GST rulings.[74] In effect, these changes adopt the income tax rulings regime for GST (and other indirect taxes). It will enable the ATO to reduce the number of GST public binding rulings and allow it to issue other types of information, such as non-binding ATO guidance.

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[72] Australian Taxation Office, Communication to the Inspector-General of Taxation, 27 March 2009 in Inspector-General of Taxation, above n 55, p 55.

[73] The Treasury, above n 63, p 26.

[74] Board of Taxation, *Review of the Legal Framework for the Administration of the Goods and Services Tax* (2008) Recommendation 17 <www.taxboard.gov.au>.

Should the ATO be legally required to produce binding information?

2.112 To overcome the challenges that may emerge if all ATO information were required to be binding, it has been suggested that the ATO should also be legally required to provide advice.

2.113 A corollary to such legal obligation would be that the ATO should delay taking compliance action until such advice is produced. This has taken place in the past, such as after the goods and services tax was introduced to give people enough time to understand what needed to be done to comply with the new regime.

2.114 However, a general rule that delayed compliance action (until ATO advice is provided) may effectively delay the date of effect of the relevant legislation. This delay may be significant given the lengthy periods of time that has been needed in the past for the ATO to produce binding advice. Consequently, the application of Parliament's intent and Government policy may be subject to administrative compliance verification much later than otherwise anticipated.

2.115 Nevertheless, imposing a legal obligation on the ATO may still need to be considered in the future. However, in the interim, there are more cautious improvements that can be sought with respect to the timeliness and scope of public ATO advice.

2.116 One approach is to encourage and assist the ATO to provide public binding advice in areas of uncertainty more quickly. Such advice should be preferred over private rulings because it minimises taxpayers' compliance costs, albeit that private rulings would still have a valuable purpose and place in the advice framework.

2.117 As a general aim, public binding advice should be simple, practical and reliable, and that one document need not cover the field — for example, it could be limited by type of factual arrangements, limited in time, limited in amount of potential tax liabilities. Importantly public binding advice should be produced on a timely basis. Taxpayers should have the choice to follow public binding advice or not (where they consider the ATO view is incorrect), but also be prepared to accept the consequences if they are ultimately incorrect.

2.118 To achieve the above, the IGT considers that uncertainty would be significantly reduced if the ATO was required to synchronise its advice at the enactment of substantial new laws.

SYNCHRONISING ATO ADVICE WITH THE ENACTMENT OF NEW LAW

2.119 In addition to the timeliness with which ATO advice is issued, and to a substantial extent, the utility of ATO advice depends upon awareness of the factual arrangements to which it applies. Typically, the ATO develops this awareness from compliance verification activities and taxpayer initiated advice requests. However, where law is proposed there may be little existing ATO awareness of the specific taxpayer factual arrangements to which the law may apply.

2.120 Therefore to enable useful ATO advice to be delivered, improved private sector engagement in policy design would be required to raise awareness of the practical application of proposed measures. Consistent with this, and to enable this type of private sector engagement to take place, the type of ATO involvement is important, such as providing its view on how policy detail would be administered in practice. Ultimately, this would be an intense and iterative process, but a more effective one.

2.121 The following example illustrates how effective private sector consultation depends upon the ATO's articulation of how it would administer the policy and law in practice:

> [In setting out the alienation of personal income as a case study of the Integrated Tax Design process (which is described in chapter 5), the Chief Tax Counsel referred to a case study in which extensive public consultation with industry and professional groups, including that involved in the Ralph review, was carried out before the legislation was drafted. The bill was reviewed by the Senate Economics Legislation Committee. Following its enactment on 30 June 2000, the ATO carried out an extensive education program targeted at tax agents. The ATO subsequently released a draft Public ruling that it considered was consistent with the policy intent in the Explanatory Memorandum and the Ralph review recommendations.]
>
> [Notwithstanding the extensive public consultations and education campaign], it was not until the release of the draft Public Rulings on the matter in April 2001 that the measure came under intensive scrutiny by the tax profession and some industry bodies.
>
> However, the further consultation which the draft Public Rulings engendered resulted in clarification of the policy intent and in the Government agreeing to legislative changes (Treasurer, *Press Release* (No 47, 29 June 2001); and Treasurer, *Press Release* (No 51, 9 July 2001) …
>
> Public Rulings are generally issued as drafts as a means of promoting consultation and input on the ATO's interpretation of the law. The alienation draft Public Rulings were successful in this regard and provided the spur to the clarification of policy and legislative change.[75]

2.122 The ATO also recognises the importance of its role in providing views during policy and legislation development on how proposed law would be administered:

> 11. … the ATO's role in tripartite tax law design [discussed further in chapter 5] is to provide high quality input into the development of tax policy and legislation, by contributing its views and experience, particularly in relation to the administrative impacts of the proposed changes to the law. This recognises the principle that tax policy and legislation should take administrative issues fully into account. Included within these administrative impacts and issues is that part of tax administration which relates to the interpretation of the laws which the ATO administers.

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[75] Michael D'Ascenzo, 'Taxation Law Design' (2002) 5(1) *Journal of Australian Taxation* 34, pp 40–41.

> 23. It is clearly preferable for tripartite discussions on any issues associated with legislation that has been introduced to Parliament to take place while it is still before the Parliament, rather than not addressing such issues until after the law is passed or takes effect.[76]

2.123 The IGT considers that this draft staff instruction (cited immediately above) should allow those ATO officers involved in policy and legislation design to provide:

- views as to whether the provisions achieve the policy outcome in relation to particular matters;
- advice as to whether draft legislation can be administered and interpreted in accordance with the underlying policy intent; and
- preliminary views (settled by Tax Counsel Network or Centre of Expertise officers) as to how the Commissioner would interpret the draft legislation.[77]

2.124 Notwithstanding this type of ATO officer involvement in policy and legislation design, the IGT considers that there is room for further ATO improvement. Requiring the ATO to articulate, during the policy and legislation design stages how it would administer the law would avoid many problems with the uncertainty arising from the ATO's administration of new law. From the ATO's own experience, it has shown that this approach surfaces many unintended anomalies, impracticalities and consequences before law is enacted.

2.125 The ATO has commented that this approach would be possible if it is a party that is 'integrated consistently throughout the policy law design process, including consultation with externals'. For example:

> during the development of the Minerals Resource Rent Tax legislation where we worked very closely with the Policy Transition Group, we provided guidance on how we would interpret legislation still in development. This required the ATO to resolve technical issues quickly, and anticipate issues that would likely arise once the law was in operation. It is not normal practice for early guidance to be provided before law has been passed by Parliament and it was only possible in this case as the ATO had been integrated consistently throughout the policy law design process, including consultation with external stakeholders. As the new resource rent tax arrangements have significant process and practical issues such as valuations, early guidance fits well with the arrangements. In other cases, the ATO may be limited to providing advice on law as enacted.[78]

2.126 In this respect, the IGT considers that some of the uncertainty caused by the ATO's administration of new law would be minimised if the ATO was required to synchronise its advice with the enactment of substantial new laws. This together with

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[76] Australian Taxation Office, *Practice Statement Law Administration PS LA 3473 (Draft)* (13 May 2011) <www.ato.gov.au>.
[77] Ibid paras [13–18].
[78] Jennie Granger, 'ATO Law Expertise: Evolution or Revolution?' (Speech delivered at the 24th Australasian Tax Teachers Association Conference, University of Sydney, 17 January 2012).

the tripartite law design approach, which is described in detail in chapter 5 of this report, should significantly improve certainty for taxpayers.

2.127 In short, this improved consultation processes for developing new law would not only consider substantive issues but will also consider what should appear in the explanatory memorandum, the synchronised ATO advice as well as the legislation itself. In addition, the tripartite tax law design team consisting of paid external tax experts as well as senior ATO and Treasury officials will provide advice on these issues to the Government before the passage of such legislation through the Parliament.

2.128 Where the ATO provides such synchronised advice on enactment, it should also be recognised that the advice may be later varied as new issues and arrangements come to light after enactment. However, any such changes should operate prospectively.

2.129 On a related issue, it has been suggested that synchronising binding ATO advice with the enactment of legislation ignores the role of tax advisers and the law. Such suggestions are viewed from a perspective that the law should set out all the obligations without the need for further explanatory materials.[79] However, the complexities of a modern tax administration system require certainty, not only of the tax laws but also, of the administrator's application of those laws. The current system is founded on confidence in the administrator as a fair and impartial one. If perceptions where to grow that application of uncertain areas of new was arbitrarily directed towards revenue outcomes, this confidence would diminish. Further, the response would lead to an ever-increasing volume and complexity of tax laws to clearly set out in law all the potential applications to potential factual scenarios.

RECOMMENDATION 2.3

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

ATO response: Matter for Government.

TAILORING THE SCOPE OF ATO PUBLIC RULINGS TO IMPROVE TIMELINESS

2.130 Another measure to improve the utility of the public rulings system is to consider the scope of these rulings and the capacity to provide timely interim certainty.

[79] D'Ascenzo, above n 75, pp 41–43.

2.131 According to the ATO, public rulings are prepared as part of the risk management process. Until recently, decisions to issue a public ruling were made by the ATO, through its Priority Technical Issues framework,[80] and in consultation with stakeholders.[81]

2.132 However, such an approach may involve significant periods of elapsed time between issues being raised for resolution and the ultimate issue of public binding advice.

2.133 Comprehensive legally binding ATO advice is most desirable. However, where developing such advice would significantly impact on elapsed timeframes, alternatives may be considered separately and in a parallel, so that periods of uncertainty are minimised.

2.134 The IGT considers taxation determinations (which are also a form of public binding advice) offer an opportunity to quickly provide taxpayer certainty on key issues while minimising the imposition on ATO technical resources. Taxation determinations tend to be more sharply focused and so do not require the same investment of ATO resources in their development. Although they do not provide comprehensive binding advice on all issues of concern, they can provide interim binding advice on the issues of most urgency and concern.

2.135 The ATO has also stated that, in practice, taxation determinations were a convenient and useful form in which to provide the ATO's view on many matters. This was also observed by other scrutineers:

> 6.78 The Committee noted general support given by taxpayers to the issuance of Determinations as a means of rapidly ascertaining the view of the Commissioner on a particular point. However, the Commissioner was concerned at the possible use of Determinations as substitutes for fully reasoned Rulings. Given the importance of the ATO issuing advice as soon as practicable and balanced with the time taken to properly determine the issues at any given taxation circumstance, the Committee considered the greater dissemination of Determinations was preferable to the provision of no information at all.[82]

2.136 More recently, a senior ATO officer publicly commented that determinations may be a means to improve timeliness of public rulings on significant issues:

> Another issue which I think should be considered is the way in which the ATO publishes its views on important or significant technical issues. For example, is the current public ruling system as effective as it could be? In other words, is it meeting community expectations?

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[80] See Australian Taxation Office, PS LA 2003/8, above n 45, now withdrawn and replaced by Australian Taxation Office, PS LA 2012/1, above n 45.

[81] Australian Taxation Office, *Public Rulings Manual Overview Kit* (30 January 2012) <www.ato.gov.au>.

[82] Joint Committee of Public Accounts, above n 27, p 116.

> There is room for improvement. Timeliness has long been a problem. Work practice changes are currently being implemented to try to improve timeliness. But I believe other questions also need to be considered.
>
> To what extent should public rulings be more issue-based and shorter in a taxation determination format, rather than the more comprehensive taxation rulings format?[83]

2.137 Sometimes the approach of first developing broader principles to apply to a range of factual arrangements leads to inordinate delays. This could be due to a number of reasons, such as lack of awareness of the range of applicable factual arrangements. In these circumstances incremental development of principles through analysing the application of the law to particular factual arrangements and publishing those views on a case by case basis would provide a quicker development of the principles in a transparent manner while improving taxpayer certainty at the same time.

RECOMMENDATION 2.4

The ATO should make more use of determinations by, for example, considering:

(a) the conversion of significant ATO Interpretative Decisions into determinations periodically; and

(b) issuing a number of determinations on key factual scenarios as a prelude to developing a public ruling on the broader topic.

ATO response: Agree.

Identification and prioritisation of potential topics for rulings and determinations is largely a demand-driven consultative and collaborative process involving representatives from the tax profession, such as the technical sub-committees of the National Tax Liaison Group (NTLG) and the NTLG Public Rulings Steering Committee. Discussion with these groups already includes consideration of the appropriate vehicle for ATO advice or guidance on any given topic. The ATO's public rulings manual and other instructional guidance also covers conversion of ATO IDs into determinations or rulings, and the use of determinations to cover specific factual scenarios.

The ATO will, however, work with the consultative forums identified above to implement a process to ensure that the forums periodically identify and consider opportunities for the conversion of significant ATO IDs into determinations and identify and prioritise potential determinations on key factual scenarios as a prelude to developing a public ruling on a broader topic.

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[83] Fitzpatrick, above n 21.

IMPROVING TIMELY ISSUE IDENTIFICATION FOR THE PUBLIC RULINGS PROGRAM

2.138 A further measure to improve the utility of the public rulings system is to expedite the identification of issues for public rulings.

2.139 In identifying issues for public binding advice, not all technical issues currently result in such advice. Any public ruling is subject to the ATO's internal process, such as the Public Rulings Panel.

2.140 The ATO advises that in informing itself on the issues for the public ruling program it collects data from internal risk assessment processes and compliance activities, and representations received through community and professional forums.[84]

> [P]ublic rulings arise out of our risk mitigation strategies. Risk processes are governed at an ATO level by the Enterprise Risk Management Framework (ERMF). All BSLs [Business and Service Lines] have risk management processes in place consistent with the ERMF (see for example LB&I [the Large Business and International BSL], Indirect Tax, and S&ME [the Small and Medium Enterprises BSL] risk intranet pages). It is generally through these processes that public rulings are internally sourced, including risks escalating out of private rulings work.[85]

2.141 Where the ATO collaborates with tax professionals through external forums, such as the National Tax Liaison Group (NTLG), this had led to a better assessment of what the priority areas of uncertainty were, as well improving the ATO's understanding and its capacity to address them effectively. Transforming the way the ATO engages with the tax profession is also seen as important with some senior ATO officers:

> Identifying the more significant issues of uncertainty or contention and providing timely views on them continues to be a significant challenge. So what things should the ATO do to continue to get better at this? …
>
> [T]he ATO's law experts and leaders need to have ongoing engagement with the tax profession about contentious and uncertain issues. During the last year or so, this has started to happen more and more, but I think a wider range of law experts (and not just the senior officers) need to be engaging this way. This type of ongoing open and frank discussions with the accounting and law firms should help to provide a better understanding of contentious issues and areas of uncertainty in the laws, as well as developing a more constructive relationship between the ATO and the profession. It would also enable a greater understanding of each other's views and perspectives…

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[84] Australian Taxation Office, above n 81.
[85] Australian Taxation Office, Communication to the Inspector-General of Taxation, 28 June 2012.

> [T]he ATO's involvement at tax conferences and seminars could be enhanced … Open and constructive dialogue on technical issues and the ATO's strategies and work practices can only be of long term benefit for the tax and superannuation systems.[86]

2.142 These opinions confirm the IGT's previous observations that the ATO needs to develop innovative ways to fulfil community expectations of the ATO as a responsive rulings administrator, rather than relying largely on taxpayers and advisers to approach the ATO for advice.

2.143 Such an issue was also discussed in the IGT's *Review into the Implications of any Delayed or Changed ATO Advice on Significant Issues*, the so-called 'u-turns' review.[87] Recommendation 5 of that review required the ATO to be more proactive in identifying areas of compliance concerns by supplementing existing consultative forums with technical issues forums and making better use of ATO and industry knowledge gleaned from the development of relevant legislative provisions.

2.144 The ATO has also used private rulings as a source for public rulings. The ATO has advised that it reviews annually the top five topics on which rulings are requested and published and that:

> [the ATO] has identified 65 instances [since 2003] where private rulings have been expressly referenced as a source or driver for, or have otherwise informed, the proposed public ruling. We have included some examples below (the text in italics is drawn from the notification form):
>
> - Leased commercial properties – lead to GSTR 2004/6 …
> - Ruling ID 3526 - home loan TD – lead to TD 2012/1 …
> - Ruling ID 3568 – mining tax improvements lead to TR 2012/D3 …
> - PTI 492 cancellation fees – lead to GSTR 2009/3.[88]

2.145 Notwithstanding this work, the IGT has also observed in a previous review that opportunities for identifying topics for public binding advice were missed in certain circumstances. In this respect the IGT recommended that the ATO improve its awareness of the topics for private rulings.[89]

2.146 Another area in which potential public rulings could be sourced are ATO Interpretative Decisions (ATOIDs). ATOIDs do not bind the ATO, however, ATO officers are required to apply the views set out in an ATOID, where applicable. In this sense, they provide an interpretative precedent for ATO officers.

2.147 The IGT also observes that common issues arising from information provided to the ATO through additional disclosures occurring before an assessment is lodged

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[86] Fitzpatrick, above n 21.
[87] Inspector-General of Taxation, Implications of Delayed or Changed ATO Advice, above n 24.
[88] Australian Taxation Office, Communication to the Inspector-General of Taxation, 28 June 2012.
[89] Inspector-General of Taxation, Administration of Public Binding Rulings, above n 39, p 5.

(pre-assessment disclosures) as well as at the time of lodgement (expanded lodgement disclosures) would be a source for informing the ATO's public rulings program on areas of uncertainty that may require public binding advice.

RECOMMENDATION 2.5

The ATO should expand the sources, that it uses to identify topics for public binding advice, to include common issues arising in pre-assessment and expanded lodgement disclosures, such as reportable tax position schedules and annual compliance arrangements.

ATO response: Agree.

The ATO continues to look for new sources for potential public rulings as they arise — such as those recommended here — and will ensure that these new products and processes are expressly included in relevant ATO staff instructional material.

REBALANCING TAXPAYER PROTECTIONS

2.148 The above discussion also raises the question whether there should be fundamental changes to aspects of the current advice framework to rebalance the protections for taxpayers.

Protection where there is no ATO advice or ATO guidance

2.149 There will inevitably be situations where ATO advice will not be available. Given the nature and volume of the information that the ATO, as an administrator provides, certain elements will be more relevant in the considering whether protections should be afforded against additional primary tax, penalties and interest.

2.150 Under the existing advice framework, most non-binding guidance will protect taxpayers against penalties and interest where it is incorrect or misleading.[90]

2.151 Those ATO communications that are not intended to be relied upon will not protect taxpayers from penalties and interest. They are specifically labelled by the ATO as 'non-binding':

> 242. No penalty or interest protection is provided where an ATO publication, or a statement in an ATO publication states that it is not intended to be relied on. Such communications should state that they are not a publication approved in writing by the Commissioner so that readers are not misled.[91]

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[90] Australian Taxation Office, above n 14, paras [212]–[214].
[91] Ibid.

2.152 Edited versions of private rulings, technical discussion papers, audit position papers and taxpayer alerts are also considered non-binding and will not protect against penalties and interest.[92]

2.153 However, in circumstances in which there is no pre-existing ATO advice or ATO guidance, taxpayers may be required to accept a risk of incorrectly self assessing tax liabilities. This may be the case where commercial imperatives prevent an extended period of time for taxpayer to allocate that risk to the Government via a private ruling.

2.154 Where ATO advice or ATO guidance is delayed or otherwise unavailable in relation to areas of significant uncertainty, this fact should be taken into account when administering penalties and interest charges to self assessing taxpayers. In this way, some of the impacts of uncertainty would be mitigated. In this respect the ATO's *MT 2008/1* states that the complexity of the law and whether the relevant law is a new measure are matters to consider in determining the standard of care that is reasonable and appropriate in the circumstances.[93]

2.155 Where concession on interest and penalties is offered, there is need for some assurance that a genuine attempt is made to apply the law to the taxpayer's situation to ensure that taxpayers have an incentive to self assess accurately. In the IGT's view, where no ATO advice or ATO guidance exists in these circumstances, penalties and interest should not apply where taxpayers have taken reasonable care in applying the law. Such a position would also provide an incentive for the ATO to quickly provide guidance to taxpayers. Consequently, the IGT also considers that the ATO will need to rationalise its advice and guidance products.

RECOMMENDATION 2.6

(a) The Government should consider introducing legislation to ensure that penalties and interest do not apply where:

(i) there is no public ATO advice (binding or non-binding) available on a substantial issue; and

(ii) the taxpayer took reasonable care (as defined in recommendation 4.2) in assessing their liability in relation to that issue.

[92] Australian Taxation Office, above n 14, paras [7], [244], [246].
[93] Australian Taxation Office, *Penalty Relating to Statements: Meaning of Reasonable Care, Recklessness and Intentional Disregard,* MT 2008/1, 11 July 2012, para [59].

RECOMMENDATION 2.6 (CONTINUED)

(b) If the Government were to introduce such legislation, the ATO should rationalise its advice and guidance products into three categories:

Category 1- protection from additional primary tax, interest and penalties;

Category 2- protection from interest and penalties; or

Category 3- protection from penalties.

ATO response: Matter for Government.

Other improvements to the existing advice framework

2.156 Submissions also raised a number of specific issues in relation to recommendations that had been made in previous IGT reviews, such as those aimed at minimising the costs and delays in private rulings. These matters, amongst others, will be considered in the course of the relevant IGT's follow up reviews in future.[94]

2.157 However, the following issues fall outside of the scope of these follow up reviews and are addressed below:

- the extent of the binding nature of TaxPack and the electronic return form preparation and lodgement package, *e-tax*;
- timeliness and transparency of decision impact statements;
- communicating changes to certain ATO guidance.

TaxPack and *e-tax*

2.158 The extent of the binding nature of TaxPack and *e-tax* is an important concern.[95]

2.159 Previously, the ROSA review considered a number of non-ruling products, such as TaxPack, were entitled to receive the same protection as public rulings:

> The Tax Office produces a number of non-ruling products in which the public, especially those preparing their own returns, should be entitled to have a high level of confidence, such as TaxPack. The Review has concluded that, even if these products are not suitable

[94] See Inspector-General of Taxation, Work Program, above n 46.
[95] See, for example, Ann O'Connell, 'The ATO and the Giving of Advice' (Paper presented at the Centre for Tax Law Workshop, 12 July 2011).

for inclusion in the formal public rulings series, some of them should have the same protection as public rulings for self-preparer taxpayers. However, it would be extremely expensive and difficult for the Tax Office to attempt, in the short term, to review all its publications to determine whether they should be binding. The Review therefore concludes that this power should be confined to non-business individual self-preparers and used as existing premier products are updated.

Recommendation 2.3

The Commissioner should be empowered to declare that advice provided for the general information of non-business individual self-preparers (for example, TaxPack) is legally binding upon the Tax Office.[96]

2.160 However, the IGT's 2009 *Review of the Tax Office's administration of public binding advice*[97] found that the ATO had not made significant parts of TaxPack or *e-tax* legally binding. The IGT notes that this position remains today.

2.161 In 2009, the ATO rewrote TaxPack to remove what it considered to be unnecessary guidance. Research conducted in that year indicated that *TaxPack 2009* was operating at a high level of efficacy, with 88 per cent of users saying it was easy to use and 65 per cent (71 per cent of non-retirees) said the language was easy to understand.[98] Only 15 per cent said that there was room to improve the wording. Importantly, the research identified retirees (60+ years old) as the group with most difficulties in understanding language and ease of use.

2.162 However, the demand for TaxPack has decreased recently, mainly due to a preference for *e-tax*. In 2010, 770,000 of the 3.1 million (approximately one-quarter) taxpayers that prepared their own tax returns (self preparers) used TaxPack. The remaining individual taxpayers used *e-tax*.[99] The ATO has also observed that self-preparers are making greater use of *e-tax* each year, from approximately 1.5 million e-tax lodgements in 2006 to 2.5 million in 2010.[100] There are also indications that significant numbers of individual taxpayers have stopped using tax agents for tax return lodgement and are using *e-tax* instead.[101]

2.163 Research conducted in 2011 into the motivations of remaining TaxPack users revealed 41 per cent were unable to lodge tax returns online (46 per cent of this group are 60+ years old) because they had no internet access or lacked computer literacy.[102] A further 30 per cent were able to lodge online but were unwilling to do so because of security concerns and lack of familiarity with the electronic lodgement methods.

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[96] The Treasury, above n 1, p 11.
[97] Inspector-General of Taxation, above n 55.
[98] Roy Morgan Research, Australian Taxation Office, *Review of TaxPack 2009 Research* (2009) pp 2–5.
[99] Australian Taxation Office, Tax Return Guide Project: Concept Brief, 20 November 2011, p 5.
[100] Australian Taxation Office, Tax Return Guide Project: Presentation, 16 December 2011, p 1.
[101] Australian Taxation Office, above n 19, p 5.
[102] Inside Story, Australian Taxation Office, *Understanding Paper Lodgers 2011: Final Marketing Research Report*, (2011) p 3.

2.164 The ATO advised that from 2011–12 it will produce TaxPack as a very short and simple set of instructions with only that information essential to completing the return form:

> to provide taxpayers with only information essential to completing the tax return, focussing on the circumstances of the majority, while making further detailed information available on the website.[103]

2.165 The ATO advises that in addition to changing TaxPack, it will develop strategies to encourage unwilling online tax return lodgers to use online lodgement and ensure those who cannot are adequately supported.[104] During the finalisation of the report, the ATO advised that the support mechanisms include additional call centre resources (to print and mail the more detailed web based content if required), support in ATO shopfronts and the Tax Help program.[105] The ATO will also focus its efforts on increasing the usage of *e-tax* and developing a web-based tax return guide that can deliver more complex instructional content.[106]

2.166 In relation to individuals' income tax return preparation, the ATO is positioning itself for a generational shift in engagement and communication. However, the IGT notes that for those taxpayers unable to lodge electronically, the ATO should support them in a manner that ensures they are able to obtain certainty with minimal additional compliance costs. In any event and regardless of the form of tax return preparation, taxpayer certainty should be preserved through robust protections.

2.167 In relation to TaxPack, the Commissioner has sought to reduce the scope of the document to a set of instructions to fill in the return form. Although, there is an intention to develop strategies to support those taxpayers unable to use electronic based systems, in the IGT's view, the ATO should not reduce the scope of TaxPack and such reduction should not be even considered until after these strategies are successfully implemented.

2.168 As set out above, the ROSA report recommended that the ATO should be able to declare general information for non-business individual self preparers as legally binding on the ATO.[107] The intention of the laws introducing the current advice framework, amongst others, were to make:

> advice in the form of rulings by the Commissioner available to many taxpayers on a wide range of matters.[108]

2.169 However, the ATO has not stated that it will increase the scope and level of protection of TaxPack or *e-tax*, notwithstanding the law's ability to cover such publications. In fact, since 2009, the ATO has indicated that it would reduce the scope

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[103] Australian Taxation Office, above n 100, p 1.
[104] Australian Taxation Office, above n 99.
[105] Australian Taxation Office, Communication to the Inspector-General of Taxation, 7 August 2012.
[106] Australian Taxation Office, Communication to the Inspector-General of Taxation, 14 March 2012.
[107] The Treasury, above n 1, Recommendation 2.3.
[108] Explanatory Memorandum, House of Representatives, Tax Laws Amendment (Improvements to Self Assessment) Bill (No 2) 2005, Ch 4.

and level of protection of TaxPack. The reasons for this are said to be that the ATO has received feedback from individuals that TaxPack was written in complicated legal terms and, if the ATO considered itself bound by TaxPack, that it needed to do so to prevent exploitation.[109] However, the IGT is not aware of any evidence that such exploitation has happened in relation to TaxPack. It is also doubtful that individuals would agree that the TaxPack should be simpler if they knew they were not protected from the adverse consequences of relying on the document. Such feedback on TaxPack's terminology should be considered in light of the limited understanding that the general public are likely to have of the self assessment system.[110]

2.170 There is no legal impediment for the ATO to declare these publications as public rulings and provide certainty to taxpayers. The ROSA recommendations allow some errors to stand and the community bear that cost.[111] TaxPack and *e-tax* has high levels of ATO clearance and the risk of any discovered error is confined to non-business self-preparers. Therefore, any ATO errors would likely be minimal.

2.171 Notwithstanding the reasons for the reluctance to issue more legally binding advice, the ATO has not acted to do so. A major impediment appears to be the ATO's perception that legally binding advice cannot be given in a simple and practical manner.[112]

2.172 In the IGT's view, it is difficult to accept that taxpayers would prefer simpler guidance even if they knew that the ATO's guidance could not be relied upon to protect them against primary tax and, in some cases, penalties and interest. It is not the fact that advice is non-binding that makes it useful, rather the fact that it is clear and simply expressed. Further, were binding public advice clearly and simply expressed, taxpayers would likely consider that binding advice of most use.

2.173 In this respect, the ATO has not acted to achieve the objectives of Treasury's ROSA review.

RECOMMENDATION 2.7

The ATO should re-instate TaxPack to its former scope and declare as public rulings the entire contents of TaxPack, e-tax and web-based individual income tax return lodgement systems.

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[109] See for example, Commonwealth, *Parliamentary Debates*, Joint Committee of Public Accounts and Audit, 23 October 2009, pp 14–17.

[110] See for example, Commonwealth Ombudsman, *The ATO and Main Camp: Report of the Investigation into the Australian Taxation Office's Handling of Claims for Tax Deductions by Investors in a Mass Marketed Tax Effective Scheme Called Main Camp* (2001) pp 12–13.

[111] See The Treasury, above n 1, p 9.

[112] Australian Taxation Office, Communication to the Inspector-General of Taxation, 27 March 2009 in Inspector-General of Taxation, above n 55, p 55.

ATO response: Disagree.

We believe that within the context of the self-assessment system the current advice and guidance framework strikes the right balance between appropriate levels of guidance for all taxpayers and appropriately graduated levels of protection.

We are concerned that shifting tools and calculators to higher categories of protection would require introducing more detailed and legalistic content. Our feedback is that taxpayers that use these products prefer more straightforward guidance on what they need to do in their circumstances rather than more detailed legal explanations required for higher protection levels such as in rulings.

We disagree that TaxPack should be reinstated and given public ruling status. Since e-tax was launched in 1999 lodgment of paper individual tax returns has declined steadily and now represents only 6.5 per cent of all individual tax returns lodged. Due to falling demand, TaxPack was replaced this year with Individual Tax Return Instructions 2012, following extensive consultation with the community. Feedback to date indicates that this change has been well received.

We will review these arrangements at the end of the lodgment season, however, we believe it is unlikely to reveal community demand for the reinstatement of TaxPack.

Decision Impact Statements

2.174 Stakeholders also raised aspects of Decision Impact Statements (DIS) as a matter of concern in submissions.

2.175 The ATO's DIS's communicate the ATO's view on the implications of particular court or tribunal decisions for the ATO.[113]

2.176 The ATO adopted the DIS as the result of a number of recommendations in the IGT's *Review of Tax Office Management of Part IVC litigation*. In particular, the IGT recommended that:

> Following a court or tribunal decision, the Tax Office should promptly make taxpayers aware that the Tax Office's view expressed in a public ruling, determination or interpretative decision may be impacted and that it is under review. It should include identifying the paragraphs that are potentially affected and provide guidance to taxpayers on how they should apply the law until the public ruling, determination or interpretative decision is formally amended or withdrawn.[114]

2.177 Submissions to this review indicated three aspects for improvement in relation to DIS's. These aspects are discussed below.

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[113] Australian Taxation Office, *Conduct of Tax Office Litigation,* PS LA 2009/9, 20 November 2009, Schedule F para [70] <www.ato.gov.au>.

[114] Inspector-General of Taxation, *Review of Tax Office Management of Part IVC Litigation* (2006) <www.igt.gov.au>, also subsidiary recommendations 7.5–7.7.

Prompt publication of the DIS

2.178 Where DIS's are produced promptly, they are more effective in giving taxpayers advance indication of where existing ATO views will be subject to change in the future. This signals to them that the area is uncertain and allows them to make decisions to allocate their risk accordingly, for example, those decisions involved in preparing tax notices and BAS in circumstances involving pressing deadlines.

2.179 In the abovementioned IGT review, the IGT observed that immediately following a decision being handed down in a litigated matter, the ATO's procedures required a consideration of the implications of the decision and whether the matter should be appealed. The ATO's finalised Adverse Decision Reports are the corporate record of that process and are maintained on the ATO's intranet. These reports record the significance and consequences of technical issues, including any impact on any published ATO view. They are made available to other staff involved in litigation. As a result, the IGT recommended that DIS's be produced within eight weeks of the date of the final decision.[115]

2.180 However, notwithstanding internal ATO requirements for DIS's to be published within eight weeks,[116] there have been significant delays. Over 90 per cent of DIS's produced from 1 July 2008 to 13 January 2012 were published after 8 weeks of the decision being handed down.

Table 2.2: Numbers of decision impact statements published from 1 July 2008 to 13 January 2012 by time taken to issue from date of decision

Period in which DIS is published (from date of decision)	Numbers of Decision Impact Statements	Percentage of Decision Impact Statement
Within 8 weeks	11	8
Between 8 weeks and 6 months	25	19
Between 6 and 12 months	82	63
More than 1 year	13	10
Total	131	100

Source: ATO

2.181 The ATO advises that a considerable number of DIS's were delayed due to consultation. This may be so, however, of the 120 DIS's being issued after 8 weeks of the decision, in only four cases was an interim DIS issued.

2.182 Notwithstanding these numbers, the ATO has reduced the timeframes for issuing DIS's over the last three years. The ATO advises that:

> [e]xcluding the 12 DIS which were published later than 52 weeks after the matter was finalised (and significantly skew averages), the ATO has reduced the average number of days beyond the 8 week timeframe to publish a DIS as follows:
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> - 2009/10 = 80.9 [days beyond the 8 week timeframe]

[115] Ibid pp 143–144, subsidiary recommendation 7.3.
[116] Australian Taxation Office, 'Online Resource Centre for Law Administration: Review of, or Appeal Against an Objection Decision — Decision Impact Statements'.

- 2010/11 = 67.10 [days beyond the 8 week timeframe]
- 2011/12 = 40.15 [days beyond the 8 week timeframe].[117]

2.183 In the IGT's view, where a DIS is released and the resulting changes to the ATO view are made promptly, the impacts of continuing uncertainty are greatly reduced. Prompt action appropriately recognises the commercial imperatives and timeframes for business and taxpayer decisions that have tax implications (for example, matters regarding trust distributions). Delays can also give rise to difficulties with the ATO's conduct of litigation.[118]

2.184 Given that considerable technical analysis is conducted immediately after a decision is handed down, eight weeks is an appropriate balance between providing taxpayers with a degree of certainty and ATO consideration on which ATO views may be affected by adverse court and tribunal decisions. The ATO should improve its governance processes to publish all DIS's within this time period.

Communicating changes to the ATO's view clearly

2.185 DIS's are most beneficial where they focus on explaining which areas of the ATO's view would change as a result of an adverse court or tribunal decision. This gives taxpayers an indication of where current ATO views would not be applied in future. Where DIS's elaborate on issues beyond these ATO views affected by the decision, they were considered to be less useful.

2.186 Some submissions suggested that understanding the ATO's position would be improved if the ATO were to publish its submissions made to the Administrative Appeals Tribunal or Federal Court upon the decision being handed down. It was felt that these documents would give taxpayers a valuable insight into the ATO's arguments as they were put to Court. They would also be relatively easy to reproduce on their own, as opposed to incorporating the arguments into an enhanced DIS. However, the ATO advises that were it to publish submissions, there is a danger that confidential information might be disclosed.

2.187 It should be noted that the Federal Court can allow parties who were not part of the litigation proceedings access to certain documents. If there is no order that a transcript be made confidential, a person may obtain a copy of the transcript in a proceeding from the Court's transcript provider.[119] However, it does not provide access to submissions made to the Court itself.

2.188 In the IGT's view, the ATO should ensure that DIS's clearly communicate those parts of the ATO's view (for example, the paragraphs in the relevant public rulings, etc.) that are being reconsidered as a result of the adverse decision.

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[117] Australian Taxation Office, Communication to the Inspector-General of Taxation, 15 February 2012.

[118] See for example, in *Howard v Commissioner of Taxation (No 3)* [2012] FCA 352 Jessup J rejected suggestions that delays in issuing a DIS with respect to the judgment in *Colonial First State Investments Ltd v Commissioner of Taxation* [2011] FCA 16 justified the ATO's omission to develop the relevant points in the submissions made at trial.

[119] Federal Court of Australia, *Non-Party Access to Court Documents*, August 2011 <www.fedcourt.gov.au>.

Perception of unduly limiting the impact of adverse decisions

2.189 It is important that the ATO strive to objectively communicate the implications of adverse decisions. Where taxpayers perceive an absence of objectivity, their confidence in the administrator is eroded. Such perceptions appear to be validated where adverse decisions are considered to be confined to the particular facts of that taxpayer's case, whereas the decisions in successful cases are considered to apply to taxpayers more broadly.

2.190 The IGT previously examined this issue in the *Review of Tax Office Management of Part IVC litigation* and found the underlying reasons were perceptions of selective use of precedent, secrecy as to the implications of adverse decisions and the ATO not fully explaining the impact of these decisions on ATO policy.[120] The IGT recommended that the ATO take action to address these perceptions by introducing a standard communication product (the DIS) as a means to address these perceptions.[121] In the IGT's follow up review, the IGT agreed that the recommendation had been implemented as he found the DIS was well received by the community and taxpayers were given an opportunity to provide feedback within eight weeks of publishing the DIS.[122]

2.191 However, during the current review, some submissions reiterated the original concerns above. They stated that recent DIS's show that adverse decisions were slightly more likely to be represented as confined to their facts than favourable decisions. Additionally, they argued that if:

- the ATO applied its view in a particular case,
- that case was litigated and the outcome was adverse to the ATO (an adverse decision), and
- the relevant DIS stated that the judicial decision was open on its facts, however, there was no change to the ATO view to accommodate the adverse decision,

the ATO should either explain what facts distinguish that case from the application of the ATO view or amend the ATO view to indicate the type of facts that will lead to a contrary outcome. They argue that to not do so would mean that the ATO's view ignores the applicability of the Court decision.

2.192 The IGT considers that further transparency would assist to minimise adverse perceptions in this respect. For example, the ATO could more clearly explain the material facts that distinguish the application of its view. Transparency would also be improved by the ATO publishing its views of issues raised in feedback on the DIS (in a similar way that it publishes a compendium to feedback received on draft public rulings). However, there are a number of difficulties in implementing such an

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[120] Inspector-General of Taxation, above n 114, p 152.
[121] Ibid p 153, key recommendation 6.
[122] Inspector-General of Taxation, *Follow Up Review into the Tax Office's Implementation of Agreed Recommendations Included in the Six Reports Prepared by the Inspector-General of Taxation between August 2003 and June 2006*, Sydney, 2007, pp 20–22 <www.igt.gov.au>.

approach without ensuring the detail of such changes are the subject of detailed consultation with DIS users.

RECOMMENDATION 2.8

The ATO should consult with taxpayers, tax practitioners and their representative bodies on ways to improve its Decision Impact Statements (DIS's). Such consultation should consider:

(a) communicating those parts of the ATO's view (for example, the paragraphs in the relevant public rulings, etc.) that are being reviewed as a result of the adverse decision;

(b) improving the timeliness of DIS's, including issuing a draft DIS particularly where a final DIS is likely to be delayed beyond the 8 week timeframe; and

(c) improving transparency of the ATO's DIS's by:

(i) explaining the material facts that distinguish the application of the ATO view for those unfavourable decisions that do not lead to a change in ATO view; and

(ii) publishing a compendium of feedback in the DIS's, and its consideration of the issues raised in that feedback.

ATO response: Agree.

Decision Impact Statements were established by the ATO following an earlier IGT recommendation in April 2006 (Key Recommendation 6 of the Review of Tax Office Management of Part IVC Litigation), and so it is timely for us to review these products with the community to ensure they continue to be fit for purpose, including identification of opportunities for improvement as suggested by this recommendation. The ATO has a number of existing consultative forums – particularly the Dispute Resolution Sub-committee of the National Tax Liaison Group (NTLG) – which we will use to consult on potential improvements to our Decision Impact Statements.

Better communication on changes to non-binding information

2.193 As discussed above, taxpayers may consult relevant ATO guidance in seeking to minimise their risks when self assessing in an areas of uncertainty.

2.194 Where this non-binding information was withdrawn or changed, stakeholders noted that it would be useful to know the ATO's reasoning behind this, particularly whether the ATO's view was changing, or whether it was being reconsidered. The ATO advises that it provides reasoning for changes or withdrawal in relation to certain types of ATO precedential documents, such as rulings and practice statements. The IGT considers that such an approach should be adopted for all precedential ATO documents to improve certainty for taxpayers.

RECOMMENDATION 2.9

The ATO should communicate the reason for withdrawing or changing any precedential documents which convey its approach to the law.

ATO response: Agree.

The ATO agrees that it is important to provide an explanation for withdrawal or changes to precedential documents which convey the ATO's approach to the law, and, as the Inspector-General has noted, we already do this for most types of precedential documents. The ATO will revise instructions (PS LA 2008/12 Public advice and guidance products: selection, development, publication and review processes) to ensure staff provide an explanation for withdrawal or changes for all precedential documents, including precedential fact sheets and guides.

CHAPTER 3 — ADMINISTRATOR'S COMPLIANCE DUTY AND ASSURANCE

BACKGROUND

3.1 As part of Australia's self assessment system, the ATO has a duty to collect tax in accordance with a correct assessment.[123] The ATO is not a party to the underlying transactions and arrangements that give rise to taxpayers' tax liabilities and, in this sense, operates in an environment of information asymmetry.

3.2 However, it is not considered to be an efficient use of Government resources for the ATO to gather all information in relation to each taxpayer and check every single tax return. This was the key reason in moving away from the former full assessment system.[124] Further, the Courts have recognised that the revenue authority has a duty of good management, which results in circumstances where not all the tax known to be due will be collected.[125] Additionally, section 44 of the *Financial Management and Accountability Act 1997* (FMA Act 1997) requires the Commissioner to manage the affairs of the ATO in a way that promotes the efficient, effective, economical and ethical use of resources for which he is responsible. This means that the ATO is not required to pursue every dollar of revenue properly payable where the costs in doing so would be prohibitive.

3.3 In this respect, the ATO takes a risk based approach to compliance actions.[126] This requires the ATO to gather relevant information and make a decision on what administrative treatment it will afford each taxpayer.

3.4 As such, the ATO is aligning itself with broader international trends in compliance assurance, particularly those aimed at:

- securing taxpayer commitments to increase cooperation and transparency as part of its tax compliance framework and embed effective tax compliance frameworks within taxpayer's broader risk management systems;[127] and
- adopting compliance risk management strategies that involve risk-orientation and differentiated responses, complemented by shifting compliance activities

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123 *Brown v Federal Commissioner of Taxation* (1999) 42 ATR 118, 130 (Hill J).
124 Joint Committee of Public Accounts, above n 27, pp 64–65.
125 *Inland Revenue Commissioners v National Federation of Self-employed & Small Businesses Ltd* [1982] AC 617, 651 (Lord Scarman).
126 Australian Taxation Office, *Compliance Program 2011–12* (2011) p 3.
127 For example, the UK's approach to Senior Accounting Officers' certificates.

upstream to address risks earlier in the sequence of events potentially leading to compliance failures.[128]

3.5 On a broad level, the ATO currently uses a number of programs and models to assist in selecting taxpayers for compliance verification.

3.6 The Compliance Program outlines the differing foci for ATO compliance activities. It is updated and published on an annual basis.

3.7 The ATO's Risk Differentiation Framework (RDF) sorts taxpayers according to the comparative likelihood and consequence ('higher' and 'lower') of their non-compliance with the tax laws on the basis of information provided to the ATO.[129] Although the RDF is currently employed in the large business market it is intended to be rolled out next to small and medium sized enterprises (SMEs) and high wealth individuals (HWIs).

3.8 The ATO also refines its approach depending on the particular market segment it is examining. For example:

- in relation to individuals lodging income tax returns, the ATO uses its computer systems to assess the risk of inaccurate claims before any refunds are issued (the tax refund integrity program);
- in relation to small businesses, the ATO uses its cash economy model and industry benchmarks to identify cases for risk assessment and compliance verification;
- the larger SME market and HWIs are more closely scrutinised using a private wealth approach that seeks to identify the controlling mind of organisations and their links between different tax entities as a means to better identify tax risks; and
- in relation to large businesses, the ATO seeks to understand not only the tax risks but the entity's tax risk governance framework and processes (which themselves form part of the ATO's risk assessment).

3.9 Compliance assurance can involve a graduated level of intensity from initial risk assessment through to full audit. Typically, it can involve increased information gathering post-assessment. However, recently, the ATO has increased its collection of detailed information before an assessment is lodged (pre-assessment disclosures) as well as increasing requirements for additional disclosures at the time of lodgement (expanded lodgement disclosures).

3.10 For individuals, this can take the form of the ATO delaying the issue of refunds pending the verification of certain claims and provision of information, such as through its tax refund integrity program.

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[128] Forum on Tax Administration, OECD, *Executive Overview: Working Smarter* (2012) p 3 <www.oecd.org>.
[129] See for example, Australian Taxation Office, *Large Business and Tax Compliance* (2010) pp 6–7.

3.11 For 'higher consequence' taxpayers (those liable to pay more tax as compared to the general taxpaying population, such as the largest businesses or larger SMEs and HWIs) this can take the form of annual compliance arrangements (ACAs), pre-lodgement compliance reviews (PCRs), international dealing schedules (IDSs) and, in some circumstances, it could also include requests for private rulings.

3.12 Pre-assessment disclosures and expanded lodgement disclosures impose additional compliance costs on taxpayers, such as additional time spent by staff and advisors in compiling and reporting extra information. At the same time, there is no corresponding reduction in the level of uncertainty, such as shorter period of review, faced by taxpayers subject to these disclosure requirements:

> For the taxpayer tax risk can arise because the taxpayer expects a particular tax result, but for any number of reasons, may end up with a different tax outcome. One of the ways in which that risk can be reduced to zero is where the ATO loses the ability to enforce a different tax outcome. If a point is reached when the ATO cannot change the tax payable in respect of particular year of income, then there is no tax risk associated with that year of income.[130]

3.13 A range of stakeholders contended in submissions that this movement in the pendulum represents a move backward towards full assessment by way of increased information gathering at or before the time of assessment without any of the previous benefits available from the former full assessment regime. It also raises the issue of whether ATO practices may be improved in order to reduce compliance costs and deliver greater certainty to taxpayers, without significantly impacting on the ATO's ability to collect the correct amount.

3.14 Key themes arising from these submissions were as follows:

- Information gathering;
- The ATO's risk differentiation framework;
- The role of the private sector adviser;
- Taxpayer uncertainty and periods of review; and
- Aspects of specific ATO activities.

3.15 Each of these themes is discussed in the sections that follow.

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[130] White and Walpole, above n 2, p 4.

INFORMATION GATHERING

Issues arising from submissions

3.16 The private sector has publicly commented on the ATO's increasing appetite for information for a number of years. However, recent changes to tax administration, both for individuals as well as businesses, have prompted a number of fundamental questions. For example, what amount of information is appropriate to collect in a self assessment environment? Should refunds of overpaid tax be delayed pending the outcome of risk identification processes, or should compliance verification occur after the amounts are refunded? If both, then where should that balance lie? Given that taxpayers operate in a self assessment environment, is it appropriate that information on sensitive tax risks be requested before taxpayers have had an opportunity to assess their affairs themselves? If a risk based approach is desirable, then what type of information should be requested to identify the potential likelihood of a risk? Should this include evidence of all material facts of each issue and evidence of sufficient taxpayer tax-risk governance processes? Should information gathering be aligned with the taxpayers' natural business systems, or should new ones be created to satisfy ATO information requests?

3.17 In addition to the ATO's recent desire for more information at, or prior to, the time of lodgement, the IGT noted in its large business report[131] that there are also external factors which affect the amount of information the ATO might require from taxpayers. For instance, the Federal Court's *Practice Note TAX 1*[132] sets out arrangements for the management of tax cases that are litigated in the Federal Court. As a consequence of this practice note, the ATO advises that it now seeks to collect more information at earlier stages to ensure that it is 'litigation-ready' at the objection stage.

3.18 Overall, many business stakeholders noted that there is often not a clear limit to the amount of information the ATO requires from a particular taxpayer in relation to pre-assessment or expanded lodgement disclosures. Furthermore, through discussions with the ATO it has been established that there is no official policy on what is a satisfactory amount of information.

3.19 Senior ATO officers confirm that, in order to determine risks for compliance assurance purposes, their objective is to obtain enough information not only to understand the transaction or arrangements but also to understand the taxpayer and be assured that they are treating their tax risks appropriately.[133]

3.20 The ATO explains that for larger business taxpayers it needs an understanding of the taxpayer's governance systems. Where the ATO was unsure

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[131] Inspector-General of Taxation, *Report into the Australian Taxation Office's Large Business Risk Review and Audit Policies, Procedures and Practices* (2011) p 31.
[132] Federal Court of Australia, *Practice Note TAX 1* (1 August 2011) <www.fedcourt.gov.au>.
[133] Australian Taxation Office, Communication to the Inspector-General of Taxation, 15 December 2011.

about a taxpayer's systems, it tests the information the taxpayer provided. Where these systems have been assured, the ATO would need to test whether the taxpayer is treating tax risks appropriately. Where the ATO is assured of both the taxpayer's systems and that they are treating risks appropriately (such as though an ACA or a PCR), there is no need for further investigation.[134]

3.21 In this respect, submissions raised a number of concerns with specific ATO compliance activities, such as ACAs. These are discussed further below.

3.22 Many representatives of individual income taxpayers also argued that delaying the refund of income tax refunds for extended periods of time in a self assessment system was disproportionate to the perceived risks which could have been better addressed through post-assessment assurance. These delays were said to substantially and adversely affect taxpayers and their advisers.

3.23 It is apparent from submissions and discussions with the ATO that, broadly:

- the costs and impacts of ATO information gathering can be significant and there is no clear guiding principle that limits how much information the ATO needs before or at lodgement of tax returns;
- ATO consultation with taxpayers on the design of information gathering activities could improve taxpayers' experience with ATO information gathering;
- there is opportunity to tailor disclosure requirements; and
- there is opportunity to reduce taxpayer uncertainty by shortening periods for administrative review.

3.24 These issues are discussed below.

Costs and impacts of ATO information gathering

3.25 At a broad level the ATO needs information to assure itself of taxpayer compliance with the tax laws. However, significant costs arise from dealing with ATO information requirements. Therefore, the costs imposed should be proportionate to the risks of non-compliance. This implies a differentiated and graduated approach to ATO information gathering based on cogent and iterative risk assessments.[135]

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[134] Australian Taxation Office, Communication to the Inspector-General of Taxation, 15 December 2011.

[135] See for example New Zealand's application of the Compliance Management Cycle and the initial concepts from the Treatment Dictionary in its Property Compliance Programme as outlined in Robert Russell, 'Our Journey on Compliance – IR's Story' (Paper presented at the ATAX UNSW 10th International Tax Administration Conference, Sydney, 2 April 2012).

3.26 The costs of tax compliance are high. However, this is neither new nor unique to Australia. There are a number of surveys indicating the costs of tax compliance. Of these studies, the ATO observes in its call for tenderers on a specific research exercise that:

> [Quantitative] [s]tudies of compliance cost in general have been undertaken in Australia and overseas by academics, business, industry and professional groups and by governments. The methodologies used and focus have varied. The quality of the research has often been mixed; even many of the biggest and well resourced studies have attracted their share of criticism. … Previous research on cost of compliance may serve as a general reference only.[136]

3.27 Historically, the ATO has publicly reported the administrative costs of compliance activities, such as operating expenditure for active compliance activities. Internally, it has used certain administrative costs, such as the full-time equivalent staff, as a proxy for costs in delivering certain compliance strategies. In some cases the ATO has also surveyed relevant taxpayers to understand their perceptions.

3.28 For changes to taxation laws, the ATO has developed a methodology to calculate the compliance costs resulting from new legislation. In summary, the ATO uses a structured qualitative assessment to explain who is impacted, how they are impacted and the magnitude of the impact. Relevant ATO and Treasury officers review these assessments and produce many of the parameters used in the quantification of compliance costs. In this respect, the quantification of the impacts arising from new law:

> are usually based on the ATO's General Compliance Cost Model. This model employs an array of estimates for the yearly expenditure on key compliance activities separated by user type (such as individuals, micro enterprise, large enterprise, etc) and the type of tax (excise, GST, etc).
>
> The key data points on which the model is based are:
>
> 1. Current time spent in compliance activity
>
> 2. Current monetary costs associated with compliance activity
>
> 3. Indications of the magnitude of variation following a proposed change
>
> To calculate the compliance cost, the model multiplies the data on time currently expended for compliance activity by the expected proportional increase/decrease. The numerical proportion employed in the model is categorically defined by an ATO analyst having assessed the variation to be low, medium or significant magnitude. By multiplying the time-based estimate produced by the average adult hourly wage, the model determines the dollar value of the marginal change in time spent on a compliance activity.

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[136] Australian Taxation Office, *Research Brief – Measuring Compliance Costs: Enhancing the ATO's Ability to Estimate Compliance Cost Impacts* (2011).

> Direct monetary costs resulting from compliance are also incorporated, such as the hiring of services (such as financial advisors) and required purchases (such as IT packages).
>
> These estimates are produced in terms of the initial variation and the ongoing impact. While most legislative changes will result in an initial compliance cost (due to re-education, and adjusting procedures) the ongoing variation may either produce increased or decreased obligations.[137]

3.29 In March 2011, the ATO invited market research suppliers to submit proposals for conducting research into compliance costs, including the provision for updating the ATO's model.[138] The ATO advises that a commercial market research firm won the tender.[139]

3.30 It is important for government to be aware of whether disclosures will increase compliance costs and intensify the costs and impacts of uncertainty inherent in the system. Where there is awareness of the costs, policy makers are better equipped to make balanced decisions such that the overall benefit to the system is the greatest that can be achieved at the lowest overall cost to the economy.

3.31 Notwithstanding their work on estimating the potential compliance costs for new law, pre-assessment and expanded lodgement disclosure obligations extend beyond information traditionally collected in the tax returns and may not directly relate to legislative change. As a basis, all agree that those with the greatest unmitigated tax risk should bear a greater compliance burden than those with a lower tax risk. However, there is a need to recognise the additional costs imposed as a result of this increased compliance burden and a need to cogently justify that imposition on the basis of a likely increase in risk. At present, it is noted that some independent surveys rate the ATO amongst those agencies imposing the greatest compliance costs on business taxpayers.[140]

3.32 To this end, the IGT observes that there would be benefit in an independent government body such as the Productivity Commission undertaking a study to measure tax related compliance costs and their impact on the administrator, the taxpayer, tax practitioners and the Australian economy as a whole. Such study would also advance understanding of the broader effects of such action and provide a cogent base from which to obtain a balanced assessment of the efficacy of the broad taxation system in this regard.

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[137] Ibid.
[138] Ibid.
[139] Australian Taxation Office, Communication to the Inspector-General of Taxation, 6 June 2012.
[140] NSW Business Chamber, *Annual Red Tape Survey 2011* (2012) <www.nswbusinesschamber.com.au>; see also, OECD, *Businesses' Views on Red Tape: Administrative and Regulatory Burdens on Small and Medium Sized Enterprises* (2001) <www.oecd.org>.

RECOMMENDATION 3.1

The Government should consider commissioning an appropriate independent body, such as the Productivity Commission, to publicly report on the cost of taxation related compliance, including taxpayers' costs and the overall cost to the economy.

ATO response: Matter for Government.

Consultation to improve the ATO's information needs

3.33 The potential to reduce the level of compliance costs indicates a need for greater consultation on the information needs of the ATO and whether those needs are proportionate to the relevant risks.

3.34 A consistent message in submissions to this review was that had the ATO consulted more effectively with the community in the design of its recent information requirements, it could have obtained the information in a manner that imposed less of a compliance burden on taxpayers. [141]

3.35 The broader issue of consulting taxpayers and advisers to determine more effective and efficient means of information gathering has been raised at peak consultative forums, such as the ATO Large Business Advisory Group's (LBAG) discussion on PCRs, and identified in other IGT reviews, such as the *Review into the ATO's small and medium enterprise audit and risk review policies, procedures and practices.*[142] Furthermore, during the course of this IGT review's working group meetings a number of ideas for improved information gathering were seen as worthy of further consideration by the ATO.

3.36 The ATO advises that it is aiming to improve its consultation on information gathering and that it is currently consulting with taxpayer groups through the National Tax Liaison Group (NTLG).

3.37 In discussions with senior ATO staff, it was noted that the ATO does consult the community when it decides to initiate a change, however, there is no programmed consultation in relation to the appropriateness of existing disclosures:

> Process of company tax return consultation
>
> The company tax return undergoes a comprehensive annual review. Not every change to the tax return and instructional material is subject to an external consultative process. However, any significant/material changes are co-designed with external stakeholders. Changes to the return form and instructional material is often the end product of a legislative change. The law design is led by Treasury and the administrative design is

[141] See also, Inspector-General of Taxation, above n 129, ch 7.

[142] Inspector-General of Taxation, *Review into the ATO's Small and Medium Enterprise Audit and Risk Review Policies, Procedures and Practices* (2011) <www.igt.gov.au>.

> the responsibility of the ATO. It is usual for both processes to involve external consultations. We also keep in close contact and liaison with the external software developers through every tax time cycle as part of the software developers consultative forum (held bi-monthly) and electronic lodgment service (ELS) forum (held annually).
>
> Examples of recent company tax return changes involving external consultations are:
>
> Taxation Of Financial Arrangements (TOFA) …
>
> Company tax return – Calculation statement …
>
> International Dealings Schedule (IDS) …
>
> Reportable tax positions.[143]

3.38 The ATO has noted that some disclosures formerly required at the time of lodgement are now obsolete and schedules should be revised accordingly. This was a result of recent ATO research in which the 1350 tax return related labels were examined. The ATO determined that some of the labels were not used and therefore should be deleted (these labels, however, not have not been deleted as yet due to capacity constraints with the ATO's Tax Time change process). At the time of finalising the report the ATO advised that:

> The ATO intends to delete these labels from the returns and schedules for the 2012-13 year onward. This is expected to see:
>
> - The removal of approximately 30 labels from the company, partnership and trusts annual income tax returns
> - The removal of about half of the labels currently on the capital gains tax schedule
> - The deletion of the capital allowances schedule
> - The deletion of the personal services income schedule
> - Consequential changes to the individual, superannuation fund and self managed superannuation fund returns to mirror the changes to the business returns.[144]

3.39 The ATO also determined that most labels were used with many being used for risk and monitoring purposes. The ATO is now considering whether these labels could be improved to make them more usable and to reduce compliance costs.[145] The ATO has been involved in community consultations as part of this project.

3.40 The ATO has also advised that it is considering a project to 'differentiate' returns depending on its feasibility.[146] The ATO's concern is that it may only achieve small and piecemeal changes to the returns in very small and staged increments. These

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[143] Australian Taxation Office, Communication to the Inspector-General of Taxation, 28 June 2012.
[144] Australian Taxation Office, Communication to the Inspector-General of Taxation, 7 August 2012.
[145] Australian Taxation Office, Communication to the Inspector-General of Taxation, 3 February 2012.
[146] Australian Taxation Office, Communication to the Inspector-General of Taxation, 28 June 2012.

limitations are largely due to the ATO's capacity to support the underlying technological system changes required.[147]

3.41 The ATO has also acknowledged that there is room for it to improve its approach to pre-assessment and expanded lodgement disclosures in order to decrease the compliance costs faced by taxpayers.

3.42 Where the ATO has consulted with taxpayers and their representatives regarding the content of pre-assessment and expanded lodgement disclosures and tax returns, it has been able to obtain a better picture of the costs associated with particular requirements and therefore tailor its approaches by balancing the costs to the taxpayer against the ATO's needs in administering tax laws.

3.43 In the IGT's view, the ATO should ensure that it consults with the community on its current and future information gathering requirements to ensure that these requirements are imposed in a manner that minimises the compliance burden on taxpayers and is proportionate to their tax risk.

3.44 Annual consultation with taxpayer representatives should take place regarding the form and content of pre-assessment and tax returns including expanded lodgement disclosures, albeit that the opportunity to give effect to any information technology changes may be limited in the short term.

RECOMMENDATION 3.2

(a) The ATO should consult with taxpayers, tax practitioners and/or their representative bodies every five years on information it seeks in company returns (as well as associated pre-assessment and expanded lodgement disclosure, such as annual compliance arrangements, pre-lodgement compliance reviews, the international dealing schedule and the reportable tax position schedules). This is in addition to its current practice of consulting on new information as the need for them arises pursuant to a change in the law.

(b) The ATO consultation with tax taxpayers, tax practitioners and/or their representative bodies on individual tax returns should include discussion on the information being sought through expanded lodgement disclosures as well as the tax return itself.

ATO response: Agree.

We will develop and implement procedures to periodically consult with relevant consultative forums and the community to review the information required on company and individual income tax returns and associated schedules as well as the information requested as part of pre-lodgment compliance reviews and annual compliance arrangements.

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[147] Ibid.

Lowering compliance costs — tailoring businesses' electronic lodgement

3.45 In the longer term, the ATO sees that there is potential to make collection of information easier and more tailored by using electronic channels to collect information which is already produced by taxpayers' own systems.

3.46 With advances in electronic communications, there may not be a need in the future for at least business taxpayers to lodge returns. Rather the ATO would merely collect an electronic copy of the business taxpayer's accounts and tax calculations, as well as some assurance of accuracy.

3.47 In the long term, the ATO should aim to align its information needs, as practicably as possible, to taxpayers' natural business and accounting systems, with the eventual aim that tax returns will not need to be lodged.

RECOMMENDATION 3.3

With the aim of reducing compliance costs, the ATO should better align its tax information collection with natural business systems, such as electronic company financial systems.

ATO response: Matter for Treasury.

This is the intent of Standard Business Reporting which is current government policy and the responsibility of the Treasury.

The ATO, as a participating agency, is committed to supporting the business outcomes of SBR and has agreed to contribute to the ongoing development of the SBR taxonomy as a whole-of-government asset.

Lowering compliance costs — individual tax return lodgements

3.48 Individuals' tax returns comprise a substantial number of all tax returns lodged. The ATO advises that, for the purposes of specific research it conducted relating to the measurement of compliance costs, these individuals can be categorised as:

- Non-business individuals (general) – people who lodge income tax returns with no business income (about 9 million taxpayers).
- Non-business individuals (complex) – generally people who lodge income tax returns with no business income but with material property and investment activity (about 5 million taxpayers).

- Business entities – either operating as a taxpayer or as a key third party (that is employers) [such as] Micro business – generally any entity (sole trader, partnership, trust, company) with business income up to $2 million in total business income (about 2 million entities).[148]

3.49 In the Australian system, employees have tax deducted from their salary and wages at source. This in an effective means to help these individuals to 'save' for a tax liability at the time of income tax return lodgement. The ATO assists employers and others by producing pro-rated schedules and a means by which these amounts can be remitted to the ATO and held pending assessment.

3.50 Although a substantial portion of individual taxpayers with simple affairs may have sufficient tax instalments deducted at source to fulfil their tax liabilities, a proportion are eligible to claim substantial deductions or offsets (such as work related expenses or rebates) as a result of a number of redistributive policy objectives effected through the tax system. This introduces increased compliance costs in terms of ensuring compliance with the tax laws and seeking advice.

3.51 The ATO is seeking to make it easier for individuals to lodge returns by adopting the Scandinavian model of pre-populating income tax returns.[149] In this respect, the ATO pre-fills individual tax returns with information sourced from third parties.

3.52 There is a compliance cost imposed on those third parties providing this data. While these costs should also be included for overall measurement in testing the effectiveness of the system, in many instances they serve the interests of the providers' clients who are also taxpayers.

3.53 The ATO advises that there was a 25 per cent increase in the take up of pre-filling for the 2010 financial year (9.4 million individuals) and a 15 per cent increase in the 2010–11 financial year (10.9 million individuals). Interestingly, for the 2010–11 financial year, the greatest use of pre-filling has been by tax agents by downloading information for 8.4 million individuals from the tax agents' portal.[150]

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[148] Australian Taxation Office, above n 136.

[149] See also Forum on Tax Administration: Taxpayer Services Subgroup, Centre for Tax Policy and Administration, OECD, *Information Note - Third Party Reporting Arrangements and Pre-filled Tax Returns: The Danish and Swedish Approaches* (2008) <www.oecd.org>.

[150] Michael D'Ascenzo, 'Mitigating risk' (Speech delivered at the 10th International Tax Conference (ATAX), Sydney, 2 April 2012).

3.54 The ATO has recently advised the IGT that it considers that, at present, it has expanded the provision of the pre-filling service as far as it can without significantly imposing additional costs on third party information providers or legislative removal of concessions delivered through the income tax system:

> The ATO considers that there is currently limited opportunity to expand its pre-filling service without legislative change to facilitate the sourcing of additional data. Any change to the reporting obligations would ideally:
>
> - require comprehensive reporting obligations for all major income and deduction items,
> - require the more timely provision of information, and
> - improve the accuracy of the information provided.
>
> Costs to third party providers will need to be weighed against the anticipated benefits.[151]

3.55 In the IGT's view, future technological improvements may further lower compliance costs for taxpayers and third party providers. However, the ultimate success in expanding the provision of pre-filling depends, to a large extent, on the degree to which social policy objectives are delivered through the tax system. In this respect, the Government has acted to increase the tax free thresholds, which may exclude a number of individuals from the requirement to lodge income tax returns. Standard deduction allowances have also been explored. There are also other approaches aimed at decreasing individuals' compliance costs which could be explored further, such as improving technological platforms.

3.56 As such, the ATO has moved to align individual tax return preparation and lodgement with changes in use of technology. *E-tax* is a valuable innovation in this respect. However, there is potential for the technology to be better utilised to improve the usability by individuals without a direct knowledge of tax law. As technology develops further, there may be potential for the ATO to develop an interview style product that prepares the return from answers to simple questions. Although current technology may not robustly support such a measure, this could be an aspiration that the ATO works towards under its long term information technology plan.

3.57 There is also the potential for future mobile telephone-based payment applications to become integrated with accounting software and lodgement systems. Recently, commercial mobile phone applications have been accepted to make certain payments electronically. With future advances in technology this may allow for the applications to determine the transactions' tax implications and record those transactions in an acceptable format which allows them to be used to pre-populate the relevant tax notice/return for electronic lodgement.

3.58 Although technological advances may bring these innovations closer the IGT considers that the ATO could explore options for further simplification in the interim.

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[151] Australian Taxation Office, Communication to the Inspector-General of Taxation, 28 June 2012.

RECOMMENDATION 3.4

The ATO should explore options for further reduction of compliance costs related to individuals' tax return lodgement obligations, such as:

(a) the earlier provision of third party information (without increase in their compliance costs); and

(b) improved technological platforms.

ATO response:

3.4(a) Matter for Government.

The ATO believes that there are limited opportunities to further expand this area without legislative change.

3.4(b) Agree.

Our future direction is to move to more web-based applications. The speed of our movement will be impacted by technological capability and cost.

In the longer term our aspiration is to move to device agnostic approaches which will enable taxpayers, regardless of the platform they use, to interact with us in a similar way.

Information gathering in relation to general anti-avoidance

3.59 Submissions raised concerns with the costs imposed by ATO information gathering in relation to the general anti-avoidance provisions.

3.60 Part IVA of the ITAA 1936 (the income tax general anti-avoidance provisions) requires the existence of a 'dominant purpose'. Defining a 'purpose' is inherently difficult to establish on an objective basis without imposing substantial compliance costs incurred as a result of calling for and examining a significant range and volume of documents and other forms of evidence.

3.61 Stakeholders, however, questioned the utility of some of the types of information requested and whether the costs imposed in retrieving that information were proportionate to the risks, particularly in circumstances in which tax avoidance purposes were absent. Stakeholders also commented there was often a lack of ATO understanding about what records are kept and what information is available about the decision making process — for example, documents about commercial decisions made 30 years ago. Such information is often not documented and is difficult to

compile. This issue was also considered in the IGT's *Report into the Australian Taxation Office's large business risk review and audit policies, procedures and practices*.[152]

3.62 Recent judicial decisions on the 'tax benefit' element of Part IVA also appear to have compounded ATO information gathering by prompting the ATO to examine in greater detail multiple counterfactuals (schemes which might have eventuated but did not).

3.63 It should be noted that the Government has recently announced an intention to amend the general anti-avoidance provisions.[153] Therefore, further assessment of the administrative impacts on information gathering would best be made some time after the ATO has implemented the relevant administrative arrangements.

THE ATO'S RISK DIFFERENTIATION FRAMEWORK

3.64 The amount and type of information required by the ATO may depend on the ATO's determination of a taxpayer's risk of non-compliance and the potential consequences of such non-compliance. In this respect, the ATO uses its Risk Differentiation Framework (RDF) to determine these risks and consequences, and the ATO's administrative treatment of those risks.

3.65 Currently, in the large business market segment, those taxpayers of higher consequence and having lower likelihood of non-compliance — 'key taxpayers' — are encouraged by the ATO to enter into ACAs. Whereas, those taxpayers of higher consequence and having higher likelihood of non-compliance — 'higher risk taxpayers' — that have not entered into ACAs may be required to participate in PCRs, consisting of questionnaires and meetings with the ATO on a routine basis.

3.66 Those taxpayers of lower consequence — low risk taxpayers — are not subject to such additional disclosure obligations and may expect to receive an ATO letter indicating that the ATO does not intend to audit the taxpayer for a particular tax year.[154]

3.67 As a result, these lower risk taxpayers may be exposed to a lower level of scrutiny by the ATO. However, stakeholders have suggested that the RDF has increased the low risk taxpayers' compliance costs by reason of increased tax corporate governance, such as increased board involvement, increased external legal advice and costs associated with contemporaneous documentation of transactions and positions taken.

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[152] See Inspector-General of Taxation, above n 131, ch 7.

[153] Mark Arbib, Assistant Treasurer, 'Maintaining the Effectiveness of the General Anti‐Avoidance Rule', Media release, 1 March 2012.

[154] Australian Taxation Office, Communication to the Inspector-General of Taxation, 12 October 2011.

RDF process perceived to lack accountability or sufficient transparency in relation to higher consequence taxpayers

3.68 During the review some submissions claimed that the ATO is not accountable or sufficiently transparent in relation to the factors used in formulating risk ratings. They perceived there to be a lack of accountability and natural justice in the process because taxpayers can be rated as 'higher risk' with little or no practical avenue for contesting that view. They state that these ratings will inevitably become generally known in the market place, with the potential to result in a negative reputational impact on the tax director, the company's tax advisers, the company's management and its board.

3.69 In this respect, the IGT recommended in his recent review, *Review into the Australian Taxation Office's large business risk review and audit policies, procedures and practices*, that the ATO provide taxpayers with the opportunity to discuss the basis for the risk rating (recommendation 4.1). This should include the ATO disclosing all facts relied upon in the risk rating and providing the taxpayer with an opportunity to discuss the rating and for the ATO to review any taxpayer reply to the information provided.

3.70 Additionally, the IGT also recommended in that review that the ATO improve its communication about RDF categories. As a result, the ATO has undertaken to consult with the LBAG to enhance the RDF risk categorisation process. Part of this communication will import a degree of accountability and transparency by affording taxpayers an opportunity to understand the basis for ATO risk ratings:

> Later this year, the Commissioner plans to write to the Chief Executive Officer of all large businesses to advise them of the ATO's view of their risk category including an explanation of the concerns that led to that view. At the same time, the ATO will meet with taxpayers in the higher risk and key taxpayer categories to outline the reasons for the ATO's view of their RDF risk category. This conversation also provides an opportunity to clarify the ATO's concerns and what is required to address those concerns.
>
> For medium risk taxpayers, this opportunity for discussion necessarily happens a little later because of the numbers involved. Generally the ATO will meet with the taxpayer at the time of commencing a compliance activity (usually a risk review), although it is an option for the taxpayer to contact the ATO at any time to discuss their RDF risk category.
>
> We will listen to any feedback that taxpayers may wish to provide and will work closely with taxpayers to clearly articulate the reasoning behind our risk categorisation. As this is a matter of informed judgment, it is reasonable for the ATO and taxpayers to hold different views, but the ATO is striving for an open and frank relationship that may, over time, lead to us sharing a common view of compliance risk.
>
> If it can be shown that the ATO's view is based on incorrect or erroneous information we undertake to correct our records and reconsider the categorisation if it is a material

> matter. Alternatively, taxpayers may provide further information to the ATO that will be taken into consideration when we undertake the next cycle of risk categorisation.[155]

3.71 The ATO's implementation of these recommendations will be examined as part of the enhanced ATO processes for ensuring that agreed IGT recommendations are more quickly and appropriately implemented.[156]

Evidence used to establish lack of transparency or engagement

3.72 In addition to the procedural fairness afforded to taxpayers in determining risk ratings, submissions also raised concerns with the evidence used for some of the RDF's inputs, such as 'transparency', 'engagement' and the tax manager's competence.

3.73 In this respect, the ATO's perception of a taxpayer's transparency, engagement and accountability can have a material impact on taxpayers.[157] Importantly, 'higher risk' taxpayers have been advised that the ATO's concerns warrant a 'more intense ongoing compliance stance such as continuous review' until the ATO sees 'strong income tax governance, engagement on potential contentious issues and a more open and transparent relationship'.[158]

3.74 While submissions generally agreed that the ATO should allocate resources in accordance with risk, they considered that these inputs were overly subjective judgements that were based on irrelevant evidence and lacked appropriate accountability.

3.75 Submissions referred the IGT to instances where they considered risks were inaccurately determined because of the subjective judgements made by ATO officers. As a result, this exposed taxpayers to unnecessary and disproportionate compliance costs.

3.76 A particular example of the subjective nature of qualitative tests was said to be the ATO's approach to information protected by law or administrative concession. In this respect, the Commissioner has made a commitment on page 30 of the ATO's *Large Business and Tax Compliance* booklet that:

> You can expect that we will ... respect your right to Legal Professional Privilege or the Accountant's Concession. This will not adversely impact our view of your cooperation.[159]

3.77 However, submissions observed that, in their experience, the ATO perceives non-provision of this information as evidence that the taxpayer is being uncooperative, resulting in an increased risk profile and an atmosphere of distrust.

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[155] Australian Taxation Office, above n 48, Item 3.
[156] See Inspector-General of Taxation, *Annual Report 2010–11* (2011) pp 13–14.
[157] Australian Taxation Office, *Large Business and Tax Compliance*, 2011, p 8 <www.ato.gov.au>.
[158] Australian Taxation Office, Communication to the Inspector-General of Taxation, 12 October 2011; see also Australian Taxation Office, above n 48, Item 3.
[159] Australian Taxation Office, above n 157, p 30.

3.78 Relevantly, a submission gave an example where taxpayers provide summary reports to their Board on the strength of their legal position (including tax) and there was ATO pressure to disclose these reports. This approach was not consistent with the ATO's Practice Statement, *PSLA 2004/14*, which states that such documents will only be requested under exceptional circumstances:

> Circumstances that may be taken to be exceptional and necessitate access to corporate board documents on tax compliance risk would include cases where:
>
> - the taxpayer has not cooperated with the Tax Office to furnish full and complete information in a timely manner
>
> - information important to the risk review or audit, including evidence as to purpose for entering into or carrying out a transaction or arrangement, cannot be sufficiently established from the taxpayer's source documents and other enquiries, or
>
> - the taxpayer has a history of serious non-compliance, for example involving fraud or evasion or persistent avoidance of their tax obligations, or is under investigation in that regard.[160]

3.79 The submission stated that the ATO has told them that other taxpayers provide this information and therefore those that do not are not transparent. Submissions state that the ATO's approach in this regard is simplistic and that it may be company policy not to share such communications at all (i.e. not limited to tax communications). It also raised the issue of whether legal professional privilege would be waived.

3.80 In a similar vein, one submission noted that the ATO sees a failure to obtain a private ruling as an indicator of risky behaviour and potential non-compliance. However, there may be a number of legitimate reasons why a compliant taxpayer would not seek a private ruling on an area of uncertainty — many of which, taxpayers consider, are of the ATO's own creation. That is to say that the taxpayers and their advisers considered that the law was reasonably clear in many instances where the ATO may suggest otherwise. Also, submissions see rulings as importing practical difficulties, being revenue biased, slow and having an unfavourable history where the ATO has some anxiety (see Chapter 2). It was noted that the current system was designed for taxpayers to make their own assessment of their tax positions and only to seek ATO advice, such as a private ruling, where the items were uncertain.

3.81 During the review the ATO advised that it would put in place measures aimed at ensuring the consistent application of risk filters and that, as a part of these measures, ATO perceptions of 'unwilling participation' will not, of itself, result in a higher risk categorisation.[161]

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[160] Australian Taxation Office, *Access to 'Corporate Board Documents on Tax Compliance Risk'*, PS LA 2004/14, 23 December 2004, para [4] <www.ato.gov.au>.

[161] Australian Taxation Office, Communication to the Inspector-General of Taxation, 9 July 2012.

3.82 In the IGT's view, certain putative indicia such as the degree of engagement and transparency that a taxpayer exhibits may be considered to be subjective measures. Given the significant potential adverse consequences arising from the risk ratings, the ATO should take action to ensure that such ratings are based on cogent criteria and independently verifiable evidence.

RECOMMENDATION 3.5

To improve community confidence that ATO risk ratings are based on cogent and independently verifiable criteria, the ATO should, to the extent possible, make publicly available more details on the risk filters and criteria it uses in its risk differentiation framework.

ATO response: Agree in principle.

We will review the material that we already publish about our approach at a market or segment level to see if there is any additional material that is able to be published.

The Risk Differentiation Framework and the ATO's risk engine

3.83 Related to the RDF, is the ATO's risk engine. This system generally provides inputs into the RDF by examining taxpayer-reported information, data from other agencies, the ATO's own intelligence and publicly available information against risk filters to identify potential compliance risks.

3.84 A number of submissions raised concerns with aspects of the risk engine and the use of RDF more broadly. These issues may be considered for review in their own right in the IGT's future forward work program.

ROLE OF THE PRIVATE SECTOR ADVISER IN A SELF ASSESSMENT SYSTEM

3.85 According to the OECD's 2008 *Study into the role of tax intermediaries*, there is a tripartite relationship between taxpayers, advisers and revenue authorities.[162] By engaging advisors and involving them in the compliance process, taxpayer compliance will be enhanced, potentially at a lower cost to the ATO. Each party has a unique set of experiences and a different perspective on issues:

> A strategy of positive engagement with tax advisers offers potentially significant benefits to all parties in the tax system. In particular, it can add to revenue bodies' understanding of tax advisers and the role they play in the tax system, as well as

[162] OECD, *Study into the Role of Tax Intermediaries* (2008) p 54 <www.oecd.org>.

> improved risk and compliance strategies and better-focussed information requests and dialogue with taxpayers, resulting in reduced compliance costs for all.[163]

3.86 There is sometimes a tension between the role advisors play in supporting the system and the work they carry out on behalf of specific taxpayers. However, the demands of clients will typically drive the services that advisors provide.[164] In this respect, the OECD paper commented that:

> The importance of the role tax advisers play in a tax system can be tested by answering a simple question: would compliance with tax laws improve if tax advisers did not exist? The Study Team found no country where the answer to that question is yes. Across the whole range of taxpayers, taxes and circumstances, the vast majority of tax advisers help their clients to avoid errors and deter them from engaging in unlawful or overly-aggressive activities.[165]

3.87 In Australia's self assessment system, professional tax advisers such as tax agents and lawyers play a significant role:

> In 1980 [under the full assessment system], 20 per cent of personal taxpayers used a tax agent. By 1992 [under the self assessment system], this figure had increased to around 75 per cent and has since remained fairly consistent. Personal taxpayers feel that the system has become too complicated, and there have been too many changes for them to be able to confidently complete their own returns … Over 90 per cent of business taxpayers use a tax agent to prepare their returns, and this figure has remained consistent at least since the 1980s.[166]

3.88 Advisors provide services and assistance to taxpayers to mitigate tax risks, typically by providing advice based on an understanding of the tax laws and a consideration of the ATO's interpretative views. In addition, advisers' expertise and involvement in shaping tax laws and administrative practices contributes to the improvement of the tax system as a whole.

3.89 The ATO and tax advisors could each be able to learn from each other in negotiating the complexities of the Australian taxation system.[167]

3.90 The ATO has openly expressed a desire to achieve a cooperative approach or 'partnership' with the tax profession.[168] Although others have questioned whether this relationship is working well with the tax profession.[169]

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[163] Ibid p 44.
[164] Ibid p 7.
[165] Ibid p 14.
[166] Margaret McKerchar, 'Tax Complexity and its Impact on the Tax Compliance and Administration' (Paper presented at the IRS Research Conference, Washington, 13-14 June, 2007) pp 190–191.
[167] See Fitzpatrick, above n 21, pp 394-400.
[168] See for example, Michael D'Ascenzo, 'A Partnership Based on Trust and Respect' (Speech delivered at the National Institute of Accountants Board Meeting, Canberra, 8 May 2007).
[169] Justin Dabner and Mark Burton, 'Lessons for Tax Administrators in Adopting the OECD's "Enhanced Relationship" Model - Australia's and New Zealand's Experiences' (2009) 63(7) *Bulletin of International Taxation* 316.

3.91 In this regard, the ATO has recently announced a 'tax practitioner action plan' which seeks to cover three themes:

> Supporting tax practitioners - by identifying areas where we can improve the support we give tax practitioners: for example making our online tools more accessible, relevant, and contemporary with a view to providing an integrated online service. This also links to the ATO Service Delivery directions, including directions in relation to increased electronic interactions, matching community trends, and with the objective of reducing compliance costs.
>
> Tax practitioner engagement - increasing the effectiveness of ATO consultation with the profession e.g. expanding relationship manager program to support the resolution of issues not able to be resolved by online tools and/or call centre assistance. Making the Professional to Professional support program more accessible; and continuing to improve consultative feedback arrangements, both ways from our forums.
>
> Compliance effectiveness - increasing our engagement with the profession around the development and implementation of the ATO compliance program. Also better understanding the interactions between tax practitioners and their clients and the influence the tax profession has on the compliance behaviour of their clients. The latter will help us develop leverage and differentiation strategies.[170]

Advisor categorisation and taxpayer risk rating

3.92 The ATO advises that it has three broad approaches to risk identification relating to tax practitioners, being:

> Firstly, there is the question of management of risk, using a Risk Differentiation Framework which considers a variety of factors, including association with particular intermediaries like tax practitioners and/or advisors.
>
> Secondly, there is the assessment of risks for tax intermediaries who may be subject to the promoter penalty laws, where we need to identify whom we focus our intention [sic] upon and how we engage with them in order to manage risks of contravention of the promoter penalty laws. We have consulted extensively with industry and the professions on these issues …
>
> Thirdly, there is the assessment of risks for tax practitioners who serve as an interface with their clients and the ATO, where we need to identify whom we focus our intention [sic] upon and how we engage with them in order to manage risks relating to taxpayer compliance with the four pillars of compliance obligations, being registration, lodgment, correct returns and debt.[171]

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[170] D'Ascenzo, above n 150.
[171] Australian Taxation Office, Communication to the Inspector-General of Taxation, 7 June 2012.

3.93 Examples of these three different approaches above include:

- the ATO's use of the risk differentiation framework to rate the comparative tax risks that large business may pose, of which the qualities of their tax advisers (including their employees, such as their tax managers) may form part of the inputs into these taxpayer risk ratings;

- the ATO's use of the risk differentiation framework in identifying those tax advisers (or 'intermediaries') of most concern for the purposes of administering the promoter penalty provisions;[172] and

- the ATO's identification of those tax practitioners with a significant number of clients whose financial performance falls outside the ATO's small business cash economy benchmarks, amongst others.

3.94 Many submissions from tax professionals expressed concern with the ATO's recent approach to assessing tax advisers' risk of non-compliance and their competence. Unlike an adverse risk rating given to a taxpayer (which may result in an increased likelihood of administrative scrutiny), an adverse risk rating for advisers may result in that adviser becoming unemployable.

3.95 It seems that, in certain circumstances, the 'aggressiveness' of an advisor is considered significant in determining the taxpayer's risk rating. In this respect, the ATO considers that if tax advisors are supportive of the system and engaged with the ATO, all things being equal, this would lower the ATO's perception of the underlying risk that their clients (taxpayers) pose to the system.

3.96 Furthermore, the ATO also considers the risk appetite of employees of advisers as material in determining the risk rating for the purposes of the promoter penalty provisions:

> Where a tax intermediary purchases an existing business unit from another entity, there are potential promoter penalty and controversial tax position risks that flow from the vendor to the purchaser. These include: …
>
> - pre-existing staff in the new business unit (especially senior leaders) may have a different attitude about acceptable conduct or risk exposure for the business that are not aligned with that of the purchaser. This culture may lead to staff not following either the spirit or the letter of the purchaser's internal control or governance processes; and
>
> - pre-existing relationships with higher risk appetite external advisors unit may continue, without the application of the purchaser's normal internal control or governance processes that would normally be used to engage such advisors.

[172] Australian Taxation Office, Communication to the Inspector-General of Taxation, 17 February 2012.

> Risks in acquiring staff from another business
>
> Where a tax intermediary hires staff who have previously worked in another entity, there are potential risks that flow from the previous employer to the new employer. These include:
>
> - the impact that the previous association of the new employee with controversial tax positions may have on the risk profile of the new employer and that of their clients;
> - potentially different attitudes about what the new employee constitutes acceptable conduct or risk exposure for their employer, which are not aligned with the culture of the new employer. This is especially important where the new employee is in a leadership position, because of the influence that they have over other staff. These attitudes may lead to such staff not following either the spirit or the letter of the new employer's internal control and governance processes …; and
> - pre-existing relationships with higher risk appetite external advisors to the previous employer may continue, without the application of the new employer's normal internal control or governance processes used to engage such advisors.
>
> The damage to the new employer that may arise can be significant, so [the ATO] encourage[s] entities to consider and manage these risks when they are hiring staff from other entities. Conversely, if an entity loses a higher risk appetite employee, it may lower the level of these risks.[173]

3.97 Stakeholders, however, have outlined situations where ATO views on advisors were not necessarily based on objective evidence. In addition, they note that where the perception is incorrect, there is no recourse but to contest this. Moreover, where the ATO's perception is communicated to taxpayers there is a negative impact on the business of the advisor or their employability.

3.98 In the IGT's view, tax advisers need to maintain their independence and be able to provide frank and fearless advice to their clients. While aggressive tax planning should be addressed, the ATO should use more appropriate mechanisms such as the promoter penalties legislation in this respect. Furthermore, if a risk differentiation system was to apply to tax practitioners, then the latter must have a right of review and be afforded due process before the ATO's risk rating of them is finalised.

3.99 Tax advisers also have an important role in contributing to the system as a whole. The aim should be to develop and maintain a mutually constructive and collaborative relationship between the ATO and the tax profession. While the RDF may be a means to encourage this relationship, the execution of this approach has potentially significant impacts and may ultimately contribute to a further lack of trust between the ATO and the profession. A deterioration in trust of this nature has many undesirable effects including an increase in the level of complexity in our tax system. In such an environment, both parties seek for more detail to be spelt out in the legislation in fear of the other party exploiting any perceived uncertainties.

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[173] Australian Taxation Office, *Guide for Tax Intermediaries - Good Governance and Promoter Penalty Laws* (2011) p 14.

RECOMMENDATION 3.6

The ATO should continue consultation with the tax profession to identify strategies to achieve a more constructive relationship. Such consultation should include discussions on whether the use of a risk differentiation system is appropriate and if so how it should be implemented.

ATO response: Agree in part.

The use of risk management approaches is fundamental to good administration and efficient use of limited resources so it is not considered an option for the ATO to consult on whether the use of a risk differentiation system is appropriate in respect of the tax profession.

To assess a tax practitioner's practice risk, we apply a risk differentiation framework (RDF) based on the risk profile of the tax practitioner's client base. We have publicly stated that we do not, and will not, release an advisor's risk categorisation to their clients

However, we will consult with the tax profession on how we implement the framework. We will give effect to this part of the recommendation through implementation of the Tax Practitioner Action Plan. This plan sets the direction, the detail, the what, the how and the when we would like to work in collaboration with tax practitioners and their professional bodies. The plan is iterative and to this end we have consulted and will continue to consult with the National Tax Liaison Group (NTLG), ATO Tax Practitioner Forum (ATPF) and Regional Tax Practitioner Working Groups.

TAXPAYER UNCERTAINTY AND PERIODS OF REVIEW

3.100 Uncertainty has a number of aspects in the Australian taxation system. One aspect concerns the advice framework, which was discussed in the previous chapter. Another aspect is the period for the ATO to amend taxpayers' tax returns.

3.101 Taxpayers are responsible for lodging their returns under the self assessment system. These returns are taken at face value by the ATO initially and subject to potential review and amendment for a period of time thereafter. The statutory time limits for ATO review of returns provide taxpayers with certainty:

> In the current legislative regime in Australia the mere making of an assessment … does not give the taxpayer certainty, because the assessment can be amended. However, the passing of time and the consequent expiry of relevant amendment periods in most cases produces a certainty that enables the taxpayer to draw a line under previous years' tax liabilities and move on, secure in the knowledge that any issues or difference of views in relation to that period or the transactions of that periods are of historical interest only.[174]

[174] White and Walpole, above n 2, p 4.

3.102 The standard period for the ATO to review and amend assessments (including amendments based on the general anti-avoidance provision) is four years. Individual taxpayers with simple affairs have a two-year period. There are also a number of specific provisions that allow the ATO an unlimited period for review in certain circumstances.

3.103 Amendment periods aim to balance certainty for taxpayers with the capacity for the ATO to detect non-compliance.[175] The ROSA review's discussion paper stated that 'setting periods too short may jeopardise the capacity of the Commissioner to detect non-compliance'.[176] The exception has been to provide a shorter period of review to individuals with simple affairs. This was because four years was considered too long, resulting in uncertainty and unnecessary compliance costs.[177]

3.104 Optimal certainty is said to be reached where the period permitted for amendment is the minimum required for the Tax Office to identify the majority of incorrect assessments and take action to correct them.[178]

Shortening the general amendment period for micro and small businesses

3.105 Recent improvements in technology and risk identification methodology have provided the opportunity for the ATO to better detect a range of risk considerations for investigation purposes including, for example, the underreporting of income in micro and small businesses. In this particular market segment, the ATO carries out risk identification of micro and small businesses on the basis of industry benchmarks sourced from a range of lodgement data and on the likelihood of underreporting of income.

3.106 Given these recent improvements, the IGT is of the view that shorter periods of review should be considered for micro and small businesses with relatively low annual turnover. This would reduce uncertainty and unnecessary compliance costs for business taxpayers that can least afford it. In determining the threshold annual turnover for access to the shorter period of review, consideration should be given to other small business thresholds, such as those delimiting access to small business concessions. Additionally, consideration should be given to the impact that shorter periods of review may have on the desire for revenue neutrality in the goods and services tax system.

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[175] See The Treasury, 'Review of Unlimited Amendment Periods in the Income Tax Laws' (Discussion paper, August 2007) p 7.
[176] Ibid p 7.
[177] Peter Costello, *Tax Reform: Not a New Tax, a New Tax System - The Howard Government's Plan for a New Tax System* (AGPS, 1998) p 147.
[178] Treasury, above n 175, p 7.

RECOMMENDATION 3.7

The Government should consider providing a shorter period of review for micro and small business taxpayers with sufficiently low turnover.

ATO response: Matter for Government.

Pre-assessment and expanded lodgement disclosures

3.107 In relation to the ATO's pre-assessment and expanded lodgement activities, taxpayers make significant and detailed disclosures to the ATO (including those made by individual taxpayers soon after lodgement pending the release of their income tax refunds). This places the ATO in a position where it can assess the compliance risk of particular issues and taxpayer circumstances at an earlier point in time. In this sense, pre-assessment and expanded lodgement disclosures effectively increase the time for the ATO to detect non-compliance. However, there is no corresponding obligation on the ATO to reach a view promptly about this information or start any assurance procedures earlier.

3.108 In this regard, the ATO's pre-assessment and expanded lodgement activities can operate to reduce taxpayer certainty.

3.109 A means to reduce the level of uncertainty arising from review periods would be to trigger the start of the periods for review from the date at which pre-assessment and expanded lodgement disclosures are made. This would encourage the ATO to start its compliance detection earlier, particularly given that substantial disclosures had already been made by the relevant taxpayers. This would also allow audits (if needed) to be carried out and concluded sooner, providing compliance assurance closer in time to the lodgement of the return. Not only would such an approach decrease periods for uncertainty, it would also decrease delays and associated costs for both the taxpayer and the ATO.

3.110 In the IGT's view, therefore, the periods of review should commence from the date at which the relevant information in pre-assessment and expanded lodgement disclosures are made.

3.111 Further, in 2005, the IGT observed that the cause for ATO delays in more complex audits has, broadly, been a combination of a linear approach to resolving issues and lack of confidence to make strategic decisions during the activities.[179] The ATO advises that, as a result, it has observed that audit staff are reluctant to damage the relationship with the taxpayer when they come across difficult issues. Therefore they ask for more information and the taxpayer challenges those requests, all contributing to delays.

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[179] Inspector-General of Taxation, *Review into Tax Office Audit Timeframes* (2005) pp 18-21 <www.igt.gov.au>.

3.112 In the IGT's view, what is needed is for the ATO to communicate the cause of its concern and discuss the issue with the taxpayer so that information requests are targeted to those key pieces of evidence that will either prove or disprove a taxpayer's compliance. This may require the use of experienced ATO case leaders. Recommendations designed to achieve that outcome have been made in recent IGT reviews.[180]

RECOMMENDATION 3.8

To reduce the extent of uncertainty for taxpayers, the Government should consider:

(a) starting the period for amendment from the date on which a taxpayer provides information that is the subject of disclosure before an assessment is lodged (pre-assessment disclosures) or as a result of increased requirements for additional disclosures at the time of lodgement (expanded lodgement disclosure), if that is earlier than the notified or required date of lodgement of the relevant income tax return; and

(b) where taxpayers provide pre-assessment disclosures or expanded lodgement disclosures, requiring the ATO to commence compliance detection activities within one year of receiving such disclosures.

ATO response: Matter for Government.

Minimising requests for extensions to amendment periods

3.113 Notwithstanding the statutory time periods for ATO review, these periods may (and have) been extended in certain circumstances.

3.114 Subsections 170(4) and 170(4B) of the ITAA 1936 provide the ATO with the ability to extend the statutory periods of review; the former on application to the Federal Court, the latter through agreement with the taxpayer. This can provide the ATO with further time to resolve audits where it has not been able to do so within the standard amendment period.

3.115 The practical situation was succinctly summarised by White and Walpole:

> In light of the costs of opposing an application to court under s170(4), many taxpayers simply acquiesce to an extension, both to save costs and so as to appear reasonable rather than risk an adverse inference being drawn by the Commissioner or a court should they oppose an application for extension of time. The taxpayer is also open to the risk, if it does not accede to the request for an extension, that the Commissioner will simply raise an amended assessment based on the information that the ATO has, leaving the taxpayer to bear the onus, via the objection process, of proving that the amended

[180] See for example, Inspector-General of Taxation, above n 131, Recommendations 5.1 and 5.2; Inspector-General of Taxation, above n 142, Recommendation 3.4.

assessment is excessive. It is therefore assumed that taxpayers generally agree to such extension requests.[181]

3.116 The law also provides for unlimited periods for review in cases of fraud and evasion.[182] However, ATO recording systems do not allow the ATO to easily identify whether a review period was extended by reason of fraud and evasion or whether it was extended by request. ATO records show that some 1800 taxpayers over the last two years had their assessments amended outside of the normal period of review. However, the ATO advises that in the vast number of these cases, the statutory time period was extended due to fraud and evasion. Based on a survey of some ATO officers, the ATO is aware of approximately 20 large business cases over the past two years in which taxpayers agreed to an extension of the amendment periods. It should be noted, however, that extensions of the amendment periods also occur in relation to other types of taxpayers — that is, non-large business taxpayers.

3.117 The ATO agrees that it is not desirable to request extensions. In its guidelines to staff the ATO states:

> As the limited period nears its end we have four options. They are:
>
> 1. Make no amendment
>
> 2. Where possible, issue an assessment. It is important to note that this assessment should not be 'tentative' assessment (for example see *Federal Commission of Taxation v Stokes*) but a definitive one
>
> 3. Apply to the Federal Court for an extension of the limited period … or
>
> 4. Ask the taxpayer to consent to an extension of the limited amendment period …
>
> Clearly the best option is to be in a position to make a proper assessment prior to the end of the limited amendment period.
>
> … **All efforts should be taken to ensure that extensions of time at the taxpayers consent are not necessary.** In many circumstances the taxpayer and their advisors may take the tactical position that it is not beneficial to grant an extension. For example they may anticipate that our request strengthens an argument that any assessment that we issue in response to a refusal by them to grant an extension of time is a tentative assessment and thus open to challenge (Stokes).[183] [emphasis in original]

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[181] White and Walpole, above n 2, pp 20–21.
[182] For example, *Income Tax Assessment Act 1936* s 170(1).
[183] Australian Taxation Office, 'Guidelines on The Legislative Timeframes for Making Amendments and for Requesting Extensions of Time to the Limited Amendment Period', ATO Intranet, 30 September 2011.

3.118 Increased rigour in these processes, such as requiring senior ATO official approval, would improve management focus on these circumstances. Such approval should use the same criteria used as if the request was made to the Federal Court, being:

> … that it was not reasonably practicable or it was inappropriate for the Commissioner to complete the examination within the limited amendment period, or that period as extended, because of
>
> (a) any action by the taxpayer; or
>
> (b) any failure of the taxpayer to take action that would have been reasonable for the taxpayer to take.[184]

3.119 The issue of senior ATO officer approval was considered in relation to large businesses in the IGT's *Review into the Australian Taxation Office's large business risk review and audit policies, procedures and practices*.[185] In response, the ATO agreed that the decision to seek an extension of time to amend a taxpayer's assessment was an important one and should not be made without due consideration. In this respect, the ATO stated that it would ensure such decisions would be made by team leaders, in discussion and consultation with their senior executive officers.[186] Although such processes appear appropriate in areas accustomed to dealing with well-resourced taxpayers, a higher level of rigour should be applied to other areas of the ATO.

3.120 In the IGT's view, extensions (other than those due to fraud or evasion) should not be available where the delays resulted from a lack of ATO efficiency in dealing with complex and difficult matters. Also, public confidence in the use of this relaxation of the statutory time limits would be improved if transparency of such decisions was increased.

RECOMMENDATION 3.9

To improve the rigour and transparency of decisions to extend the statutory timeframes for review, the ATO should:

(a) require Senior Executive approval before the taxpayer is asked to agree to an extension to the timeframe; and

[184] *Income Tax Assessment Act 1936* s 170(7) item 1.
[185] See Inspector-General of Taxation, above n 131, pp 125–126.
[186] Ibid pp 137–138.

RECOMMENDATION 3.9 (CONTINUED)

(b) publicly report on the cases in which extensions to the periods of review are requested and the reasons why compliance activities could not be completed within the statutory timeframes (in a manner that takes account of secrecy or privacy laws).

ATO response:

3.9(a) Agree.

In response to Recommendation 8.6 in the Inspector-General of Taxation's Review into the ATO's large business risk review and audit policies, procedures and practices, we advised that the decision to seek an extension of time to amend a taxpayer's assessment should be made by our team leaders, in discussion and consultation with their senior executive officer, as appropriate. A guidance note setting out the grounds and approval processes for extending the amendment period was published on 8 June 2012.

We agree to expand the application of this guidance note to all relevant parts of the ATO and will review the process after 12 months of operation to evaluate how it has bedded down.

3.9(b) Agree in principle.

The information to support the requirements is not currently captured consistently across our compliance areas. IT systems and business processes will need to be changed to provision the requirements. In some cases these requirements are quite complex. This work will be subject to prioritisation on the Enterprise Solutions and Technology Forward Program of Work and possibly funding allocation/provision.

Unlimited periods of review

3.121 The IGT received submissions citing the persistence of a number of unlimited amendment periods, or periods of review. Moreover, many stakeholders have claimed that these unlimited periods are not consistent with the operation of a system of self assessment. They queried that 'if it is accepted that four years for income tax assessments is 'about right' by both the ATO's and taxpayers' perspectives, then why are there still unlimited periods for certain things?'

3.122 Treasury's ROSA report identified many instances where the ATO had unlimited time to amend assessments and recommended further work to reduce the periods for unlimited review.[187] In this regard, Treasury's *Review of Unlimited Amendment Periods in the Income Tax Laws – Discussion Paper* examined unlimited

[187] The Treasury, above n 1, Recommendation 3.7.

amendment periods and proposed to replace most of them with the standard amendment periods, fixed amendment periods, or amendment periods based on a contingent event.

3.123 As a result, Schedule 6 to the *Tax Laws Amendment (2010 Measures No. 2) Act 2010* repealed over 100 uncontroversial provisions that had provided the ATO with unlimited time to amend assessments. The remaining unlimited periods were to be replaced with contingent or fixed amendment periods at a later date, subject to the Government's legislative priorities.[188]

Transfer pricing

3.124 A key area in which unlimited periods of review continue to apply is in relation to transfer pricing.[189]

3.125 Compliance assurance of transfer pricing transactions is typically complex and requires a greater amount of time to obtain and process information. This is largely due to issues involving obtaining information and valuations. In this respect, the ATO now requires a certain amount of this work to be done by taxpayers before claims are made. The ATO, consistent with other major global revenue administrators, also offers Advance Pricing Agreements as a means to reach agreement on the method of application of the arm's length principle to taxpayers' international related party dealings on a prospective basis.

3.126 Timeframes may also be stretched where taxpayers have applied for a Mutual Agreement Procedure (MAP). A MAP is a process by which compensating adjustments might be agreed to between Australian and other countries' Competent Authorities. This is aimed at minimising the extent of double taxation arising from the transfer pricing amendments. Such compensating adjustments may be agreed to many years later and will need to be reflected in amendments to the taxpayer's original assessment.

3.127 The OECD's Forum on Tax Administration (FTA) has recently undertaken a comprehensive examination of dealing with transfer pricing.[190] As part of the FTA's work, it conducted a survey of member countries (43 OECD and non-OECD countries) that revealed the average resolution for transfer pricing cases was 540 days. In relation to the difficulties in obtaining information the survey revealed:

- Obtaining information across borders is a particular issue for some countries whereas others have very effective international relationships and use their double taxation treaty networks to good effect …
- The ease of access to and the quality of relevant supporting documentation is a key practical issue for auditors.

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[188] The Treasury, 'Repeal of Certain Unlimited Periods for Amending Assessments — Summary of Consultation Process' <www.treasury.gov.au>.
[189] *Income Tax Assessment Act 1936* s 190(9B).
[190] OECD, *Dealing Effectively with the Challenges of Transfer Pricing* (2012) <http://www.oecd.org>.

- The risk assessment process is central to the success of transfer pricing programmes but countries approach this in very different ways, the differences in approach being driven to some extent by the different environments in which they are operating and the particular constraints they have to work within.[191]

3.128 The FTA work is instructive and may provide the ATO with substantial practical improvements in reducing delays experienced in transfer pricing disputes. The IGT may examine the potential for ATO improvements in managing transfer pricing issues in the future.

3.129 Although transfer pricing claims may be complex, other developed countries have a limited (albeit extended) period of review for transfer pricing cases. Many developed countries, such as the United Kingdom (UK),[192] do not provide special extended periods of review for transfer pricing issues — rather, the standard period of review applies. In other countries, the time limit is merely extended — for example, in Japan, the general period of review is five years, extended to six years in transfer pricing cases.[193]

3.130 In this respect, it is important to note that the Treasury has indicated in a recent consultation paper the need to reconsider the amendment periods for transfer pricing cases:

> General amendment rules which allow for a two-year or four-year amendment period may not be sufficient to examine cases such as transfer pricing, due to the complexity of those transactions and the difficulty in obtaining verification information. Nevertheless, even for these cases a finite, albeit longer, amendment period may be more appropriate than an unlimited amendment period. The timeframe for a longer amendment period should be sufficient for the Commissioner to ensure compliance, but not so long as to create unwarranted risk and uncertainty for taxpayers involved. A compromise of eight years, from the time the Commissioner gives the taxpayer the notice of assessment, may be more appropriate.[194]

3.131 The IGT also considers that while a number of these cases can be very complex, there is a need to ensure the administrators have an incentive to resolve them at the earliest opportunity. Unduly long timeframes raise consistency and continuity issues regarding personnel engaged on these matters. Whereas shorter periods tend to focus organisational energy and imperatives toward resolution.

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[191] Ibid pp 16–17.

[192] See *Finance Act 1998* (UK) sch 18 para 46(1) as amended by *Finance Act 2008* (UK) sch 39 para 42(2).

[193] Deloitte, *2011 Global Transfer Pricing Desktop Reference*, 2011, p 60 <www.deloitte.com>.

[194] The Treasury, 'Review of Unlimited Amendment Periods in the Income Tax Laws (Consultation paper, November 2007), p 11; also referred to in The Treasury, 'Income Tax: Cross Border Profit Allocation — Review of Transfer Pricing Rules' (Consultation paper, 1 November 2011) p 20.

RECOMMENDATION 3.10

To improve the certainty in relation to the review of transfer pricing matters, the Government should consider providing the same period of review for these matters as exists for the general period of review.

ATO response: Matter for Government.

Losses

3.132 Submissions revealed prevailing confusion on the event that triggers the statutory period of review for amending losses. They observed that taxpayers with carried forward losses may not fully utilise those losses for many years after they were first incurred. As a result they experience additional uncertainty and compliance costs. Difficulties may also arise in relation to record retention and critical corporate memory being lost. They argued that the ROSA review intended to address these issues.

3.133 Prior to the ROSA review and the enactment of the *Taxation Laws Amendment (Improvements to Self Assessment) Act (No. 2) 2006*, the time period for amendment was triggered when tax became due and payable. Therefore, a taxpayer with no liability, or a loss, did not have tax 'due and payable' and there was no 'assessment'.[195] The resulting effect was that the ATO and taxpayer would have an unlimited period to change the purported assessment because the time limits for review were not triggered. This effectively exposed taxpayers to an unlimited period of review for unutilised losses. The tax laws were amended to include 'nil' assessments in the definition of 'assessment', as a result of the ROSA report's recommendation 3.4:

> From the 2004-05 income year, the period of review for loss and nil liability cases should be equivalent to the period for the Tax Office to amend assessments creating liabilities.[196]

3.134 Importantly, however, the ROSA review also considered that the deductibility of a tax loss would be determined in the year that the taxpayer had income in which to offset the loss, indicating that this could be many years after the loss was incurred.[197] The view was confirmed in the explanatory memorandum to the amending legislation:

> 2.51 The meaning of assessment does not extend to the ascertainment of the amount of a tax loss. The deductibility of a tax loss will be determined in the year that the taxpayer has income against which to offset the loss, in accordance with normal deduction principles.[198]

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[195] See *FC of T v Ryan* 2000 ATC 4079; note also *FCT v BCD Technologies Pty Ltd* [2005] FCA 708.
[196] The Treasury, above n 1, Recommendation 3.4.
[197] Ibid pp 32–33.
[198] Explanatory Memorandum, House of Representatives, Tax Laws Amendment (Improvements to Self Assessment) Bill (No 2) 2005, p 23.

> … Example 2.5
>
> A company returns losses of $10 million in the first year, $12 million in the second year, $5 million in year 3 and $3 million in year 4. In year 5, the taxpayer returns a taxable income of $10 million after deducting $30 million for losses of previous years. During year 6, the taxpayer is audited with the result that the company's first year return was incorrect and should have returned a taxable income of $8 million. Under the new law, the ATO would be unable to issue an assessment of a positive liability for year one. However, the year 5 assessment can be amended to disallow the $10 million deduction claimed for the loss brought forward from year one.[199]

3.135 Notwithstanding the fact that the law allows the ATO to review the deductibility of a carried forward loss in the year in which the taxpayer seeks to recoup them, the ATO has sought to improve its focus on assessing the deductibility of losses in the year in which they are incurred. For example, in the 2005–06 year, the ATO sought to conduct 'real time compliance activity' to examine the validity of losses being carried forward:

> Losses
>
> We are still concerned that some businesses are generating and claiming losses that do not reflect genuine commercial arrangements, lack economic substance, or do not reflect the intent of the various capital gains tax events.
>
> In response to these concerns and to recommendations in the Report on aspects of income tax self assessment, we are doing more real-time compliance activity, with an increasing focus on:
>
> - the validity of losses being carried forward
> - the origin of losses generated, and
> - the origin of losses transferred into consolidated groups.[200]

3.136 The IGT considers that it is preferable, for both taxpayers and the ATO, that the amendment period for losses be the same as the general amendment period — that is, the ATO can only challenge losses within four years of the year in which those losses are incurred and it cannot challenge them thereafter even in a year in which the taxpayer seeks to recoup those losses. Such a situation is followed in a number of other jurisdictions.[201] Dealing with losses at an earlier point in time not only provides certainty to both parties much earlier but also allows the investigations to occur when relevant records and corporate memory are likely to be at their best.

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[199] Ibid.
[200] Australian Taxation Office, *Compliance Program 2005–06* (2005) p 47.
[201] For example, Sweden.

RECOMMENDATION 3.11

The Government should consider setting the amendment period for losses to only four years from the year in which those losses are incurred.

ATO response: Matter for Government.

ASPECTS OF SPECIFIC ATO ACTIVITIES

3.137 Submissions also expressed concern with aspects of certain pre-lodgement compliance and expanded lodgement disclosures, being the income tax refund integrity program, annual compliance arrangements (ACAs), the International Dealing Schedule (IDS) and pre-lodgement compliance reviews (PCRs). These concerns are outlined below.

Income tax refund integrity program

3.138 The ATO's income tax refund integrity program stops individual income tax refunds from issuing where various risk attributes are triggered. In this respect, it differs from other ATO lodgement processing compliance verification activities, such as income matching.

3.139 Where a refund is stopped under the income tax refund integrity program, the ATO issues a letter to advise of potential delays. For the last financial year this delay was of at least three months.

3.140 Many advisers to individuals commented that, notwithstanding ATO public claims that the program identified most as fraudulent claims, the advisers observed significant delays with refunds ultimately not being adjusted. In many cases these were small amounts that did not indicate a risk worthy of pre-assessment review and delay. As a result tax practitioners have incurred unproductive work in contacting the ATO to check on progress and taxpayers have suffered the effects of reduced cash flows.

3.141 In response, it has been publicly reported that:

> [T]he ATO understands that the time taken to process the income tax returns held for 'integrity checks' has an impact [on] some tax agents. [The Deputy Commissioner] said that, while registered tax agents lodge 71 per cent of individual returns, less than half of the returns held for integrity checks were prepared by tax agents. With more than 21,000 tax agents preparing returns, [the Deputy Commissioner] said 'this overall is a positive reflection of the quality of work done by [tax agents]'. Returns prepared by tax agents are significantly less likely to be reviewed, than self-prepared returns, the Deputy Commissioner said.
>
> [The] Deputy Commissioner … said most affected tax agents 'had only 1 or 2 returns held for review, however, we are concerned with a small group of tax agents who had

> significant numbers of held returns; half of the tax agent prepared held returns, were lodged by just 1,200 tax agents'.
>
> Last year, [the Deputy Commissioner] said the ATO checked around 29,000 returns and found more than 20,000 refunds were incorrect or fraudulent. This year, it expects to review about 30,000 returns to remove any incorrect or fraudulent claims before refunds were issued. Since 1 July 2011, 106,000 tax returns with refund claims totalling $447m had been held. The Deputy Commissioner acknowledged this has meant that the processing of some tax returns has taken longer than anticipated and resulted in delays in receiving an expected refund. To date, [the Deputy Commissioner] said ATO reviews had resulted in amendments to 80 per cent of held returns. 'These results support the necessity to review these types of claims', she said.
>
> [The Deputy Commissioner] said the ATO undertakes to contact tax agents with held returns by the end of May 2012, with more information about the returns the ATO holds. [The Deputy Commissioner] said the ATO may send a review letter, make phone contact, and/or finalise the case. Where multiple returns lodged by a tax agent have been held, [the Deputy Commissioner] said the ATO may visit or phone to address the issues collectively.[202]

3.142 The IGT may examine the effectiveness of this program through his forward work program. The design of the program, especially delaying the issue of refunds of small amounts pending delayed ATO compliance verification, suggests that more could be done to better engage the community on understanding the impacts of the program and its benefits.

Costs and benefits of Annual Compliance Arrangements (ACAs)

3.143 The ATO's Annual Compliance Arrangements (ACAs) have merit, based on the United States of America's (USA) positive's experience with its Compliance Assurance Program (CAP) — a comparable program whereby taxpayers work collaboratively with the Internal Revenue Service (IRS) to identify and resolve potential tax issues before the tax return is filed each year.[203]

3.144 On this basis, applying the ACA approach to a wider range of taxpayers could be beneficial, however, improvements are required.

3.145 Some business taxpayers have asserted that in order to enter into an ACA, a large amount of additional work was often required by taxpayers in dealing with the ATO, resulting in higher costs. This higher cost can be beneficial where the taxpayer's existing tax risk management processes are inadequate to ensure that its compliance risks are minimised or eliminated. However, the costs can be disproportionate where existing processes are adequate.

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[202] Terry Hayes, 'Delayed Tax Refunds - ATO Explains', *Thomson Reuters Weekly Tax Bulletin* (online) 4 May 2012.
[203] Internal Revenue Service (IRS), 'IRS Expands and Makes Permanent its Compliance Assurance Process (CAP) for Large Corporate Taxpayers' (Media Release, IR-2011-32, 31 March 2011) <www.irs.gov>.

3.146 In this respect, many submissions considered that the targeting of ACAs could be improved to exclude taxpayers that already have strong governance processes, have developed a cooperative relationship with the ATO and behave in a compliant manner. Other submissions have made more general suggestions that refinements could be made to the ACA process in order to make it less resource intensive and the benefits more accessible, with a view to widening the availability of the process to other taxpayers. Still other submissions suggested that ACAs were not really necessary at all.

3.147 The ATO has provided qualitative survey results from twelve participants which indicate that ACAs do not impose a significant increase in costs. This survey was conducted in May 2011. However, no figures were provided and the methodology of the survey may not have enabled the ATO to receive unbiased information. For example, ATO audit staff managing the ACAs contacted taxpayers in ACAs to obtain their views, ATO staff views were accepted to represent the views of taxpayers not involved in ACAs and taxpayer comments were received that ACAs were more costly than audits or reviews.[204]

3.148 All respondents to the ATO survey did, however, comment that there were benefits in terms of improved access to ATO staff and obtaining administrative certainty earlier (even though some delays in delivery had still been experienced).

3.149 In relation to ATO surveys more generally, the IGT has observed in other reviews that the ATO has drawn certain conclusions about the comfort and direction it receives from these surveys.[205] The IGT considers that this is an area that is ripening for review, given the stakeholder feedback that the IGT receives often differs from the survey results and the implications that the results have for ATO management direction.

3.150 Submissions did observe that ACAs had benefits in terms of administrative certainty in relation to uncontroversial issues. However, there was some debate over whether the ATO's sign-off letters that say 'no further action at this time' provided sufficient certainty such that the ATO would not re-examine these issues at a later point in time.

3.151 Importantly, however, ACAs were perceived as not delivering certainty on a timely basis where controversial issues were concerned — for example, taxpayers did not consider it beneficial to be told to get a private ruling after protracted and involved discussions on issues over many months. In these circumstances, taxpayers may determine that the cost involved in maintaining an ACA is not justified given that certainty cannot be guaranteed in those very instances where it is most needed— that is, certainty in relation to the ATO's treatment of controversial issues.

3.152 Submissions also argued that the low take up of ACAs suggests that many taxpayers and advisers do not consider the costs of ACAs are commensurate with the benefits. The IGT observes that many stakeholders who were reticent to engage in ACAs perceived that, although their governance processes are adequate for their own

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[204] Australian Taxation Office, Communication to the Inspector-General of Taxation, 19 September 2011.
[205] See for example, Inspector-General of Taxation, above n 131, p viii.

tax risk management purposes, they were unsure whether they would meet the ATO's expectations and considered the potential costs in dealing with the ATO on this issue would reap proportionate benefits.

3.153 It should be noted that the take up of the USA's ACA equivalent (the CAP) was also slow to start with, but has now become more popular.[206] However, it is important to appreciate that the situation may have certain jurisdiction specific reasons for this more recent development.

3.154 Overall, it is clear that taxpayers and advisers strongly doubt whether the observed benefits in entering an ACA are proportionate with the costs. The IGT observes that uncertainty on the extent of information gathering and resulting costs (both in terms of a taxpayer's direct administrative costs and their ongoing resourcing to maintain ongoing ATO expectations) underpin these concerns.

3.155 If the ATO were to more clearly quantify, at the outset, the expected costs of information gathering and more clearly demonstrate the commitment to delivery of the benefits arising from that increased level of information provided, greater taxpayer and adviser acceptance of the ACA may result.

Widening ACA availability — increased workload and impact on ATO delivery

3.156 If ACAs are improved to the extent that they are an attractive option for a greater number of taxpayers and advisers, then there may be concerns with the ATO's ability to appropriately deal with this increase in demand.

3.157 Managing an increased workload may become an increasing concern when the ATO rolls out pre-assessment and expanded lodgement disclosure initiatives to a wider range of taxpayers.[207]

3.158 In summary, the concerns are that the ATO could be in a situation where it is over promising and under delivering. In this respect, the IGT considers that the ATO could benefit from examining overseas approaches, such as those of Singapore, the UK, the Netherlands and the USA.

Singapore — outsourcing assurance work

3.159 In order to address the ATO's assurance requirements, it has been suggested that some assurance work could be outsourced to external professionals who have been accredited by the ATO. This may be similar to the process employed by the Singapore revenue authorities (the Assisted Compliance Assurance Program (ACAP)).

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[206] IRS, above n 203.

[207] See Katie Walsh, 'Top-Heavy ATO Units Face Staff Cuts', *Australian Financial Review* (Sydney), 12 July 2012, p 11.

3.160 Under the ACAP, the Inland Revenue Authority of Singapore (IRAS) allows accredited tax practitioners (either internal or external to the taxpayer) to review the eligible taxpayer's GST compliance practices in order to:

> provide guidance for businesses to voluntarily initiate a holistic risk-based review on the effectiveness of their internal controls to enhance their GST compliance capability, including accurate GST reporting.[208]

3.161 Under the ACAP program, the applicant and reviewer must follow the IRAS' methodology. Independent assurance of the taxpayer's control framework may be performed. The final step in the ACAP process is for the IRAS to review the case and afford ACAP status to taxpayers. Depending on the rating of the adequacy and effectiveness of the applicant's controls, transaction and reporting levels, the IRAS may afford 'ACAP Premium' or 'ACAP Merit' status.[209]

3.162 As a result of being accorded ACAP status taxpayers receive the following benefits:

> for either 5 years [for ACAP Premium status] or three years [for ACAP Merit status]:
>
> (a) Step-down of IRAS-GST compliance activities unless significant anomalies are noted in GST declarations;
>
> (b) Expeditious GST refunds, if no anomalies are noted;
>
> (c) Dedicated team to handle GST Rulings and resolve GST issues expeditiously; and
>
> (d) Auto-renewal of the GST schemes (for example Major Exporter Scheme status), if applicable.[210]

3.163 In addition, the IRAS offers taxpayers incentives to engage with it under the ACAP. They agree to:

> (a) Co-fund 50 per cent of the explicit fees incurred by businesses for the purpose of ACAP Review, subject to a cap of $50,000 per ACAP Applicant; and
>
> (b) Grant an exceptional one-time waiver of penalties for past GST errors (regardless of the period to which the errors may relate) disclosed voluntarily in the course of the first ACAP undertaken by the business. This waiver applies only to past errors that occurred within the statutory time-bar period, and where fraudulent intent was absent.[211]

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[208] Inland Revenue Authority of Singapore, *IRAS e-Tax Guide – GST: Assisted Compliance Assurance Programme (ACAP)*, Singapore, 5 April 2011, p 1 < www.iras.gov.sg>.
[209] Ibid pp 11–12.
[210] Ibid p 3.
[211] Ibid p 2.

United Kingdom — improving relationships and timeliness through senior officers as key contact points and clearance processes

3.164 In the UK, around 2000 of the large business population have been allocated Customer Relationship Managers (CRMs). Each CRM services around six large business taxpayers.[212] A CRM typically has 10–20 years of service in HMRC and has professional tax qualifications in at least one of the taxes.

3.165 A CRM's primary role is to manage the relationship between the taxpayer and HMRC across all taxes and duties.[213] They have the primary responsibility and accountability for resolving issues with their client taxpayers. They are either the lead direct tax or indirect tax specialist, depending on their tax technical background, and are accountable for deciding HMRC's position unless the issue turns on a novel or contentious technical interpretation.[214]

3.166 The CRM could be seen as loosely equivalent to the ATO's key client manager. However, CRMs are responsible for resolving disputes and deciding HMRC's position. In this respect, they are able to marshal HMRC's resources and have senior technical expertise.

3.167 Submissions comment that this customer management model is effective in reducing delays and improving the relationship between the administrator and the taxpayer.

3.168 Also in the UK, when taxpayers are considering large, high risk transactions, they are able to apply for clearance on certain issues from the revenue authority regarding HMRC's view of the transaction. HMRC's advice will be issued within 28 days as the norm and bind HMRC even if the view is incorrect at law, so long as all material facts were disclosed and the taxpayer reasonably relied upon the advice.[215]

3.169 Submissions comment that this process is much less formal than the ATO's ACA or private binding ruling processes. They observe that a key difference between an ACA and the UK's Tax Compliance Risk Management approach (the UK's equivalent to the ATO's *Large business and tax compliance* booklet) is the amount of disclosure required.

3.170 Overall, HMRC believes that this approach with large businesses has procured an additional £8 billion in compliance revenue in 2010–11.[216] It is noteworthy that while collections have improved, the relationship between the revenue authority and taxpayers in this market segment has also improved. Questions, however, have

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[212] Her Majesty's Revenue & Customs (HMRC) and Capgemini Consulting, *International Tax Benchmarking: Final report 2011*, London (2011) p 76 <www.hmrc.gov.uk>.

[213] HMRC, *About the Customer Relationship Management Model* <www.hmrc.gov.uk >.

[214] HMRC, *Roles and Responsibilities of LBS Client Relationship Managers and Sector Leaders*, 22 December 2006, <www.hmrc.gov.uk>.

[215] HMRC, *Clearance Service for Businesses - How to Get Certainty on Significant Business Tax Issues* <www.hmrc.gov.uk >.

[216] David Gauke (Speech delivered at the Hundred Group, London, 28 February 2012) <www.hm-treasury.gov.uk>.

been raised whether this relationship between HMRC and taxpayers is 'too close'.[217] Nevertheless, the UK Government has acknowledged the achievements of this program — that is, improved relationships have resulted in improved collections and reduced costs for the revenue authority and taxpayers.[218]

3.171 Underpinning this relationship is a legal requirement that Senior Accounting Officers (mainly Chief Financial Officers) of large companies certify that they have taken reasonable steps to ensure that appropriate tax accounting arrangements (i.e. arrangements that enable the company's relevant liabilities to be calculated accurately in all material respects) have been established and maintained.[219] This requirement was introduced to address an 'accountability gap' in ensuring that accounting arrangements are fit for the purpose of delivering correct and complete tax returns. The ATO considers that the Senior Accounting Officer certificate is the key feature underpinning cooperative taxpayer relationships in this context.[220] It is of the view that this echoes the same commitment that taxpayers are required to undertake when entering into an ACA.

Netherlands — horizontal monitoring

3.172 Since March 2008, the Netherlands Tax and Customs Administration (NTCA) has sought to shift its enforcement policy from a 'control based on an absence of trust' to 'monitoring through trust'. The basis for this policy is that 'the government no longer stands above the citizen, but rather the two stand side by side'. As a result the NTCA introduced horizontal monitoring as a means to establish mutual trust, understanding and transparency.[221]

3.173 Horizontal monitoring can involve 'enforcement covenants' with very large businesses. These covenants include agreements on the manner and intrusiveness of monitoring and the ways the parties work together. They are based on self-regulation by the taxpayer establishing an 'Internal Control Framework' to control business processes (as a result of financial governance legislation). The NTCA determines whether the tax control framework (part of the internal control framework) provides reliable tax information and, if so, requires little monitoring. The NTCA's aim is to be less concerned with tax issues and more concerned that the business is and remains in control.[222]

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[217] See, See Treasury Committee, Parliament of the United Kingdom, *Administration and Effectiveness of HM Revenue and Customs: Sixteenth Report of Session 2010–12* (2011) <www.parliament.gov.uk>.

[218] UK Chancellor of the Exchequer, Communication to the Chief Executive of HMRC, 29 March 2012 <www.hmrc.gov.uk>.

[219] HMRC, *Duties of Senior Accounting Officers of Qualifying Companies – Guidance* (19 August 2009) <www.hmrc.gov.uk>.

[220] Australian Taxation Office, Communication to Inspector-General of Taxation, 7 February 2012.

[221] Netherlands Tax and Customs Administration, *Tax Control Framework – From a Focus on Risks to Being in Control: A Different Approach*, TCF Working Group, March 2008.

[222] Ibid.

3.174 The ATO advises the IGT that it is aware of the Dutch model but it has had little influence with the ATO because the ATO was well-advanced in the development of its ACAs at the time:

> The ATO initiated the development of the ACA product based on feedback and experience with FCA [Forward Compliance Agreement] processes. Therefore, although we shared our experiences with other countries we did not consider similar ACA products from other countries in the design process.[223]

3.175 The IGT considers that there is some merit in reconsidering this approach at a future time. It should also be noted that the original Forward Compliance Agreement product had a very small uptake and was ultimately discontinued, albeit it provided learnings for the development of the ACA product. [224]

USA — the Compliance Assurance Process (CAP)

3.176 In the 2005, the USA piloted with 17 taxpayers with $10 million or more in assets a process to conduct real-time compliance reviews. These reviews aimed to establish the correct tax treatment of tax return positions prior to these taxpayers filing their federal income tax returns.[225] Based on its success, the CAP was expanded and made permanent in March 2011.[226] In the 2011 financial year there were 140 taxpayers participating in CAPs.

3.177 The CAP program consists of three phases: Pre-CAP, CAP and Compliance Maintenance.

3.178 In the Pre-CAP phase taxpayers and the IRS work together to close off examinations of filed returns with a view to progressing to the CAP phase. During this phase taxpayers are expected to display the same level of transparency and cooperation that is required of taxpayers in the CAP phase, which is to make open, comprehensive, and prompt disclosures of the transactions, descriptions of steps within the transaction that have material effect on their relevant tax liabilities, and other tax return items related to the positions taken on their filed tax returns.[227]

3.179 In the CAP phase, and in addition to that outlined above, taxpayers are expected to disclose their proposed tax positions with regard to their disclosures. Taxpayers that resolve all material items and positions taken with regard to transactions are assured that the IRS will accept their tax returns if filed consistent with the resolutions agreed between the taxpayer and the IRS. Items and positions that cannot be resolved prior to the filing of the return, or any new material items or

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[223] Australian Taxation Office, Communication to the Inspector-General of Taxation, 23 February 2012.
[224] See Michael D'Ascenzo, 'Delivering for the Community: Making Tax and Superannuation Easier, Cheaper and More Personalised (2008) 3(2) *Journal of the Australasian Tax Teachers Association* 23, p 29; Quigley, above n 38.
[225] IRS, *Internal Revenue Manual* (2011) section 4._.1.1 <www.irs.gov>.
[226] IRS, above n 203.
[227] IRS, above n 225, section 4._.1.3.

positions discovered on the return as filed, are resolved through traditional examination processes.[228]

3.180 For taxpayers that continue to meet the CAP eligibility requirements and expectations may progress to the Compliance Maintenance phase. In this phase, taxpayers must execute a memorandum of understanding and continue to make open, comprehensive, and contemporaneous disclosures of their completed business transactions, the relevant steps and their positions on items that would have material effect on their tax liabilities. In return, the IRS reduces the level of review based on the complexity and number of issues, and the taxpayer's history of compliance, cooperation and transparency in the CAP.[229]

IGT observation

3.181 In relation to the ATO's ACAs, the IGT considers overall that based on the USA's experience, the aims of ACAs can form an important part of the ATO's objective to improve certainty for taxpayers while allaying ATO concerns about potential tax risks. However, work remains to minimise costs. Additionally, any increase in ACA workload is likely to add to these costs through delays and therefore detract from one of the key benefits — 'real time' ATO response to issues.

3.182 In the light of the discussion above, the IGT considers that as a matter of priority the ATO should investigate alternative models, such as those in Singapore, to provide an improved service. Such a model need not be adopted in whole — for example, the ATO may consider that external assurers should refer limited matters to ATO for review at certain points in the process or if certain technical issues are encountered. Importantly, the involvement of the tax profession in carrying out this initiative on behalf of the ATO would best promote increased engagement with the ATO by tax practitioners and taxpayers alike.

3.183 Such an approach is equivalent to the ATO's approach towards the type of prudential reviews undertaken by taxpayers' representatives in relation to Wickenby matters and the overseas voluntary disclosure initiative.

RECOMMENDATION 3.12

(a) With the aim of making Annual Compliance Arrangements (ACAs) more widely available to taxpayers, the ATO should publicly communicate the expected work required to enter and maintain an ACA as well as the expected benefits.

[228] Ibid.
[229] Ibid.

RECOMMENDATION 3.12 (CONTINUED)

(b) With the aim of appropriately addressing the expected increased ATO workload with respect to ACAs and to reduce timeframes and compliance costs associated with ACAs, the ATO should consider overseas models, such as those in Singapore and the United Kingdom.

ATO response: Agree.

The ATO will publish more information about the way in which ACAs operate and the outcomes of a survey of ACA participants that was conducted last year.

We regularly monitor international developments for best practice.

We are currently scoping a jointly-administered, external prudential review process for large market taxpayers categorised as 'lower' and 'medium' risk where further assurance on certain aspects is sought. The project will identify and explore options through a collaborative and consultative approach with the community.

If the review process is considered viable, a pilot will be undertaken before commencement of the program. We will, however, reserve the right to open up assessments and review arrangements where appropriate.

Pre-lodgement compliance reviews (PCRs)

3.184 The pre-lodgement compliance review (PCR) is a real-time identification and assessment of a taxpayer's material tax risks. It is used with taxpayers who are identified as 'higher consequence' under the ATO's RDF that are also not in an ACA.

3.185 The ATO uses the PCR to provide a high-level understanding of a taxpayer's business operations and key transactions, and contributes to identifying the taxpayer's compliance level and risk profile.[230] It is also aimed at providing the ATO with an opportunity to address in real time a number of related compliance matters during the pre-lodgement period. These include:

- updating or undertaking a tax governance review
- engaging with taxpayers to facilitate the disclosure of tax risks including the early disclosure component of the RTP requirements
- applying the Taxation of Financial Arrangements compliance risk strategy, and
- facilitating private ruling processes.[231]

[230] Australian Taxation Office, Communication to the Inspector-General of Taxation, 28 November 2011.
[231] Ibid.

3.186 However, a PCR will not provide taxpayers with practical certainty or ATO sign off on issues. It will, however, provide taxpayers with a 'PCR plan (framework)':

> The PCR plan (framework) will take into account a range of factors and is tailored to each taxpayer. It is also important to emphasise that the PCR plan (framework) will specifically recognise the appropriate level of intensity required in our day-to-day engagement with the taxpayer.
>
> Our aim is to encourage disclosure of all material risks in real time prior to the lodgment of the return. This incorporates RTP [Reportable Tax Position] considerations. Ideally, this requires the ATO and the taxpayer to work cooperatively and establish a framework that facilitates the raising of tax risks in an environment of openness and respect.[232]

3.187 Submissions expressed doubts about the purpose and focus of PCRs. At one extreme there are suspicions that PCRs are designed to create a more costly imposition to effectively push (or an economic incentive for) taxpayers into an ACA. At the other extreme, there are mixed messages as to whether PCRs are targeted at compliant or non-compliant taxpayers and whether they are designed to work in a cooperative relationship or in an uncooperative relationship. For example, it is said to be done on a voluntary basis for 'higher consequence' (Q1 and Q2) taxpayers but with an implicit threat of compulsory information gathering action (such as section 264 of the ITAA 1936).

3.188 Submissions also expressed concern that for disclosures made under PCRs, it is unclear whether they will attract penalties and interest and whether such disclosures would be closed off to further review and amendment.

3.189 In the IGT's view, the ATO could do more to address the taxpaying community's concerns by improving the understanding of these ATO activities. In particular, if the ATO were to more clearly quantify, at the outset, the expected costs of information gathering and clearly articulate the benefits arising from that increased level of information provided, greater taxpayer and adviser acceptance of the PCR would result. This would have a greater desirable impact on shaping taxpayer compliance attitudes and behaviours.

RECOMMENDATION 3.13

The ATO should, in consultation with the community, develop and publish comprehensive materials on pre-lodgement compliance reviews. These materials should include advice regarding:

(a) what the ATO will and will not do during these compliance activities;

[232] Ibid.

RECOMMENDATION 3.13 (CONTINUED)

(b) the manner in which those activities will be conducted; and

(c) effective escalation processes where ATO officers do not meet these expectations.

ATO response: Agree.

Pre-lodgment compliance reviews are only used in the large market.

We consider the Large Business and Tax Compliance booklet to be the appropriate document in which to publish this material. It is currently being redrafted following extensive consultation with the Large Business Advisory Group.

Income tax return schedules

3.190 Submissions raised a number of concerns with the focus and utility of some information required in tax return schedules. The IDS was raised as a particular example in this regard.

3.191 The IDS replaces the schedule 25A (relating to international related party transactions) and thin capitalisation schedules to the income tax return form. Approximately 12,000–14,000 taxpayers currently complete the schedule 25A and/or thin capitalisation schedule.

3.192 The IDS comprises 40 questions, with 30 of those questions being replicated from the former schedules. Ten questions are new and were the subject of consultation.

3.193 In relation to the IDS, the ATO advised that:

> the IDS is intended to provide better data collection on higher risk international issues, leading to enhanced risk management, intelligence, mitigation and reporting to stakeholders on overall effectiveness.
>
> … IDS data, when subject to analysis helps refine international risks and mitigation strategies. This process allows better targeting of compliance activities and reduced costs for low risk taxpayers.[233]

3.194 Some submissions claim that the IDS is an example of ATO efficiencies being made at taxpayer expense.

3.195 With regard to the information requested about non-related party international dealings, the ATO considers that 'there is a higher tax compliance risk associated with international dealings by Australian taxpayers with particular tax

[233] Australian Taxation Office, communication to the Inspector-General of Taxation, 14 October 2011.

jurisdictions'. To help the ATO develop compliance strategies to combat these risks, the ATO is therefore 'seeking to identify the principal specified countries where the taxpayers' activities are undertaken and the level of taxpayer's activities in those countries'. The ATO has explained that it needs 'appropriate data to manage the compliance risk associated with activities with specified countries and this is best collected via the IDS rather than through other post-lodgement compliance activities'.[234] The ATO advises that this schedule is needed:

> Because international dealings in particular countries pose a significant compliance risk, we must manage that risk by collecting the international risk data provided at this question, which is not available from AUSTRAC.[235]

3.196 Submissions were concerned that significant costs were imposed because the IDS asks the taxpayer to collect data they do not naturally collect from existing systems. Instead the IDS asks for unrelated party expenditure and revenue dollars (not relevant to the taxpayer's liability) and related party derivatives. This imposed additional costs over and above managing their own affairs because taxpayers did not have systems in place to collect and collate this information. In order to comply with the request for disclosure, the information had to be either manually extracted or a new system developed. In effect, taxpayers expressed the view that they are expected to bear the compliance costs for perceived risks that do not relate to themselves.

3.197 Additionally, submissions expressed concern that the compliance burden imposed by the IDS is disproportionate to the compliance risks as the required level of disclosures are of the same intensity experienced during audits. They argue that the ATO has not achieved its stated objectives of 'aligning, where possible, the information [taxpayers] already collected under their normal business systems' (ATO letter to [submitter] dated 10 June 2009), and 'to reduce and standardise compliance/reporting costs'.[236]

3.198 Concerns with this approach have been raised with the ATO. For example, at a teleconference hosted by the ATO on 25 October 2011, tax professionals expressed concern about the $1 million threshold for completing the IDS and, due to the compliance burden on small and medium sized enterprises (SMEs), argued that the threshold should be revised upwards. The threshold was subsequently raised to $2 million. However, representatives of SMEs have advised that this threshold is not likely to be effective in reducing unnecessary costs for this market segment.

3.199 The IDS has since been rolled out to all taxpayers for the 2011–12 income year.

3.200 In the IGT's view, disproportionate costs are imposed on taxpayers where they are required to provide information in relation to other taxpayers' potential risks. To help minimise the compliance costs in these circumstances, the ATO should consult

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[234] Australian Taxation Office, *Overview of the Key Changes to the International Dealings Schedule - Financial Services* (5 September 2011) <www.ato.gov.au>.

[235] Australian Taxation Office, *International Dealings Schedule - Financial Services 2011 (*14 July 2011) <www.ato.gov.au>.

[236] ATO, IDS Workshop (Minutes, 2 July 2009).

with taxpayers as part of its annual consultation on the information that it seeks in tax returns and associated schedules (see recommendation 3.2).

3.201 Additionally, there are significant difficulties in imposing a change in expanded lodgement disclosures halfway through the reporting period for many taxpayers without providing sufficient time to implement changes.

Reportable tax position schedules

3.202 The reportable tax position (RTP) schedule is a new initiative that is currently being piloted by the ATO.

3.203 The ATO has stated that the RTP schedule:

> require[s] the disclosure of those ... material issues that a robust governance process would escalate for the attention of senior management…
>
> A reportable tax position is a position that is any of the following:
>
> a) [a] material position that is about as likely to be correct as incorrect or less likely to be correct than incorrect;
>
> b) [a] material position in respect of which uncertainty about taxes payable or recoverable is recognised and/or disclosed in the taxpayer's or a related party's financial statements ; and
>
> c) [a] position in respect of a reportable transaction.[237]

3.204 Although submissions to this review raised a number of concerns with this initiative, the schedule has not yet been fully implemented. Furthermore, the IGT understands that consultation between the ATO, taxpayers and their representatives are advanced and focusing on implementation issues. As such, the IGT may consider the RTP schedule at a later time if stakeholder concerns arise with its operation.

[237] Australian Taxation Office, *Reportable Tax Positions, Introduction* (22 December 2011) <www.ato.gov.au>.

CHAPTER 4 — PENALTIES AND THE INTEREST CHARGE REGIME

BACKGROUND

4.1 As stated earlier, recent compliance approaches of revenue authorities, such as pre-assessment and expanded lodgement disclosures, suggest that the pendulum has swung from a pure self assessment system towards a hybrid system that is closer to full assessment, without any of the previous benefits available from the former regime. In the light of this, it seems logical that our current penalty and interest regime be revisited.

4.2 The purpose of penalties is to encourage certain behaviours and discourage others.[238]

4.3 Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953) provides for the following administrative penalties, among others, where an entity makes a statement to the Commissioner:

- that is false or misleading in a material particular which results from a failure to take reasonable care (the reasonable care penalty);[239] and
- which treats an income tax law[240] as applying to a matter in a particular way that, when having regard to the relevant authorities, is not reasonably arguable and there is a shortfall amount that exceeds the applicable threshold (the RAP penalty).[241]

4.4 The reasonable care penalty encourages taxpayers to take reasonable steps to ensure that they self assess in accordance with the law.

4.5 Where larger tax amounts are at issue, the RAP penalty encourages taxpayers to have regard to relevant authorities (that is, legislation, extrinsic materials and judicial decisions) and take a reasonable view of authorities to ensure that the position is about as likely as not to be correct (or more so).

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[238] See the discussion in Paul Sokolowski, 'The Administrative Penalty Regime — A Swinging Reminder of Just Swinging?' (Paper presented at the 25th National Convention (Tax Institute of Australia), Melbourne, 3–5 March 2010) pp 5-6.

[239] See *Taxation Administration Act 1953* sch 1 ss 284-75(1), (4), 284-90(1) item 3.

[240] Note that these provisions also apply to the Mineral Resource Rent Tax.

[241] *Taxation Administration Act 1953* s 285-75(2).

SUSTAINABLE PENALTY DECISIONS

4.6 Submissions raised a number of issues in relation to the application of penalties. The main issue was that taxpayers considered the ATO used penalties as a bargaining chip during negotiations, as evidenced by the high numbers and amounts of penalties that have not been sustained on internal and external reviews. As an example, some submissions pointed to cases in which the ATO maintained RAP penalties even though the Federal Court, at first instance, had ruled in the taxpayer's favour, and only remitted them just before appeals were to be heard before the Full Federal Court.[242]

4.7 These claims have also been made at the ATO's consultative forums. In response, the ATO undertook a review of the 49 large business cases for the last three years (2007–08 to 2009–10) in which additional primary tax was levied. The results and penalty considerations for these cases are summarised in the tables below.

ATO review of large business cases with penalties for 2007–08 to 2009–10

Results for LB&I audits completed for FY 2007/08 to 2009/10 YTD

	2007/08	2008/09	2009/10	Total for 3 years
Number of audits completed	33	44	16	93
Audits NFAd	17	16	11	44
Number of audits with additional tax raised (audits with penalties raised)	16 (9)	28 (19)	5 (3)	49 (31)
	48%	66%	31%	54%
Total results	$1,285	$1,207	$140	$2,632
Total Penalties	$237	$226	$72	$535
	18%	19%	52%	20%

Penalty consideration for the LB&I cases where additional taxes were raised

	2007/08	2008/09	2009/10
NUMBER OF AUDITS WITH ADDITIONAL TAX RAISED (CASES WITH NO PENALTIES IMPOSED)	16 (7)	28 (9)	5 (2)
WHT MATTER (a)		2	1
SETTLED CASES (b)	5 (2)	6 (1)	
REASONABLE ARGUABLE POSITION CONSIDERED	6 (1)	7 (3)	
NO REASONABLE CARE WITH RAP CONSIDERED		1	
RECKLESS		2	
REASONABLE CARE	2 (2)	3 (3)	1 (1)
OUTSIDE OF s 284-75(2)(d) Threshold (c)		1 (1)	
SCHEME PENALTIES - RAP Considered		2	1
SCHEME PENALTIES - RAP Not Held		1	1
VOLUNTARY DISCLOSURES	2 (2)	1 (1)	1 (1)
NO RAP HELD BY TPR	1	2	
TOTALS	**16**	**28**	**5**

Source: ATO

Notes:

(a) RAPs only apply to Income Tax so Withholding Tax cases have been excluded.
(b) Penalty decisions would be agreed as part of the Settlement Agreement.
(c) The shortfall amount must be more than the greater of $10,000 or 1 per cent of the income tax on the basis of the taxpayer's return.
(d) Total results and Total penalty amounts are in $millions.

[242] E.g. *Commissioner of Taxation v BHP Billiton Finance Limited; Commissioner of Taxation v BHP Billiton Limited* [2010] FCAFC 25.

4.8 In relation to these tables, the ATO reports:

> Of these 49 cases, 31 (63.2 per cent) had penalty [sic] remitted, including 18 (36.7 per cent) where penalties were remitted in full. The reasons for penalty remission is set out in the above table (see figures in brackets for penalties remitted in full). Importantly, for the 31 cases where penalties were remitted, 14 (45 per cent) required consideration of whether or not the taxpayer had a RAP. (The other 17 cases that did not require RAP consideration includes cases that were settled and those involving adjustments such as withholding tax etc.)
>
> Of the 14 cases involving RAP consideration there were only 3 (21 per cent) cases where the taxpayer was not considered to have a RAP …
>
> [I]ncluded within the 49 cases where additional tax was raised, four cases were voluntary disclosures which were made during the course of the audit. Importantly, for all of these cases where VDs [Voluntary Disclosures] were made the Commissioner's Discretion was exercised and penalties were remitted in full.[243]

4.9 The ATO's internal quality assurance processes (the Integrated Quality Framework or IQF) also selects certain cases for review. In relation to large businesses, over the period 1 August 2009 to 17 June 2010, 284 cases were reviewed. Of these cases 82 had penalty decisions that were reviewed. Only 4 of these 82 cases were found to fall below the ATO's expected standards, on the basis of procedural and recording matters.[244]

4.10 However, following the IGT raising the issue of sustainability of penalty decisions in 2009,[245] the ATO internally reviewed penalty decision making and found that only 87 per cent of all audit cases met the ATO's standards for correctness during the period 1 April 2009 to 31 March 2010.[246]

4.11 In 2011, to assist it identify the underlying reasons for unsustainable penalty decisions (among other things), the ATO reviewed the 393 penalty decisions that did not meet the ATO's standards for correctness and appropriateness during the 1 July 2009 to 30 June 2010 period.[247] Of 'open' cases reviewed by the IQF, or cases that were not yet finalised and therefore could be corrected before finalisation, just under 9 per cent (53 cases) failed to meet both standards. For 'closed' or finalised cases, just under 14 per cent (340 cases) failed to meet both standards. The review concluded that the three main reasons for failure to meet the standards were, in descending order:

- technical errors;

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[243] Australian Taxation Office, Communication to the Inspector-General of Taxation, 14 October 2011.
[244] Ibid.
[245] Inspector-General of Taxation, *Review into Aspects of the Tax Office's Settlement of Active Compliance Activities* (2009) p 17 <www.igt.gov.au>.
[246] Australian Taxation Office, 'Penalties — Continuous Improvement Report', Internal Document, 26 May 2011, p 7.
[247] Ibid.

- recording/evidentiary deficiencies; and
- poor or incorrect notification/communication.

4.12 The ATO also observed that there were frequently some degree of overlap between technical errors and recording/evidentiary errors. Improved training was identified as a means to address these results.

4.13 The issue of unsustainable penalty decisions is not new. For example, the Joint Committee of Public Accounts recommended, in as early as 1993, that if the ATO retained the power to impose administrative culpability penalties, then it be determined in all instances by legally qualified ATO officers who are independent of the divisions conducting audits.[248]

4.14 The IGT has also reviewed this particular issue in a number of prior reviews and concluded that significant numbers of unsustainable penalty decisions arise because of a lack of ATO compliance officer discipline in dealing with evidentiary matters for the rate of penalty sought to be imposed.[249] As a result, the IGT recommended in the *Review into aspects of the Tax Office's settlement of active compliance activities* that the ATO improve the evidentiary basis for penalty decisions, among other things (recommendation 16).

4.15 More recently, the IGT recommended in the *Review into the ATO's small and medium enterprise audit and risk review policies, procedures and practices* that SME officers improve the evidentiary basis for compliance decisions (including penalties) by using the Facts and Evidence Worksheet to develop technical positions (recommendation 3.4). The IGT will review the ATO's implementation of these recommendations in the course of his follow-up to these reviews.

4.16 It should also be noted that the ATO's systems do not currently provide for reports in relation to the numbers of cases in which RAP and reasonable care penalties were imposed, or overturned, or their quantum. Management monitoring of these figures would assist in identifying opportunities to improve consistency and technical discipline in applying these culpability penalties. Information should be published to improve transparency on this issue.

[248] Joint Committee of Public Accounts, above n 27, p 300.
[249] Inspector-General of Taxation, above n 245, p 17.

RECOMMENDATION 4.1

To improve the transparency of ATO penalty decisions, the ATO should:

(a) improve its internal reporting to determine the numbers of cases, and their quantum, in which reasonably arguable position and/or reasonable care penalties were applied and remitted; and

(b) publish these figures.

ATO response: Agree in principle.

The information to support the requirements is not currently captured consistently across our compliance areas. IT systems and business processes will need to be changed to provision the requirements. In some cases these requirements are quite complex. This work will be subject to prioritisation on the Enterprise Solutions and Technology Forward Program of Work and possibly funding allocation/provision.

EVIDENCE OF REASONABLE CARE

4.17 Stakeholders also raised concerns that where taxpayers are required to provide documentation to prove that they took reasonable care (such as evidence of research or advice sought), some of this documentation would require the disclosure of material that would be inconsistent with the maintenance of legal professional privilege (LPP), client legal privilege and the accountants' concession.

4.18 In these circumstances, maintaining their rights would expose them to adverse consequences, such the potential application of reasonable care penalties and a higher risk rating (as discussed above), bringing increased ongoing compliance costs with it.

4.19 As a general principle, the way in which reasonable care penalties are levied should not disadvantage taxpayers who choose to exercise their rights to maintain confidentiality.

4.20 Submissions argue that the ATO should, therefore, accept evidence of tax advice sought, rather than the advice itself. For example, this could take the form of a declaration by the taxpayer's legal advisor that advice was sought and provided in relation to a matter.

4.21 Subsection 284-75(6) of Schedule 1 to the TAA 1953 provides that, in certain circumstances, a taxpayer will not be liable for a reasonable care penalty if the taxpayer engaged a registered tax agent or BAS agent. This provision is part of the recently enacted tax practitioner safe harbour provisions. To be eligible for this exception from liability, amongst others, the taxpayer bears the evidentiary burden to prove that they

gave the agent all relevant information and the agent made the statement.[250] The agent must also not make a statement which amounts to an intentional disregard for the law or recklessness.[251]

4.22 Relevantly, subsections 30–10(9) and (10) of the *Tax Agent Services Act 2009* (TASA 2009) also require registered tax agents and BAS agents to take reasonable care:

> (9) You must take reasonable care in ascertaining a client's state of affairs, to the extent that ascertaining the state of those affairs is relevant to a statement you are making or a thing you are doing on behalf of the client.
>
> (10) You must take reasonable care to ensure that *taxation laws are applied correctly to the circumstances in relation to which you are providing advice to a client.

4.23 The Tax Practitioners Board provides practical principles which can be applied:

> 128. Taking reasonable care will in many cases require that a tax agent or BAS agent ask questions based on their professional knowledge and experience in seeking information. Where there are grounds to doubt the information provided by a client, the tax agent or BAS agent must take positive steps and make reasonable enquiries to satisfy themselves as to the completeness and/or accuracy of that information.
>
> 129. Where a statement provided by a client seems plausible and is consistent with previously established statements and the agent has no basis on which to doubt the client's reliability or the veracity of the information supplied, the tax agent or BAS agent may discharge their responsibility by accepting the statement provided by the client without further checking.
>
> 130. However, if the information supplied by a client seems implausible or inconsistent with a previous pattern of claim or statement, further enquiries would be required.
>
> 131. Again, whilst there is no requirement to audit, examine or review books and records or other source documents supplied by a client, a tax agent or BAS agent does not discharge their responsibility in such a case by simply accepting what they have been told.
>
> 132. Where information has been provided by a suitable, independent, third party expert and there is no prior experience to the contrary, it may be reasonable for a tax agent or BAS agent to rely on that information without further checking or enquiries.
>
> ... 134. This principle [subsection 30-10(10) of the TASA 2009] does not require agents to determine the correct application of the law; rather it requires agents to take reasonable care to ensure the correct interpretation and application of the law in the circumstances.

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[250] *Taxation Administration Act 1953* sch 1 s 284–75(6)(b).
[251] Ibid sch 1 s 284–75(6)(d).

> … 137. Where a tax agent or BAS agent is uncertain about how a taxation law applies to a particular set of circumstances, taking reasonable care may include seeking clarification from relevant authorities and sources such as:
>
> - legislation and related extrinsic material (for example, explanatory memoranda);
> - relevant case law;
> - rulings and determinations issued by the Commissioner on the topic;
> - the Commissioner's instructions in documents such as income tax returns, BAS returns, fact sheets and practice statements;
> - information published or provided by a recognised professional association or other regulatory agency; or
> - information or relevant commentaries published by other experts, registered agents or specialists.
>
> 138. In consulting relevant authorities and sources, the tax agent or BAS agent may choose to seek assistance from another appropriately qualified person who has the ability and resources to provide advice on taxation laws.[252]

4.24 Difficulties arise, however, in proving that taxpayers have taken reasonable care. For example, a lack of reasonable care may be indicated where the taxpayer seeks advice on the wrong question, misapplies the advice given or does not provide information which, if provided, would have changed the tax practitioner's advice. In such circumstances, taxpayers may be effectively forced to waive rights of confidentiality in relation to the advice to refute the application of reasonable care penalties.

4.25 The IGT considers that more could be done to clarify this area of the law in a manner that preserves taxpayers' rights to confidential communications. There is scope for the ATO to publish binding advice that reasonable care has been met where certain circumstances exist, such as the taxpayer having consulted a registered tax agent in relation to the issue.

RECOMMENDATION 4.2

The Government should consider whether taxpayers should be presumed to have taken reasonable care where they have consulted a registered tax agent or a lawyer with regards to the issue in question and provided all the information that would be reasonably required by the adviser to provide advice on the issue.

ATO response: Matter for Government.

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[252] Tax Practitioners Board, *Explanatory Paper TPB 01/2010: Code of Professional Conduct* (2010) pp 28-34 <www.tpb.gov.au>; note that Australian Taxation Office, *Penalty Relating to Statements: Meaning of Reasonable Care, Recklessness and Intentional Disregard,* MT 2008/1, 11 July 2012, paras [85], [86] and [89], are similar to this material.

RAP PENALTY THRESHOLD

4.26 Submissions argued that the threshold for considering a RAP penalty was too low and effectively imposed disproportionate compliance costs in relation to the risk sought to be addressed.

4.27 In this respect, a taxpayer will not be liable to a RAP penalty where:

> You have a *shortfall amount, all or part of which resulted from you or your agent treating an *income tax law as applying to a matter or identical matters in a particular way that was not *reasonably arguable, and that amount is more than the greater of $10,000 or 1 per cent of the income tax payable by you for the income year, worked out on the basis of your *income tax return.[253]

4.28 This has the effect of ensuring that those taxpayers with smaller shortfalls, or shortfalls which are not a significant proportion of their total taxable income, do not need to consider whether they are exposed to a RAP penalty. Instead, they need only be concerned with whether they have taken reasonable care.

4.29 The standard of proof to establish RAP is more onerous than the standard for reasonable care. Also, due to the technical nature of what the test requires, greater compliance costs will be incurred — such as the costs of engaging professional tax services and dealing with the ATO in relation to these penalties. These costs are regressive. Therefore, for smaller potential shortfalls, smaller taxpayers would incur disproportionate compliance costs in seeking professional advice on tax positions.

4.30 By lifting the threshold, to say $100,000, many small business and individual taxpayers would only have to ensure they meet the reasonable care standard, rather than incurring significant additional costs.

RECOMMENDATION 4.3

The Government should consider whether the current threshold for RAP penalties should be increased to more appropriately balance the mischief for which they were intended to address against the compliance costs to small businesses and individuals.

ATO response: Matter for Government.

ONUS OF PROOF FOR DISPROVING THE RAP PENALTY

4.31 Submissions observed unnecessary and substantial compliance costs arising from the onus of disproving the applicability of RAP penalties, particularly in relation unsustainable penalty decisions.

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[253] By operation of s 284-75(2) and item 4 in the table at s 284-90 (note items 5 and 6 similarly provide for trusts and partnerships) of sch 1 to the *Taxation Administration Act 1953*.

4.32 As discussed above, the IGT has reviewed the basis for penalty decision making in a number of reviews and made a number of recommendations directed at improving the quality of penalty decision making.

4.33 According to ATO's expectations of how its officers should approach RAP penalty decisions, an ATO officer should make their judgment based on an assessment of the taxpayer's application of the law to the facts and whether it is as likely as not to be correct.

4.34 Under subdivision 284-B of Schedule 1 to the TAA 1953, there are four main steps in determining liability of penalties:

> Step 1 - Determine whether a penalty for false or misleading statement is imposed by law
>
> Step 2 - Assess the amount of the penalty
>
> Step 3 - Determine whether the penalty should be remitted in full or in part
>
> Step 4 - Notify the entity of the liability to pay the penalty.[254]

4.35 Importantly, in relation to the RAP penalty provided by subsection 284-75(2), step 1 requires the Commissioner to establish a negative proposition — that is, that the statement made by the taxpayer was not reasonably arguable. Among other things, subsection 284-15(1) defines a matter as reasonably arguable if:

> it would be concluded in the circumstances, having regard to relevant authorities, that what is argued for is about as likely to be correct as incorrect, or is more likely to be correct than incorrect.

4.36 Subsection 284-15(3) of Schedule 1 to the TAA 1953 provides that the relevant authorities include:

> (a) a taxation law;
>
> (b) material for the purposes of subsection 15AB(1) of the Acts Interpretation Act 1901;
>
> (c) a decision of a court (whether or not an Australian court), the AAT or a Board of Review;
>
> (d) a public ruling.

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[254] Australian Taxation Office, *Administration of Shortfall Penalty for False or Misleading Statement,* Practice Statement PS LA 2006/2, 25 August 2006, para [22] <www.ato.gov.au>.

4.37 Justice Hill in the Walstern case[255] outlined the applicable principles to subsection 284-75(2) of Schedule 1 to the TAA 1953, to include:

> 5. It is not necessary that the decision maker form the view that the taxpayer's argument in an objective sense is more likely to be right than wrong. That this is so follows from the fact that tax has already been short paid, that is to say the premise against which the question is raised for decision is that the taxpayer's argument has already been found to be wrong. Nor can it be necessary that the decision maker form the view that it is just as likely that the taxpayer's argument is correct as the argument which the decision maker considers to be the correct argument for the decision maker has already formed the view that the taxpayer's argument is wrong. The standard is not as high as that. The word 'about' indicates the need for balancing the two arguments, with the consequence that there must be room for it to be argued which of the two positions is correct so that on balance the taxpayer's argument can objectively be said to be one that while wrong could be argued on rational grounds to be right. …
>
> 7. Subject to what has been said the view advanced by the taxpayer must be one where objectively it would be concluded that having regard to the material included within the definition of 'authority' a reasoned argument can be made which argument when contrasted with the argument which is accepted as correct is about as likely as not correct. That is to say the two arguments, namely, that which is advanced by the taxpayer and that which reflects the correct view will be finely balanced. The case must thus be one where reasonable minds could differ as to which view, that of the taxpayer or that ultimately adopted by the Commissioner was correct. There must, in other words, be room for a real and rational difference of opinion between the two views such that while the taxpayer's view is ultimately seen to be wrong it is nevertheless 'about' as likely to be correct as the correct view. A question of judgment is involved.

4.38 Submissions claimed that, notwithstanding this judicial guidance, in practice and as a short-cut method, ATO officers compare the taxpayer's arguments to the ATO's own view of how the law applied to the facts. This leads to impressions that the ATO has difficulty accepting any position adopted by the taxpayer, which is different to the ATO's view, could be reasonably arguable. They argue that the test for RAP does not require the taxpayer's view to be the better view, only that there be room for a real and rational difference of opinion between the two views such that while the taxpayer's view is ultimately seen to be wrong it is nevertheless 'about' as likely to be correct as the one that ultimately proves to be the correct view.

4.39 Once a RAP penalty is applied, it is incumbent upon the taxpayer to prove the basis for any remission of penalty or that the application of the penalty is incorrect. As a consequence of this, the potential cost the ATO bears for levying a penalty incorrectly is low, whereas the cost that the taxpayer bears is higher. Furthermore, this diverts the resources of taxpayers and the ATO away from focusing on the substantive issue.

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[255] *Walstern v FC of T* (2003) 54 ATR 423. Note that Justice Hill's reasoning was based on the predecessor to sections 285-15 and 284-75(2). However, the extrinsic materials to subdivision 284-B indicate that the RAP concept has the same meaning as its predecessor.

4.40 The IGT observes that if the onus placed on the ATO to explain why the taxpayer's view is not real and rational, there would automatically be a greater level of accountability for ATO decisions regarding RAP penalties. A similar approach to placing the onus on the revenue authority is being employed in the UK in relation to the general anti-avoidance rules that are being considered there.[256]

4.41 Placing the burden of proof on the ATO would also reduce taxpayer perceptions that these penalties are not justified and may be being used as leverage. It would ensure that the ATO carefully evaluated a taxpayer's position before claiming that it is not reasonably arguable.

RECOMMENDATION 4.4

In relation to the penalty for no reasonably arguable position, the Government should consider amending the law to place the onus on the ATO to provide reasons for why it considers the taxpayer's view could not be argued on rational grounds to be about as likely as not, or more likely, to be correct.

ATO response: Matter for Government.

RELATIONSHIP BETWEEN REASONABLE CARE AND RAP PENALTIES

4.42 During the review, stakeholders raised concerns that there was currently a lack of clarity around the interaction between the reasonable care and RAP penalty tests. For example, in the NTLG Minutes of its March 2011 meeting, professional bodies referred the ATO to the recent Administrative Appeal Tribunal decisions in Shin[257] and Traviati,[258] in which it was observed that a RAP is a higher standard of care than reasonable care.

4.43 The ATO, however, considers the reasonable care and RAP penalty tests as independent of each other:

> 39. Unlike the reasonably arguable position test which focuses solely on the merits of the position taken, the reasonable care test has regard to the efforts taken by an entity or their agent to comply with their tax obligations. There is no personal circumstances part of the reasonably arguable position test as it applies a purely objective standard involving an analysis of the law and application of the law to the relevant facts.
>
> 40. In this sense the reasonably arguable position test imposes a higher standard than that required to demonstrate reasonable care. Because of these differences an entity may not have a reasonably arguable position in relation to a matter despite having satisfied the reasonable care test.

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[256] HMRC, 'A General Anti-Abuse Rule: Consultation Document', 12 June 2012, p 21 <www.hmrc.gov.au>.
[257] *Shin and Commissioner of Taxation* [2010] AATA 1012.
[258] *Traviati and Commissioner of Taxation* [2011] AATA 478.

> 41. Although demonstrating a reasonably arguable position involves the application of a purely objective test, an entity will usually reach their position (at the time of making the statement) as a result of researching and considering the relevant authorities. In these circumstances, the efforts made by the entity to arrive at the correct taxation treatment will also demonstrate that reasonable care has been shown.[259]

4.44 In June 2012, the ATO's view prevailed in the appeal to the AAT decision in Traviati. In the appeal Middleton J found that, as a matter of statutory construction, reasonable care and reasonably arguable position are independent standards:

> Put another way, ss 226G, 226H and 226J [of the ITAA 1936, that is, the predecessors to the current penalties for lack of reasonable care, recklessness and intentional disregard of the law] all examined the means (or process) that the taxpayer had utilised in complying with the Act. Section 226K [the predecessor to the current penalty for no reasonably arguable position] only examined whether, as an end, the taxpayer had a reasonably arguable position.[260]

4.45 In the Second Reading speech to the legislation enacting the reasonable care and reasonably arguable position penalties, the then Minister assisting the Treasurer set out the following policy aims:

> Reasonable Care and Reasonably Arguable Position
>
> The whole idea of the new understatement penalties is to ensure that people do not get penalised when they have made an honest and genuine attempt to correctly determine their taxable income. The Bill replaces the existing system where penalty is automatically attracted at the rate of 200 per cent and remitted at the discretion of the Commissioner. In so doing, it reduces the risk of penalties for taxpayers, provided taxpayers adhere to the standards of reasonable care and, where appropriate, reasonably arguable position.
>
> The reasonable care standard requires a taxpayer to exercise the care that an ordinary person would be likely to have exercised in the circumstances of the taxpayer. Reasonable care requires taxpayers to make a reasonable attempt to comply with their tax obligations. The effort required is commensurate with all the taxpayer's circumstances, including the taxpayer's knowledge, education and skill.
>
> The Government has opted to favour equity in this area by choosing a standard which has regard to the taxpayer's circumstances. However, following experience in the United States, the Government considers it appropriate that a more rigorous standard apply where the item at issue is very large, for example, generally more than $10,000 in tax. Where the interpretation of the law for such large items is in issue, we expect taxpayers to exercise more care; that is, the taxpayer must have a reasonably arguable position on the matter.

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[259] ATO, *Penalty Relating to Statements: Meaning of Reasonable Care, Recklessness and Intentional Disregard*, MT 2008/1, 7 March 2012 <www.ato.gov.au>; see also ATO, *Shortfall Penalties: Administrative Penalty for Taking a Position That is Not Reasonably Arguable,* MT 2008/2, 1 June 2011, paras [27]-[31] <www.ato.gov.au>.

[260] *Commissioner of Taxation v Traviati* [2012] FCA 546, para [71].

> The reasonably arguable position standard will, because of the $10,000 threshold, apply only to relatively few taxpayers. The crux of the standard is that taxpayers should not take positions at law which, at the time taken, are not about as arguable as an alternative position. All said and done, the standard is about analysing the law and its application to the facts. If there is a strong argument to support the taxpayer's position, that may be enough. However, the Government does not want taxpayers to take positions which are not defensible or which do not have reasonable prospects of success.[261]

4.46 On the basis of the current interpretation of the legislative provisions, the application of the RAP and reasonable care penalties, in tandem, can lead to anomalous outcomes in practice which appear inconsistent with the original policy aims — that is, a taxpayer can be penalised for not making a reasonable attempt to comply with the law (a lower standard) in circumstances where their position at law is as likely to be correct, if not more so (a higher standard, and without penalty). The IGT considers that the penalty provisions could be improved to protect taxpayers from these anomalous outcomes — that is, where a taxpayer has a reasonably arguable position they would be deemed to have met the reasonable care standard.

RECOMMENDATION 4.5

The Government should consider whether taxpayers should be deemed to have taken reasonable care where they have met the higher standard of a reasonably arguable position.

ATO response: Matter for Government.

RAP PENALTY'S INTERACTION WITH THE REPORTABLE TAX POSITION SCHEDULE

4.47 As a particular aspect of the penalty regime, submissions from large business expressed some confusion over the ATO's potential approach to penalties in relation to matters disclosed in the reportable tax position (RTP) schedule.

4.48 RTPs include positions that are 'about as likely to be correct as incorrect or less likely to be correct than incorrect'. A reasonably arguable position is also defined in the law as 'about as likely to be correct as incorrect, or is more likely to be correct than incorrect' (see subsection 285-15(1) of Schedule 1 to the TAA 1953).

4.49 This being so, the disclosure of a RTP may effectively amount to an admission that the taxpayer does not have a RAP and thus expose them to a RAP penalty. The ATO may overcome this perception by providing an incentive to disclose matters in RTP schedules.

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[261] Commonwealth, *Parliamentary Debates*, House of Representatives, 26 May 1992, p 2774-2779 (Mr Baldwin), second reading speech to the Taxation Laws Amendment (Self Assessment) Bill 1992.

RECOMMENDATION 4.6

The ATO should consider reducing penalties relating to a lack of reasonably arguable position for taxpayers who have made relevant disclosures in reportable tax position schedules.

ATO response: Agree in principle.

The ATO continues to encourage taxpayers to engage early with us to seek clarity around uncertain tax positions before they are taken, including through requests for private rulings (for which penalty protection is available). The ATO will consider the circumstances in which a penalty reduction may be warranted where a taxpayer has made a sufficient disclosure as part of a reportable tax position schedule and has been cooperative in dealings with the ATO.

THE INTEREST CHARGE REGIME (GIC AND SIC)

4.50 The primary design function of interest charge regime is to compensate the Commonwealth for the time value of money (e.g. the Shortfall Interest Charge or SIC, and a proportion of the General Interest Charge or GIC).[262] In circumstances where a tax debt is raised and known, interest charges may also have a secondary function, as a quasi-penalty, to discourage the use of tax debts as a source of business or private finance).[263]

4.51 This is reflected in the current regime where two rates of interest charge can apply to tax liabilities:

- the GIC — determined by adding a 7 per cent uplift factor to the 90-day bank accepted bill rate (published by the Reserve Bank); and
- the SIC — determined by adding a 3 per cent uplift factor to the 90-day bank accepted bill rate.

4.52 These interest charges can apply in three circumstances:

- Where, the liability was self assessed correctly but not paid by the due date of the original assessment — in which case the GIC is applicable.
- Where the liability was self assessed incorrectly and there was a shortfall in tax paid, however, once the correct liability was determined the tax was paid by the due date of the amended assessment — in which case the SIC is applicable.

[262] The Treasury, above n 1. p 53.
[263] Ibid pp 49, 52.

- The liability was self assessed incorrectly and there was a shortfall in tax paid, however, once the correct liability was determined the tax was not paid by the due date of the amended assessment — in which case the GIC is applicable.

Interest accruing during ATO delays

4.53 Submissions described various situations where there was ATO delay in developing its view or otherwise deciding not to pursue compliance action. In certain situations, taxpayers had disclosed information to the ATO regarding areas of significant uncertainty, however, no view was forthcoming from the ATO and no determination was provided as to whether the issue was considered 'closed' or not.

4.54 The key theme was that where there is an area of significant uncertainty, and where the ATO is delayed in developing its view, then there should be some concession on interest charges. In this way, the costs and impacts of uncertainty would be somewhat mitigated, despite the complexity of the circumstances and the resultant ATO delay, particularly in the light of disclosures which had already been made by taxpayers.

4.55 In this regard, the IGT notes that where taxpayers are engaged with the ATO under an ACA, there may be an undertaking to provide concessional treatment on penalties and interest where material tax risks have been disclosed.[264]

4.56 Interest charges play an important role in self assessment systems. They compensate the consolidated revenue for the time-value of the taxpayer's use of the money. They also deter taxpayers using the consolidated revenue as a source of unsecured credit.

4.57 However, it may not be appropriate to charge interest where the delay giving rise to the interest liability is beyond the control of the taxpayer. In circumstances where the ATO is responsible for delays in the compliance assurance processes (including delays in issuing amendments after the ATO has sufficient information to do so), it will be unfair to charge the taxpayer for those periods as it is beyond the taxpayer's control.

4.58 The ATO has previously committed to remit interest to the base rate for the period that a large business audit extended beyond two years.[265] Therefore, the IGT considers that capping interest to two years should persuade the ATO to complete compliance detection and verification sooner for pre-lodgement, expanded lodgement disclosures and tax returns.

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[264] Australian Taxation Office, *Annual Compliance Arrangements - What You Need to Know* (13 December 2011) <www.ato.gov.au>.

[265] ATO, 'Tax Office to Complete Large Audits within Two Years' (Media Release, NAT 2006/34, 30 August 2006); ATO, *Remission of Shortfall Interest Charge and General Interest Charge for Shortfall Periods,* PS LA 2006/8, 11 July 2012, paras [66]–[70].

RECOMMENDATION 4.7

The Government should consider providing taxpayer protection from penalties and cap SIC at two years for issues which have been the subject of pre-lodgement, expanded lodgement disclosures and tax returns.

ATO response: Matter for Government.

Punitive levels and regressive effect on small businesses

4.59 A number of submissions claimed that the GIC and the SIC rates operate as a punitive measure. In addition, some stakeholders observed that taxpayers can borrow at different rates and suggested that it may be appropriate to differentiate rates as between different taxpayers — for example, large business may be able to access funds at interest rates well below those charged under the SIC or GIC regime, whereas small business may only be able to access funds from financial institutions at rates in excess of the SIC or GIC.

4.60 The ROSA report considered this issue:

> The base rate [the 90-day bank bill rate] feeds through movements in the overall profile of interest rates, ensuring that the GIC retains commercial relevance. The uplift factor's role is to make the GIC rate sufficiently high to encourage the payment of tax liabilities when due, discouraging the use of tax debts as a source of business or private finance. Although the GIC is calculated by adding the uplift factor to the base rate, the uplift factor is not intended to reflect the risk premium that applies to the normal finance costs of affected taxpayers, nor to serve as a penalty for having engaged in blameworthy conduct.
>
> … Businesses tend to carry tax deductible debt as part of their financing structure and the GIC is therefore primarily a cost of finance issue. By design, the GIC will generally impose a substantial premium over the rates at which healthy businesses would normally borrow, the extent of that premium varying according to the businesses' credit ratings.
>
> With individuals and very small businesses, the impacts can vary significantly. For some, the net impact of the GIC could be favourable or negligible, while others could experience a penalty effect. The fact that many businesses incur GIC, rather than borrow commercially to clear crystallised tax debts, indicates that the GIC rate is not excessive in many instances — and may even constitute a 'soft', application-free source of finance. However, for others, rather than providing loan benefits, shortfalls can cause a cash flow crisis, or cause larger debts than a proprietor would voluntarily have allowed to accrue.
>
> … for many taxpayers the base rate would be below — sometimes well below — their normal borrowing rate, potentially giving them significant loan benefits from having made a shortfall. This could provide an incentive for risk-taking across a wide range of high risk sectors. It should also be noted that, because of tax deductibility, the base rate would not normally compensate the revenue fully for the time value of money.

> The Review considers that, in principle, the objective of a shortfall interest charge should be to neutralise loan benefits that taxpayers might typically receive from their shortfall, so that they do not receive an advantage over those who assess correctly.[266]

4.61 Interest charges can also have a regressive effect on smaller businesses. These businesses may be less likely to be able to absorb the cost of an amended assessment than a larger business. This is because small businesses typically have fewer resources available and much less access to credit to address debts, including tax debts, such that any additional unanticipated cost erodes these businesses' profitability faster than larger businesses.

4.62 Furthermore, small businesses with large tax debts are likely to suffer from reduced access to bank funding as a result of their tax debts, compounding any existing difficulties in raising funds.

4.63 One solution would be to reduce the GIC and SIC uplift factors, with the effect that the lower rates would be less onerous, particularly for small businesses.

4.64 This issue was considered by the ROSA report:

> In practice, it is not feasible to fine-tune the interest charge to the circumstances of each taxpayer. Further, it is not feasible to apply differential rates to different market segments (such as individuals, very small businesses and other businesses), because the loan benefit within segments can vary widely. Similarly, because tax deductibility is only one factor affecting the impact of shortfall interest on a particular taxpayer, the Review does not recommend altering current arrangements whereby all GIC is tax deductible.
>
> The Review therefore proposes a uniform interest charge on shortfall amounts. A consequence of having a single rate is that, in practice, some taxpayers will receive a loan benefit and some taxpayers will incur a penalty effect after paying the shortfall interest charge. Once the shortfall and related interest have been notified to the taxpayer, the GIC should operate normally at the usual rate.[267]

4.65 The IGT considers that the view expressed in the Treasury's report has merit and in the absence of compelling reasons otherwise makes no recommendation for change at this time.

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[266] The Treasury, above n 1, pp 49–53.
[267] The Treasury, above n 1, pp 53–54.

CHAPTER 5 — COMPLEXITY, TAX LAW DESIGN AND THE COMMISSIONER'S ROLE

5.1 A former Commissioner, Michael Carmody, has observed:

> In a dynamic business environment it is difficult for any law, let alone one as expansive as tax law, to contemplate fully the practicality of administration for all types of taxpayers — from large international corporations to small home-based businesses (Michael Carmody, former Commissioner of Taxation, 2004).[268]

5.2 The complexity that taxpayers face is not just due to tax legislation, but also the way that legislation is interpreted and enforced by the administrator. It is therefore clear that the administrator has a crucial role in designing tax policy and developing the legislation that gives effect to that policy.

COMPLEXITY IN THE TAX SYSTEM

5.3 Complexity in the tax system is an issue that is neither unique to Australia nor new.[269] Complexity in the tax system has been identified as arising from the coherence, detail and volume of rules and exceptions. However, more recently,[270] greater focus has been given to complexity arising as a function of policy and design process and the administrative approach:

> [A] major source of complexity in the current system is the way policies are designed. Over time, policy objectives have tended to become more sophisticated.
>
> Policies have also tended to be changed in isolation, and without a coherent framework for the whole system. This has complicated the tax laws and made tax compliance and administration more difficult.
>
> While policy design needs to place a premium on reducing complexity, this alone is not enough to ensure that taxpayers will experience a more certain system. The way in which the laws are designed, and the administrative approach taken to implementing those laws, also influence the level of complexity experienced by taxpayers.[271]

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[268] Michael Carmody, 'The Art of Tax Administration — Two Years on' (Speech delivered at the 6th International Conference on Tax Administration, Sydney, 15 April 2004) <www.ato.gov.au>.

[269] See for example, Sir Robert Garran, *Prosper the Commonwealth* (Angus and Robertson, Sydney, 1958) in The Treasury, above n 1, p 65; ATO, *Commissioner of Taxation*: *Annual Report 1990–1991* (1991) p 10.

[270] See for example, Joint Committee of Public Accounts, above n 49, pp 80–81.

[271] Australia's Future Tax System, above n 6, Part 2 vol 2 p 655.

5.4 The impacts of complexity are substantial and varied and include the increased uncertainty of taxpayers' obligations and increased costs:

> [Complexity] generates uncertainty about the way the system operates and the way it should operate. This uncertainty tends to reduce trust between stakeholders in the system. At worst, this can undermine confidence in the integrity and legitimacy of the system.
>
> Complexity reduces the system's transparency, makes it harder for taxpayers to understand their obligations, increases the risk of non-compliance and hinders the making of properly informed decisions. It creates uncertainty and risk, which taxpayers spend time and money dealing with. Some taxpayers arrange their affairs to take advantage of the complexity and its unintended consequences.
>
> ... The complexity of the current system imposes considerable costs on the community. It has exposed both taxpayers and government to higher levels of risk and uncertainty.[272]

5.5 Although uncertainty and costs are undesirable in the tax system, striving for certainty can paradoxically result in increased uncertainty and costs, depending on the methods used. This is because, taxpayers may seek comfort on the tax treatment of arrangements through even more prescriptive rules and binding advice:

> As factual circumstances vary greatly, covering a wide range of circumstances in detail is likely to result in law that is long and complicated. Complex circumstances are not easily clarified through elaboration in the law, at least not without generating legislation of inordinate length. Indeed, by introducing more boundaries between the legal concepts, potentially there is increased scope for ambiguity and uncertainty. Long and detailed law can also make it harder to find the underlying policy intent and thus increase the risk that the courts will interpret the legislation in a way unintended by Parliament. When a statute is cast in a very specific way, new circumstances can generate loopholes or inequities, requiring further specific legislation and so on.[273]

5.6 Additionally, the ATO itself also may seek comprehensive laws and advice aimed at addressing potential tax avoidance.

TAX LAW POLICY DESIGN

5.7 The recent improvements to tax law policy design can be traced back to Federal Parliament's Joint Committee of Public Accounts (JCPA) 1993 review. At that time, proposals for change were developed by the Treasury. The ATO had a limited role in providing advice to the Treasury on the technical validity of proposals and how they may be administered. Once a government decision was made to change the laws, the ATO's role was then to implement it, often by fleshing out the details of broad

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[272] Australia's Future Tax System, above n 6, Part 2 vol 2 pp 651–652; see also McKerchar, above n 166.
[273] The Treasury, above n 1, p 66.

decisions. The Office of Parliamentary Counsel (OPC) then drafted laws according to ATO instructions.[274]

5.8 At that time private sector involvement in policy design was limited. However, it was recognised that there were limits to what the ATO, Treasury and the OPC knew about how the policies, as expressed in legislation, may apply to various business arrangements. Broader consultation was seen to be an approach that would assist the understanding of the potential implementation of the laws in the self assessment environment and improve their effectiveness in achieving their policy objectives.

5.9 The JCPA considered the suggestions for improvement, which were mainly focussed on the structural arrangements for legislative drafting and the involvement of community in the policy and administration of the tax system.[275] The JCPA recommended, amongst other things, that economic and administrative policy be integrated.[276]

5.10 The 1998 Ralph report provided a practical articulation of this objective, by recommending a more systemic and integrated tax design process between the Treasury, ATO and OPC, drawing on external expertise to consider the practical application at the same time as developing the policy intent.[277]

5.11 These proposed arrangements were seen as reforming the administrative interface between business and the ATO which would, in turn, reduce compliance costs and the time taken to resolve disputes over the interpretation of the law.[278] One of the intended results would be the substantial reduction in the incidence of unintended consequences of the law, such as those involving perceptions of unnecessary complexity and uncertainty in the application of the law, inconsistency with commercial practice and difficulties in compliance or inconsistency with the policy.[279]

5.12 By 2002, the newly formed Board of Taxation recommended that both structural and consultative changes could be made to improve the policy design of tax laws. Amongst other things, this included the transfer of the legislative drafting function to the Treasury and greater consultation.[280] On 2 May 2002, the government announced that it would act on the Board of Taxation's recommendations:

> The new arrangements will [provide] maximum opportunity for legislation to be developed in a manner consistent with the policy intent set by Government. Working arrangements between the ATO and the Treasury will ensure that the administrative,

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[274] Joint Committee of Public Accounts, above n 49, pp 85-86.
[275] Ibid p 88.
[276] Ibid.
[277] Review of Business Taxation, above n 28, p 95, Recommendation 1.1.
[278] Ibid p 97.
[279] Ibid p 134.
[280] Board of Taxation, *Government Consultation with the Community on the Development of Taxation Legislation: A Report to the Treasurer and the Minister for Revenue and Assistant Treasurer* (2002) <www.taxboard.gov.au>.

> compliance and interpretive experience of the ATO fully contributes to policy and legislation processes.[281]

5.13 Such benefits were also recognised in the 2009 Henry review:

> A consultative approach to developing policy and legislation can help ensure the system responds to the needs and expectations of the community. It provides stakeholders with an opportunity to inform policy-makers about the impact of the tax system on their different circumstances. It allows governments to benefit from the practical experience, skills and knowledge of stakeholders and incorporate this into policy design. This helps generate better targeted and more practical solutions. It also gives governments more information about the range of options available and the benefits, costs and risks associated with those options.[282]

5.14 A review of the tax design process was undertaken by a Tax Design Review Panel (the Review Panel) established by the Assistant Treasurer in 2008. It made a number of recommendations aimed at improving the policy design of new law. Broadly, these recommendations were aimed at a number of objectives, including:

- improving the quality of law through consultation, and
- increasing community input into the prioritisation of changes to tax law.

5.15 From at least 2002, the ATO also recognised the benefits of increased consultation, such as in the capital allowances context:

> Whatever view one takes on the approaches adopted to date, there is a growing acknowledgment that effective consultation is a necessary ingredient for good tax design - from policy design to implementation, service delivery and the development of regulatory systems and approaches.[283]

5.16 What constitutes 'effective consultation' has been a matter of ongoing inquiry that has been refined by successive reviews and implementation of changes. However, two main characteristics are emerging from this work:

- involvement of relevant private sector experts, not distracted by commercial pressures or interests; and
- detailed ATO advice on how it would implement the policy and law.

5.17 To the extent that these characteristics are relevant, they are discussed below.

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[281] Peter Costello, 'Reforms to Community Consultation Processes and Agency Accountabilities in Tax Design' (Media Release, 2 May 2002) <www.ministers.treasury.gov.au>.
[282] Australia's Future Tax System, above n 6, Part 2 vol 2 pp 648–649.
[283] D'Ascenzo, above n 75, p 59.

Private sector experts and tri-partite tax law design teams

5.18 Private sector experts with relevant skills and experience are well-placed to contribute to the consultation process.[284] Such experts should be able to inform the policy and legislation design process by bringing practical knowledge of the tax law, industry structures and commercial practices.[285]

5.19 In determining the identification of such experts, the Review Panel reported that the Board of Taxation had been considering a 'Consultation Centre' that comprised tax experts nominated by tax professional bodies.[286] However, the Review Panel later considered that Treasury was well placed to do this without establishing a new body:

> The Review Panel considered a proposal previously advanced by the Board of Taxation for a Consultation Centre, comprising tax experts nominated by tax professional bodies, to provide advice to Treasury and to identify private sector experts to be engaged by Treasury on specific projects. The Panel concluded that Treasury, with the support of the Tax Office and the Board of Taxation, was already well placed to identify experts it could engage for professional advice. Rather than establish a new body, the Board of Taxation's Advisory Panel could assist with identifying experts if required. (The Board of Taxation's Advisory Panel draws together some of Australia's leading tax professionals who have volunteered their knowledge and expertise to help the Board with its work. Panel members are appointed on the basis of their individual capabilities and expertise, rather than as representatives of particular interest groups).[287]

5.20 The Government largely relies on private sector experts providing their time and expertise on a pro bono basis. In this respect, both the Board of Taxation and the Review Panel recommended that such experts be paid for their involvement in the policy and legislation design consultation processes.[288] The Panel considered that engaging private sector experts on a confidential fee-paying basis would impose fiduciary obligations to ensure that advice was provided in the national interest and a commercial focus was given to the experts.[289] However, it considered that such experts be engaged for smaller policy changes, as major policy changes would still involve broader public consultation.[290]

5.21 Although the relevant recommendations were accepted by the Government, data published in the Board of Taxation's discussion paper in its post implementation review suggest that these recommendations were not materially implemented during the review period.[291] The discussion paper for the review noted that statistically,

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[284] Board of Taxation, *Improving Australia's Tax Consultation System: A Report to the Treasurer* (2007) Recommendation 3.
[285] Tax Design Review Panel, *Better Tax Design and Implementation — A Report to the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs* (2008) pp 32–33, Recommendation 12.
[286] Ibid p 10.
[287] Ibid p 24.
[288] Ibid Recommendation 1; Board of Taxation, above n 284, Recommendation 3.
[289] Tax Design Review Panel, above n 285, pp 23–24.
[290] Ibid Recommendation 1.
[291] Board of Taxation, 'Post-Implementation Review of the Tax Design Review Panel Recommendations' (Discussion Paper, 2011) p 24.

external consultants were only engaged on 7 out of the 90 measures enacted over the review period.[292] The report of the Board of Taxation's review has not yet been released.

5.22 The Review Panel also recommended that private sector involvement should continue throughout the tax design process and, for substantive measures (i.e. those not of a very limited impact involving straightforward drafting), the monitoring of its implementation:

> Recommendation 2: Tri-partite design teams
>
> Substantive tax changes should be developed by a tri-partite team led by the Treasury, which includes tax officers and private sector experts. The team should have carriage of the measure throughout the design phase and should also monitor its implementation. Where appropriate, the Office of Parliamentary Counsel (OPC) should also be involved at the policy design stage.[293]

5.23 Ultimately, all parties agree that such issues are best dealt with where there is an existing consultative forum with a pre-existing focus on the technical areas — that is, a consultative forum being populated with practitioners who apply the law in practice (both from the ATO as well as private sector) who were also involved in the new law's development process. Such a process ensures a well-considered approach to issues of concern, as well as, a forum in which to bring together the various views.

5.24 In the IGT's view, there is merit in the existing public consultation process to be augmented by a tripartite tax law design team consisting of paid external tax experts as well as ATO and Treasury senior officials. Such a team can consider matters arising from public consultation, determine what needs to be in the legislation, the explanatory memorandum as well as any synchronised ATO advice and advise the Government accordingly prior to the passage of the relevant legislation through Parliament.

Explanatory memoranda and the text of the law

5.25 One particular issue raised during the IGT's review involved certain instances where the text of the law and the explanatory memorandum were not considered to be consistent. Submissions raised a number of examples where the policy intent of the law was clear, however, the ATO claimed that the drafting of the statue was inconsistent with this policy. As a result the ATO's interpretation and administration of the law was not consistent with, in some cases, a reading of the law,[294] or in other cases, the explanatory memorandum.

5.26 For example, in relation to foreign income tax offsets and the medicare levy, submissions noted that the ATO had recently reconsidered its administrative approach, adopting a stance that was more consistent with the relevant explanatory

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[292] Ibid p 23.
[293] Tax Design Review Panel, above n 285, p 25.
[294] See for example, *Deputy Commissioner of Taxation v PM Developments Pty Ltd* [2008] FCA 1886.

memorandum as well as external opinion. This was only after taxpayers had made lengthy submissions, convincing the ATO to take a more practical, purposive approach.

5.27 The ATO has explained that the principles of statutory construction limit the extent to which the ATO can give effect to the policy evidenced in the explanatory memorandum. This limit is reached where additional words would be required to be inserted into the text of the law to give effect to that policy intent:

> The conclusion of Spiegelman J. in *R v. Young* ((1999) 46 NSWLR 681) is relevant here: it is not appropriate to take 'an expression of intention' in the extrinsic materials to justify inserting words, 'when the result cannot be reasonably deducted from the words actually used by a recognised technique of construction' (at p.690). As Logan J. observed, it is for Parliament to give effect to the intention by amending the law (cf: *Cooper Brookes (Wollongong) Pty Ltd v FCT* (1981) 147 CLR 297; [1981] HCA 26).[295]

5.28 Where these limits are reached, seeking legislative amendment is seen as more appropriate.

5.29 The Henry Review voiced suggestions that transferring the role of policy and legislative design from the ATO to Treasury in 2002 has reduced the ATO's ability to administer the law purposively. However, it observed that formalising the ATO's involvement in tri-partite teams in 2008 allows the ATO to contribute to, and understand, the policy objectives of new law.[296]

5.30 As stated earlier, the IGT is of the view that there is merit in augmenting the existing public consultation processes with tripartite tax law design teams, comprising ATO and Treasury senior officials as well as paid external tax experts, who are engaged to provide advice on the proposed law, relevant explanatory memoranda and the nature and timing of ATO advice. The timing of ATO advice to synchronise with the enactment of substantial new law is discussed in more detail in relation to recommendation 2.2 in chapter 2.

5.31 It should also be noted that the Board of Taxation was tasked to review the implementation of the Review Panel's recommendations on tax law design.[297] The report of this review may shed further light on this issue when it is released.

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[295] D'Ascenzo, above n 20.
[296] Australia's Future Tax System, above n 6, Part 2, vol 2, pp 652–653.
[297] Tax Design Review Panel, above n 285, p 38.

RECOMMENDATION 5.1

To improve taxpayer and administrative certainty, the Government should consider improving tax law design by:

(a) augmenting existing public consultation processes with tri-partite design teams to determine, for significant proposed tax law, what detail should be provided in the law, explanatory memorandum and the nature and timing of ATO public binding advice;

(b) where the ATO is required to synchronise its public binding advice with the enactment of the law (see recommendation 2.3), ensuring the ATO is appropriately engaged to do so; and

(c) on presentation of the proposed legislation in Parliament, requiring the ATO to provide public confirmation on the nature and timing of the advice to be provided).

ATO response: Matter for Government.

CARE AND MAINTENANCE OF THE TAX LAWS

5.32 It is also important to recognise that notwithstanding an ideal process being followed in developing tax laws, unforeseen outcomes may arise that require legislative amendments.

5.33 In this respect, the Review Panel counselled against the 'quest for perfect legislation' and that greater post-enactment monitoring of implementation should take place.[298]

5.34 The Review Panel considered that the need for refinements and advice is a necessary and healthy part of maintaining a complex system. It recommended that tri-partite design teams should monitor new law to ensure it is operating as intended by identifying any legislative refinements that are needed and ensuring that administrative products and guidance material are in place.[299] The IGT also considers that refinements in ATO advice, so long as changes are applied prospectively, are also healthy and reflect an acknowledgement that unknown issues may arise in the reporting and lodgement cycle.

5.35 During the IGT review, the ATO and private sector members commented that ongoing monitoring of newly enacted legislation is beneficial where it is conducted by those who were involved in the policy and legislation design of the new laws. The ATO's consultative forums and the Tax Issues Entry System have provided forums for externals to raise these issues and for them to be considered.

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[298] Ibid.
[299] Ibid.

5.36 For example, the ATO supported such a process in the implementation of the Taxation of Financial Arrangements legislation (although participants were not paid for their involvement). Under the National Tax Liaison Group (NTLG) Finance and Investments Sub Group a specially formed sub-committee — the NTLG TOFA Working Group — was established on 13 November 2008 to assist the ATO in implementing the Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2000 (TOFA Bill). The working group comprised engagement with key private sector, Treasury and ATO representatives for the purpose of 'early identification of significant issues so that, if they can be appropriately addressed by interpretative means, the Tax Office may provide timely responses when the bills become law.' The Working Group also interacted with other specialist sub groups whose purpose was to take financial arrangement specific complex issues off line to a smaller group of experts, for example, the Treasury led specific consultations on interactions between TOFA and consolidations regimes.[300]

5.37 For new, major law, the ATO should ensure that it establishes an expert consultative forum to consider and expedite the resolution of uncertainty arising from the enactment of new law and maintain this forum for a reasonable period of time thereafter. As set out above, the ATO does this to a certain extent. However, in the event that recommendations 2.3 and 5.1 are implemented, there will be a need to monitor more closely its synchronised public binding advice. As noted earlier, in these circumstances, advice is being issued without the benefit of any private ruling requests or compliance activities and, therefore, it is more likely that scenarios will emerge which may not have anticipated.

RECOMMENDATION 5.2

In the event that recommendation 5.1 is implemented, the ATO should monitor more closely the need for updated ATO advice through its consultative forums following the enactment of significant new law and for a reasonable period after that enactment.

ATO response: Matter for Government.

The ATO will consider this recommendation should the Government agree to recommendation 5.1.

POSITIVE DISCRETION TO ACT IN TAXPAYERS' FAVOUR

5.38 Once an unintended anomaly, impracticality or consequence is identified after a new law is enacted, the question arises as to how it should be addressed. Timely legislative change is not always possible and, hence, an administrative solution needs to be explored.

[300] Australian Taxation Office, Communication to the Inspector-General of Taxation, 26 November 2011.

5.39 A positive discretion to act in the taxpayers' favour provides the administrator with a power to relax the strict interpretation of the law for the purpose of making administration easier or to provide relief from hardship at the margins of the law.[301]

5.40 Such a power was considered by the Treasury in 2005 in its ROSA Report. It rejected the proposal and concluded that the Australian system achieved the same result through the use of the Commissioner's general powers of administration and binding ATO advice. The ATO only needed to provide a binding statement of interpretation or intended compliance practice.[302] However, the ATO's view is that it cannot bind itself to a view of the law that it considers to be wrong, even if it produces inconvenient outcomes for the community or an individual taxpayer.[303]

5.41 The issue was raised again during the Tax Design Review Panel in 2008. The Review Panel did not examine the issue, but recommended the Government further consider the issue.[304] In this regard, in 2009, Treasury released a discussion paper[305] but has not to date published a final report. However, the submissions to that review are publicly available. In summary, there are differing perspectives on the appropriateness or desirability for the Commissioner to have such a power and how that power should operate in practice.

5.42 Some submissions noted that although such a discretion would improve the flexibility of administration, this would potentially be at the expense of weakening of taxpayer certainty and the rule of law. As a consequence, it was considered that such a power would, if affected, have to be subject to strict conditions for use. That is, it should:

- only be exercised for the benefit of taxpayers in order to provide relief (including through the reduction of compliance and administrative costs);
- only be used where it would achieve better and timelier results than changes to legislation could effect;
- be used where the law results in unfair treatment in particular circumstances;
- be used to address minor as opposed to major issues; and
- to give effect to the underlying policy of the legislation where it is consistent with the earlier objectives outlined above.

5.43 However, where the policy intent of legislation is not clear, problems may arise in determining how such a discretion should apply. Frequently, in areas of the

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[301] The Treasury, above n 1, p 72.
[302] Ibid p 73.
[303] See Bruce Quigley, 'The Commissioner's Powers of General Administration: How Far Can He Go?' (Paper presented at the 24th National Convention (Tax Institute of Australia), Sydney, 12 March 2009) <www.ato.gov.au>.
[304] Tax Design Review Panel, above n 285, Recommendation 24.
[305] The Treasury, 'An 'Extra Statutory Concession' Power for the Commissioner of Taxation?' (Discussion paper, 12 May 2009).

law which contain anomalies, or where unintended outcomes arise, Parliament will not have considered the issue or expressed their intention.

5.44 Submissions to the discussion paper also noted the need for transparency and a strong governance structure to support the implementation of a positive discretion to act in the taxpayers' favour. Some felt that governance and consultation would be necessary because taxpayers and tax professionals perceive that the ATO is not culturally minded to provide taxpayer concessions.

5.45 However, it was noted that the rigours of transparency and good governance might see deterioration in the timeliness of any administrative response. In this way, one of the main advantages of such a discretion over simply changing the law would be negated.

5.46 Moreover, it was also noted that the same resource constraints which delay the drafting and enactment of amending laws may also affect the timeframes for exercise of such a discretion.

5.47 As a result, it was observed that there would not likely be any relief to Treasury from its role in formulating tax policy and drafting laws gained because of a positive discretion to act in the taxpayers' favour. Notwithstanding this view, submissions expressed a fear, however, that the existence of such a discretion would reduce the impetus for high quality drafting, or for speedy amendment to the law itself.

5.48 Problems may also arise regarding consistency between taxpayers. There may be situations where a concession provides relief and advantage to one taxpayer while it may disadvantage other taxpayers. In this way a positive discretion to act in one taxpayers' favour might be perceived to undermine the objective of equity in the eyes of another taxpayer.

5.49 Even when such a discretion was seen as appropriate, it was emphasised that it should only be used as an intermediary step (that is, a 'stop gap').

5.50 Accordingly, where such a discretion was supported, the model often suggested was one where the resulting concession would be suspended until parliament had considered the matter.

5.51 Submissions to the IGT review reiterated the views expressed in the Treasury review. Moreover, some stakeholders perceive that the impacts of anomalous or impractical outcomes are already within the Commissioner's existing powers to address through adjusting compliance activity while the law is in the process of being changed. They asserted that the granting of any additional power might cause the judiciary to read down the scope of existing powers.

5.52 The IGT considers that there is a need for a mechanism to provide flexibility in circumstances involving unintended anomalies, impracticalities or consequences.

However, it should be noted that the ATO considers it currently does not have such power.[306]

5.53 More broadly, recent emerging thinking on such a mechanism indicates that such a power could serve the needs of raising revenue in a responsive and cooperative manner and enables enforcement consistent with a taxpayer's behaviour.[307] Reconfiguring the Commissioner's discretionary powers in line with recent developments in the field of responsive regulation could potentially foster better compliance, as well as address the difficulties faced by taxpayers. In this respect, the IGT notes that Treasury's report on the Review Panel's recommendation has not been released and may shed further light on this matter.

5.54 Pending the release of this report, it remains to be considered what action could be taken in the short term.

COMMISSIONER'S GENERAL POWERS OF ADMINISTRATION

5.55 Currently, the Commissioner's general powers of administration give the tax administrator a degree of flexibility for the good management of the tax system. The purpose of these powers is intended to ensure that the tax laws are administered effectively and efficiently.

5.56 Many suggest that the general powers of administration can be exercised to address unintended anomalies, impracticalities and consequences arising from the tax laws. Many also agree that such an exercise should be consistent with the policy objectives of the relevant law in question. A general discretion to ignore the law without regard to the policy objectives would not be consistent with using such powers to ameliorate the impacts of unintended anomalies, impracticalities or consequences of the tax laws.

5.57 Action that required an exercise of these powers inconsistent with the policy objectives of the law, such as alleviating the effects of changing accounting treatments from one year to the next, would be more appropriately addressed through a change in the law itself. In these circumstances, quick and effective consultation between the ATO, the Treasury and relevant private sector representatives will be critical to the successful resolution of resulting adverse impacts.

5.58 There are also circumstances where the policy intent is not clear, causing difficulties in determining whether law change or administrative response, if at all, is needed. In these circumstances also, quick and effective consultation between the ATO, the Treasury and relevant private sector representatives will be critical.

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[306] See, ATO, *Escalating a Proposal Requiring the Exercise of the Commissioner's Powers of General Administration*, PSLA 2009/4, 19 May 2009 <www.ato.gov.au>.

[307] Judith Freedman, 'Responsive Regulation, Risk, and Rules: Applying the Theory to Tax Practice' (2012) 44(3) *UBC Law Review* 627 <http:ssrn.com/abstract=2027406>; Chris Evans, Judith Freedman and Richard Krever (eds), *The Delicate Balance: Tax, Discretion and the Rule of Law* (IBFD, 2011).

5.59 In April 2004, the former Commissioner announced (the 2004 announcement) that the general powers of administration would be exercised in circumstances where relaxing the formalities of the law would achieve practical compliance without onerous compliance costs:

> At times [the difficulty in the law fully contemplating the practicality of administration for all types of taxpayers] can lead to potentially disproportionate costs because the detailed evidentiary requirements for compliance are out of step with what is reasonably practical for business. At other times a failure to meet the formalities of compliance, can have severe consequences notwithstanding that there has been substantive compliance with the law.
>
> This has raised the question of the extent to which my power of general administration of the law - which embodies the good management rule - can be utilised to address these issues.
>
> Also relevant are my responsibilities under the Financial Management and Accountability Act to apply resources in an efficient, effective and ethical way and the generally purposive approach to interpretation of the law reflected in section 15AA of the Acts Interpretation Act.
>
> Over the years we have provided guidance on achieving sensible outcomes, for example, in substantiation of a range of expenses such as laundry and home-office expenses.
>
> More recently, our practice statement on the treatment of low cost assets was designed to enable businesses to substantively meet the requirements of the law without onerous costs.
>
> The point of this discussion is that I believe more can be done in the interests of reducing compliance costs.
>
> … Criteria for considering candidate areas of application of the law are being established. They include:
>
> For example:
>
> - the approach should be consistent with achievement of the policy intent of the legislation;
> - the approach adopted should result in achieving substantive compliance at reduced cost;
> - as far as practical the approach should reflect industry practice;
> - any resulting risks to the revenue need to be appropriately managed;

- material adverse impacts on third parties are to be avoided;
- taxpayers should retain the choice as to whether to adopt the approach or not.

Transparency is to be achieved by publishing agreed approaches through a dedicated series of Practice Statements.[308]

5.60 Since that announcement, the ATO produced 18 Practice Statements Law Administration (General Administration) (PSLA(GA)), providing details on the Commissioner's exercise of his general powers of administration to waive of the formalities of the law to reduce compliance costs.[309] This program was received well by members of the taxpaying community.[310] The last PSLA(GA) released before this review was started was on 19 November 2008.

5.61 The above ATO approach appears consistent with the Treasury's conclusion in its ROSA report — that is, the Commissioner will exercise its general powers of administration so long as such exercise gives effect to the object and purpose of the legislative provision being applied, improves the smooth running of the tax laws and assists taxpayers to more easily comply with the tax law.[311]

5.62 In May 2009, the ATO released practice statement, *PSLA 2009/4 – Escalating a proposal requiring the exercise of the Commissioner's powers of general administration* (PSLA 2009/4). According to this practice statement, ATO employees are allowed to exercise the general powers of administration in relation to matters which are routine. Examples of a routine matters are, decisions or acts made in accordance with established staff instructions, such as, the selection of taxpayers for audit or the decision not to pursue compliance action for prior years in relation to a particular taxpayer.[312]

5.63 Non-routine matters, on the other hand, require the Commissioner himself to exercise the powers of general administration. According to PSLA 2009/4:

> An example of a non-routine matter involving the exercise of the Commissioner's powers of general administration would be the decision not to undertake active compliance action in relation to a particular class of taxpayers or an industry group in respect of prior years or periods, where the ATO identifies that the particular class of taxpayers or industry group have not been complying with the law.[313]

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[308] Carmody, above n 268.
[309] Practice Statements Law Administration (General Administration) are used to explain the exercise of the Commissioner's general powers of administration in relation to particular areas of the law: ATO, *Law Administration Practice Statements*, PS LA 1998/1, 2011, para [25].
[310] For example, Taxpayers Australia, *Administrative Concessions* (10 May 2004) <www.taxpayer.com.au>.
[311] The Treasury, above n 1, p 72.
[312] ATO, above n 306, paras [14]–[19].
[313] Ibid para [19].

5.64 Any recommendation for a practical compliance solution, including the publication of a General Administration Law Administration Practice Statement (LAPS (GA)), must also be escalated for the Commissioner's decision.[314]

5.65 PSLA 2009/4 sets out a prescribed process by which matters are raised to the Commissioner's attention for his decision. Fundamentally, no proposal can be made to the Commissioner without obtaining written advice from the relevant ATO's internal technical specialists, the Personal Tax and Administration Centre of Expertise (Admin COE). However, the final decision on whether the powers can be exercised lie with the Commissioner himself.

5.66 There have been 21 matters in which such written advice was obtained from the COEs. Eight related to income tax, six related to indirect taxes, five related to superannuation and two related to ATO operational work. However, only eleven matters (three involving income tax) were escalated by the business lines to the Commissioner for approval. Of the matters that were not escalated, five presented a low risk to revenue and were treated as a 'routine' matter, one was referred to Treasury and three are under consideration by the business lines. Overall, since the release of PSLA 2009/4, the Commissioner has personally exercised his general powers of administration in 10 matters (3 in relation to income tax).[315]

5.67 In comparing the 2004 announcement to PSLA 2009/4, there are similarities and differences. This ATO practice statement reiterates the criteria set out in the 2004 announcement.[316] However, it is different to the 2004 announcement in three material ways.

5.68 First, the 2004 announcement states that transparency will be achieved by explaining the exercise of the powers in a PSLA(GA). However, PSLA 2009/4 does not require publication as it may not be 'an appropriate response to a particular issue in administration'. Until 28 March 2012, no PSLAs (GA) had been published since PSLA 2009/4 came into effect notwithstanding the general powers of administration being exercised personally by the Commissioner. Instead, some have been published on ATO webpages. See for example, administrative arrangements in recognition of the late enactment of law arising as a result of Bamford published on an ATO webpage 'Improving the taxation of trust income' and the relaxation of substantiation provisions in the context of the Anstis decision[317] published on an ATO webpage 'Study expense changes for students receiving Austudy, ABSTUDY and Youth Allowance'.

5.69 This reduction in transparency appears to feed perceptions of inconsistency, as evidenced in submissions to the review.

5.70 Second, the 2004 announcement appears to contemplate that the general power of administration may be exercised where the result is open on a plain reading of the tax law. For example, the exercise of the general power of administration in

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[314] Ibid para [6].
[315] Australian Taxation Office, Communication with the Inspector-General of Taxation, 16 March 2012.
[316] ATO, above n 306, para [12(g)].
[317] *Commissioner of Taxation v Anstis* [2010] HCA 40.

PSLA 2004/1 (GA) allowed taxpayers to lodge family trust and interposed entity elections after the statutory timeframe had expired.

5.71 PSLA 2009/4, however, states that these powers are narrow in scope and must be exercised consistent with the plain meaning of the tax laws:

> 3. The powers of general administration assist the Commissioner to administer the taxation laws in accordance with Parliament's legislative intent. The Commissioner's powers of general administration are **narrow in scope** [emphasis in original] in that they can only be exercised in relation to management and administrative decisions. They do not authorise the Commissioner to administer the taxation laws inconsistently with their purpose or object, whether express or implied, or their plain meaning. They support the principle that the Commissioner must interpret and administer each Act to give effect to its intention as discerned from it as a whole, not, for example, by interpreting a particular section in isolation from the rest of the Act. The provisions must be interpreted having regard to the context in which they appear. The Commissioner's powers of general administration also cannot remedy defects or omissions in the law. In addition, where the law is open to more than one interpretation the alternative interpretations of the law should be explored before considering reliance on the powers of general administration.[318]

5.72 Third, the 2004 announcement is clearly aimed at minimising compliance costs for taxpayers in circumstances where the formalities of the law could be relaxed without affecting substantial compliance. However, PSLA 2009/4 clearly indicates that the exercise of the powers of general administration is inappropriate in these areas and that the ATO's role is to advise Treasury:

> 5. The principles of administrative law and statutory interpretation require the Commissioner to operate within the bounds of the powers conferred on him by Parliament and to use them to give effect to Parliament's legislative intent as discerned by the application of those principles. As such, the powers of general administration cannot be used to extend, confine or undermine Parliament's intentions.
>
> 6. Furthermore, the Commissioner's role is to apply the law not the policy, and the powers can not be used to remedy defects or omissions in the law. Instead, the Commissioner has a responsibility to advise Treasury where the tax and superannuation laws do not give effect to their underlying policy, for example, where they produce unintended consequences, anomalies, or significant compliance costs inconsistent with the policy intent, or where a legislative solution may be needed to address an emerging compliance issue.[319]

5.73 This approach was amplified in the Second Commissioner's speech heralding the release of PSLA 2009/4:

> Furthermore, the Commissioner's role is to apply the law not the policy. The powers cannot be used to remedy defects or omissions in the law. Where the law is clear, the

[318] Australian Taxation Office, above n 306.
[319] Ibid Appendix B paras [5]–[6].

> Commissioner has a duty to apply that law, even if it produces inconvenient outcomes for the community or for an individual taxpayer. Instead, the Commissioner has a responsibility to advise Treasury where the tax and superannuation laws do not give effect to their underlying policy, for example, where they produce unintended consequences, anomalies, or significant compliance costs inconsistent with the policy intent, or where a legislative solution may be needed to address an emerging compliance issue.[320]

5.74 In this sense the ATO's public statements on the exercise of the powers have narrowed the scope for the exercise of those powers. This view is also reflected in submissions to the review based on their observations in their dealings with the ATO.

5.75 In the IGT's view, the additional requirement in paragraph 3 of the PSLA 2009/4 that the exercise of the power be consistent with a plain reading of the law precludes the purpose for which the 2004 announcement was made — that is, to waive the formal requirements of the law where the policy objectives were achieved and compliance costs reduced. Arguably, the exercise of the general power of administration PSLA 2004/1 (GA) would not have occurred under the criteria for PSLA 2009/4.

5.76 As a matter of principle, the Commissioner should have the flexibility to administer the tax laws such that the policy objectives of the law are substantially achieved in a manner that minimises taxpayers' compliance costs. Precision can come at a high cost of compliance. This, in itself, can make the tax system less robust. However, transparency is key to minimising adverse perceptions of the ATO's exercise of such powers.

5.77 It should also be noted that, under the current arrangements, exercising the powers for these purposes may cause difficulties in later years. It is clearly preferable that powers exercised in relation to controversial or ambiguous matters should be reflected in later legislative change. This indicates that the exercise of these powers should be temporary, pending a reasonable time for Government and Parliament to consider legislative change. A period of three years may be sufficient in most cases to provide such as opportunity.

5.78 It is essential that the ATO co-operate with the Treasury (as the policy adviser to Government) and private sector stakeholders to assist in considering an amendment to the law, if required, such as where there is a need for policy clarification. Here the ATO's consultative forums and the Tax Issues Entry System provide a forum for raising such issues. The augmentation of existing tax law design consultation processes with the tri-partite design teams (as discussed above), may also have a role to play.

5.79 The question arises, however, as to what if the law change does not address all of the undesirable consequences or takes longer than anticipated to fix? Where it is not evident that those consequences were considered by the law change, then it may tend to indicate that the process was not complete and that there is further need for

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[320] Quigley, above n 303.

considering law change. In these circumstances taxpayers may be in the same position as before, however, they would have received a reprieve for a period of time.

5.80 Circumstances may also arise where the law is in the process of being changed but the period for the general power of administration elapses. In these situations, taxpayers could be provided a 'safe harbour' by the Commissioner exercising his general powers of administration not to seek compliance until the laws are passed. A similar exercise of these powers was made in relation to the ATO's approach on service trusts.[321]

5.81 Where the law itself gives rise to an inequity, there may be scope for the ATO to extend the general powers not to seek compliance where the risk to the revenue is not material. However, issues of potential impacts on the competitors and the rule of law would need to be closely considered.

5.82 In making the following recommendation the IGT is in no way intending to restrict the operation of the good management rule that is currently effected through the Commissioner's current general power of administration.

RECOMMENDATION 5.3

(a) The Government should consider providing the Commissioner of Taxation with the power to not take compliance action with respect to identified unintended, anomalous, inequitable or, impractical consequences of the tax laws for a period of three years whilst the Government takes any corrective action.

(b) In the longer term, the Government should consider whether the Commissioner should be provided with broader powers in line with recent developments in the field of responsive regulation that may foster better compliance, whilst also addressing the difficulties faced by taxpayers.

ATO response: Matter for Government.

LIABILITY DISCRETIONS

5.83 Whilst, as described above, there are circumstances where the Commissioner should have some discretion to alleviate adverse consequences of strict adherence to law, there are other instances in our tax laws where Commissioner's discretions are not so desirable.

5.84 One such area is where the calculation of taxpayers' liabilities relies upon the Commissioner exercising a discretion. These discretions may involve forming an

[321] Australian Taxation Office, *Your Service Entity Arrangements* (2006) pp 3-4 <www.ato.gov.au>.

opinion, attaining a state of mind, making a determination, exercising a power or refusing to do any of these actions.[322]

5.85 Although discretions are desirable in that they can provide flexibility in the system, discretions also hinder taxpayers from ascertaining the consequences of their transactions at the time they are undertaken. Additionally, such provisions may not allow taxpayers to exercise objective reasonableness to determine their liability and not be penalised if that determination is subsequently disputed by the ATO with the benefit of hindsight.[323]

5.86 These types of discretions were identified as a source of concern as early as 1991,[324] and work was undertaken to remove many of them, such as through the Tax Law Improvement Project.[325] Notwithstanding this action, however, such discretions in the tax laws still remain.

5.87 More recently, Treasury's 2004 ROSA review reinvigorated the resolve to replace those discretions with objective tests.[326] The ROSA report recommended that action be taken:

> Recommendation 6.3
>
> Treasury should conduct a detailed review of discretions that go to the determination of a taxpayer's liability and, wherever practical, recommend replacement tests that a taxpayer can apply at the time of lodgement.[327]

5.88 As part of Treasury's subsequent detailed review, Treasury released a discussion paper that, among other things, provides distinctions between different types of discretions in the lax laws:

- liability discretions — discretions that 'authorise the Commissioner to make decisions affecting assessable income', either containing a 'choice for the Commissioner about certain facts [or] requiring the Commissioner to determine what is reasonable in the circumstances';[328]

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[322] The Treasury, 'Review of Discretions in the Income Tax Laws' (Discussion Paper, 2007) p 1.
[323] Dirkis and Bondfield, above n 15, p 214.
[324] John Kerin (Treasurer), *Improvements to Self Assessment: Priority Tasks – An Information Paper* (1991) pp 10-11; see also JCPA, above n 49, p 81.
[325] The TLIP was a government-funded a three year project with the aim to simplify the income tax law by rewriting the law with a better structure and make it easier to understand. From 1994, the TLIP worked to rewrite many tax law provisions, culminating in the *Income Tax Assessment Act 1997* and innovations in legislation design, such as its architecture, and legislative expression.
[326] The Treasury, above n 1, p 62.
[327] Ibid p 63.
[328] The Treasury, above n 322, pp 7, 10.

- administrative discretions — discretions that allow the Commissioner 'to modify rules which might be harsh for certain taxpayers if they were given a very strict legal application';[329] and
- anti-avoidance discretions — discretions that 'enable the Commissioner to protect the revenue against aggressive tax planning'.[330]

5.89 The Treasury review identified 825 discretions falling within these three categories:

- 114 liability discretions;
- 499 administrative discretions; and
- 212 anti-avoidance discretions.[331]

5.90 Treasury proposed a principle based approach in examining whether and how a liability discretion could be replaced, by considering three practical questions:

> Is there any reason why the provision should depend on the Commissioner's discretion?
>
> Can the taxpayer either: a. apply a reasonableness test; or, b. demonstrate that certain facts exist where currently the Commissioner must be satisfied?
>
> Would changing the legislation introduce extra legislative complexity or additional compliance costs?[332]

5.91 In relation to the discretions concerning administrative matters, Treasury proposed their retention as they provided flexibility and, in appropriate cases, allowed the Commissioner 'to focus on practical compliance rather than the letter of the law'. However, Treasury suggested that it could be possible to replace a number of specific discretions about particular topics with a broader principle (such as 'that wherever the law requires things to be done by a certain time, the Commissioner may extend the time for doing those things').

5.92 Treasury also concluded that there was no compelling reason to replace discretions to prevent avoidance as they were considered necessary to enable the Commissioner to protect the revenue against aggressive tax planning. Relevantly, Treasury also questioned whether all of the specific anti-avoidance provisions were necessary, given the effectiveness of the general anti-avoidance provision. It undertook to conduct a separate project to determine whether these specific anti-avoidance provisions could be consolidated or removed.[333]

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[329] Ibid p 8.
[330] Ibid p 10.
[331] Ibid p 4.
[332] Ibid p 14.
[333] Ibid.

5.93 As Treasury has not concluded this review of discretions, an examination of the published submissions to that Treasury review is instructive in understanding the particular concerns with these types of discretions.

5.94 In these submissions there was some debate over whether certain provisions were correctly classified as liability, administrative or anti-avoidance discretions. Overall, however, submissions supported the replacement of liability discretions with objective tests — that is, tests that a taxpayer can objectively apply at the time of lodgement. Objective tests of fact were preferred over tests of reasonableness (i.e. replacing the Commissioner's discretion to determine what is reasonable with an objective test that incorporates an element of reasonableness into the taxpayer's decisions) because a reasonableness test may not operate to reduce uncertainty or compliance costs.

5.95 It was noted that objective tests of fact may not be straightforward and there may be an ongoing need for the ATO to issue binding rulings to assist taxpayers with these tests, if at a somewhat reduced compliance burden than exists with liability discretions. However, this need could be mitigated if the legislation and supporting materials explained the objective behind the provision and set out the criteria to be taken into account. Additionally, submissions supported transitional arrangements that would help to minimise the increased compliance costs in becoming familiar with the new replacement tests.

5.96 Some caution was expressed that, unless replacement tests explained the underlying policy objective and clear criteria, there may be harsh, impractical or unintended consequences. One example of this was provided by the ICAA:

> Under the alternative continuity of ownership test (COT) contained in the former section 80(2) a loss could be taken into account by a company if 'the Commissioner [was] satisfied, or [considered] that it [was] reasonable to assume' that there had been the requisite continuity. When those provisions were rewritten into the ITAA97 the discretion was removed and replaced with an objective test of reasonableness (see section 165-155(2)). That change lead to significant compliance difficulties for taxpayers which the Commissioner could not alleviate administratively. It was also one reason for the introduction in *Taxation Laws Amendment Act (No 5) 2003* of the 'default' same business test time to address circumstances where a company failed the COT but was unable to identify the precise date on which that failure occurred.
>
> As a consequence, the objective test should ideally contain a safe harbour provision and/or there should be a remedial or fall back Commissioner's discretion to alleviate taxpayers from any unintended harshness or compliance difficulties.[334]

[334] Institute of Chartered Accountants in Australia, Communication to the Inspector-General of Taxation, 1 August 2011, p 3 <www.charteredaccountants.com.au>.

5.97 It should also be noted that some commentators suggest that there may be practical problems in rewriting longstanding provisions. For example, there may be a risk that a rewritten objective test will not be consistent with the original policy:

> This could result in a narrowing of the practical scope of the discretion without a review of the validity of the original policy position. This can occur where the Commissioner applies a discretion in circumstances not expressly contemplated at the time the discretion was enacted. This variation may have occurred due to the courts having adopted an alternative interpretation. For example, the scope of discretion in the domicile test in s 6(1) of the ITAA36 definition of a 'resident' or 'resident of Australia' has been widened due to the Federal Court's interpretation of 'permanent place of abode' in *Applegate v Federal Commissioner of Taxation*. As a result the domicile test also fails to meet its legislative intention of capturing government workers (i.e., the purpose of the domicile test was to extend the scope of the Act to ensure that '. . . Agent-Generals for the Australian States together with members of their staffs, to be treated as residents').[335]

5.98 Comments were also made on the potential for discretions in future provisions. Some perceived a move in legislation affecting the business community (not just tax) towards increasing the number of discretions in the law and making the regulator's power in relation to these quite broad. These submissions argued that any discretions should be narrow and any perceived avoidance should be dealt with under the general anti-avoidance rules. Although they acknowledged that there may be circumstances where a liability discretion is the preferred option, they considered that this should only be seen as a viable option after carefully considering whether clear self-executing criteria was an appropriate option.

5.99 In submissions to this IGT review, the above views were restated. In addition to these views, concerns were raised with suggestions that certainty in relation to the exercise of the Commissioner's liability discretions could easily be obtained through obtaining ATO binding advice. In this respect, the difficulties in obtaining ATO binding advice also compound the degree of uncertainty experienced by the relevant taxpayers and the resulting costs.

5.100 In its submission published on its website, the ICAA provided an example of how the difficulty in obtaining binding ATO advice has contributed to the continuing uncertainty faced in resolving issues of liability discretions and an unwilling reliance on non-binding ATO material:

> [I]n 2007 when the Institute sought to have the ATO provide guidance on the effect of the share capital tainting rules, the ATO agreed to issue a fact sheet on the issue. One particularly important issue identified at the time upon which we sought ATO guidance was the application of these rules to equity based remuneration arrangements. The ATO's response to the Institute was that:
>
> *[The rights and obligations arising under these arrangements] may vary from case to case and would, in particular, require a thorough analysis of the vesting conditions, if any, which feature*

[335] Dirkis and Bondfield, above n 15, p 214.

in particular arrangements. Because of the wide range of circumstances that may arise commercially and such diversity in facts, it is more appropriate to deal with questions of this nature by way of the private rulings process.

Almost four years later, this issue has now been escalated by the Public Rulings Steering Committee to the NTLG. At its June 2011 meeting the ATO agreed to issue a public binding ruling providing that external members provide detailed information on the transactions and accounting entries arising in some common employee share scheme structures. This issue is now identified as a 'Top Strategic Issue'.

More recently, the ATO has responded that it is not prepared to issue a public ruling or other guidance on whether it would exercise its discretion in section 152-152(4) of the ITAA 1997 to extend the two year period for payments by a company or trust to a CGT concession stakeholder to be treated as exempt under the small business 15 year exemption rules (See minutes of NTLG Losses and CGT meeting of June 2011, agenda item 6). The fact that general guidance is provided in the CGT Tax Guide is not sufficient for taxpayers to self assess. So taxpayers must resort to requesting private binding rulings.

The problem with the length of time it takes to obtain a public ruling and the increasing tendency to 'make do' with other non-binding products is most likely to manifest itself in relation to new legislation. So, for example, to deal with the recent Corporations Act changes to the circumstances in which dividends may be paid (section 254T) and the consequential tax amendments, the Institute was happy to proceed via ATO fact sheets which are in the process of being prepared.[336]

5.101 Another example raised by a number of stakeholders (including tax practitioners servicing small and medium sized enterprises) was the ATO's apparent reluctance to issue ATO binding advice in relation to demergers for private companies.

5.102 In the IGT's view, this example indicates great scope for increased administrative efficiencies and taxpayer certainty by replacing liability discretions with objective tests. It also indicates a greater need for the ATO and tax practitioners to engage more effectively in dialogue to resolve technical issues of concern to numbers of taxpayers (an issue discussed further below).

5.103 Overall, taxpayer certainty could be improved and compliance costs reduced by a combination of the Treasury progressing its review of the replacement of the tax law discretions and the ATO releasing public binding advice in relation to any liability discretions remaining after that replacement work.[337] During the IGT's review, widespread support for Treasury's completion of its review was voiced. However, given the potential number of discretions remaining in the tax laws and the need to examine the replacement of those discretions on a case by case basis, there would be

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[336] Institute of Chartered Accountants in Australia, Communication to the Inspector-General of Taxation, 1 August 2011, p 3 <www.charteredaccountants.com.au>.

[337] It has been noted that as a matter of law the Commissioner may not bind himself to the future exercise of a discretion. However, public binding guidance on the potential relevant criteria and process that he may use in exercising a discretion would not operate to bind the Commissioner and would assist to reduce some taxpayer uncertainty and compliance costs.

considerable benefit in the ATO and the taxpaying community identifying the immediate priorities.

RECOMMENDATION 5.4

(a) The ATO should consult with taxpayers, tax practitioners and their representative bodies to identify discretions that should be replaced with an objective test and advise the Government of these discretions.

(b) In consultation with taxpayers, tax practitioners and their representative bodies, the Government should consider:

(i) replacing liability discretions in tax laws with objective tests; and

(ii) replacing specific administrative discretions in relation to particular topics with a broader principle.

(c) The ATO should periodically consult on whether further ATO advice should be provided with respect to any liability discretions and where such advice is provided, what factors the Commissioner would consider as relevant and his reasoning in exercising his discretion.

ATO response:

5.4(a) Matter for Treasury.

The Treasury is the agency with primary responsibility for public consultations and advising Government on potential law design. The ATO will work closely with Treasury through any such consultation and advice process.

5.4(b) Matter for Government.

5.4(c) Agree.

Identification and prioritisation of potential topics for rulings and determinations is largely a demand-driven consultative and collaborative process involving representatives from the tax profession, such as the technical sub-committees of the National Tax Liaison Group (NTLG) and the NTLG Public Rulings Steering Committee, and the ATO continues to actively encourage the engagement of the tax professions in these processes.

The ATO will work with our various consultative groups to identify and prioritise any areas of uncertainty or significant concern in relation to tax law discretions that affect, either directly or indirectly, a taxpayer's liability and which could benefit from possible tax rulings or determinations. The ATO will also implement a process with relevant consultative groups to ensure that we regularly focus on identifying any potential areas of uncertainty or significant concern in relation to tax law discretions that affect, either directly or indirectly, a taxpayer's liability.

CHAPTER 6 — IMPLEMENTATION OF TREASURY'S ROSA RECOMMENDATIONS AND OTHER ISSUES

IMPLEMENTATION OF TREASURY'S ROSA RECOMMENDATIONS

6.1 On 16 December 2004, the Government released Treasury's *Report on Aspects of Income Tax Self Assessment* (the ROSA report), which made 54 recommendations (ROSA recommendations). These are set out in appendix 6.

6.2 Of the ROSA recommendations, 29 required legislative response and 25 were administrative in nature. Of these 25 administrative recommendations, 17 were to be implemented by the ATO, five by Treasury, two by the IGT, and one by the Board of Taxation in conjunction with Treasury. All the ROSA recommendations requiring legislative change also required consequential administrative changes by the ATO.

6.3 The government committed to adopting the recommended legislative changes arising from the report. The ATO committed to implementing the administrative changes. The most important changes were to:

- improve certainty through providing for a better framework for the provision of Tax Office advice and introducing ways to make that advice more accessible and timely, and binding in a wider range of cases;
- improve certainty by reducing the periods allowed for the Tax Office to increase a taxpayer's liability in a wide range of situations (this will mean that approximately 8 million individual taxpayers and over 745,000 very small businesses will have a shorter period of review);
- mitigate the interest and penalty consequences of taxpayer errors arising from uncertainties in the self assessment system; [and]
- provide for future improvements through better policy processes, law design and administrative approaches.[338]

Process for implementation

6.4 Soon after the ROSA report was released, the ATO established a project management governance framework to oversee the implementation of the ROSA recommendations (see appendix 7).

6.5 In summary, this framework included a ROSA implementation team overseeing five project teams, each with a particular focus. Approval for work was

[338] Peter Costello, 'Outcome of the Review of Aspects of Income Tax Self Assessment' (Media Release, 16 December 2004) <www.treasury.gov.au>.

obtained from the relevant ATO Deputy Commissioners and National Program Managers, with sign off by the ROSA First Assistant Commissioner (FAC). Through the ROSA FAC, the ATO Executive, Policy Implementation Forum and Tax Policy Coordination Centre were kept informed on a regular basis through reports as well as provided sign off and resolution of major issues.

6.6 The ROSA implementation team was disbanded in May 2006.

6.7 The ATO has also given updates of the implementation of the ROSA recommendations to its consultative forum, the National Tax Liaison Group (NTLG).

Status of implementation

6.8 As at 19 September 2011, the ATO advised that it had implemented all administrative recommendations, except for two:

> Recommendation 2.9 – [A]dvice to tax agents
>
> The Tax Office should continue to replace large 'mail-outs' to tax agents with more targeted electronic contacts, and a 'whole-of-agency' view should be applied to volumes of information distributed.
>
> Recommendation 4.4 - Penalties
>
> The Tax Office should explain more fully, for example in a Ruling or Practice Statement, how it exercises the discretion to remit tax shortfall penalties, including in Part IVA cases.

6.9 With regard to ROSA recommendation 2.9 the ATO advises:

> A preferred delivery mechanism to electronically support preferencing, including the delivery of notices of assessment and statement of accounts has been developed. Work to deliver the changes is currently being scheduled as part of the 'ATO Online 2015' forward plan.

6.10 With regard to recommendation 4.4, the ATO released a draft practice statement (PSLA 3545) on 22 September 2011. The ATO advised that:

> The ATO will be consulting internally and externally concurrently. External consultation will be via the NTLG and ATPF.[339]

Issues arising from submissions

6.11 Submissions to this review suggested that although the ATO may have completed some action in response to the ROSA recommendations, some recommendations had not been implemented effectively as they did not achieve the desired effect in certain instances.

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[339] Australian Taxation Office, Communication to the Inspector-General of Taxation, 19 September 2011.

6.12 Underlying these concerns was an observed ATO reluctance to issue more legally binding advice. A major impediment appears to be the ATO's perception that legally binding advice cannot be given in a simple and practical manner (see for example, the ATO's recent approach to TaxPack). In this respect, the ATO has not acted to achieve the objectives of Treasury's ROSA review. These issues are discussed in more detail in chapter 2 of this review, together with relevant recommendations.

OTHER ISSUES — DISPUTE RESOLUTION

6.13 The balance of power during dispute resolution processes was another issue raised by submissions. The ATO is seen as an organisation with substantial resources and power. It was considered, particularly by smaller taxpayers and advisers, that acquiescing to ATO views was preferable to incurring significant compliance costs in prosecuting their case.

6.14 The ROSA review suggested that greater use of alternative dispute resolution (ADR) has proven successful in other situations and could prove successful in improving addressing this potential issue.[340] The IGT's recent *Review into the ATO's use of early and alternative dispute resolution* (ADR review) deals with these issues more fully.

6.15 Also relevant is the ATO's current Transforming Tax Technical Decision Making project which is intended to reduce the likelihood of disputation through the engagement of more senior ATO experts earlier in the compliance process. However, it is acknowledged that not all disputes will be resolved at that time, or at a later stage.

6.16 In this respect, the IGT's submission to the Tax Forum[341] advanced the position that the ATO's dispute management framework would be much enhanced by establishing a separate appeals area within the ATO to improve its current handling of objections and conduct of litigation. Such an area would be headed by the appointment of an additional Second Commissioner from the private sector, who would inject a wider range of experiences and perspectives into ATO management and provide intelligence and insight regarding trends in corporate governance and taxation risks. An extract of this submission is reproduced in appendix 8.

6.17 Ultimately, an appeals area, as proposed by the IGT, would provide an independent internal review at the objection stage, providing continuous feedback to better inform and enhance primary decision-making and support better selection of cases for litigation. Furthermore, by having specialised litigators as well as technical experts, it should also result in better management of the entire litigation process.

6.18 This was an issue considered in the IGT's ADR review. As a result the IGT recommended that in working towards the structure outlined in his submission to the Government's Tax Forum, the ATO establish a pilot 'Appeals Section' under the

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[340] The Treasury, above n 63, p 74.

[341] The Federal Government's Tax Forum which was convened on 4–5 October 2011; Inspector-General of Taxation, 'Tax Forum — Next Steps for Australia' (Submission to Australian Government, September 2011) pp 17-18 <www.igt.gov.au>.

current Second Commissioner — Law to carry out the objection and litigation function for the most complex cases.

6.19 The ATO did not support this recommendation.

APPENDIX 1 — TERMS OF REFERENCE AND SUBMISSION GUIDELINES

PURPOSE OF THIS DOCUMENT

The Inspector-General of Taxation (IGT) is seeking your submissions on his review into improving the self assessment system. This review was originally listed on our 4 April 2011 work program announcement as our Review of the Australian Taxation Office's (ATO's) implementation of the Report on Aspects of Income Tax Self Assessment (ROSA) recommendations. This document explains how you can make a submission to this review. It also sets out the scope of the area for inquiry and discusses some of the issues for focus in the review.

BACKGROUND

Since 1986-87, Australia's income tax system has been administered on a self assessment basis. Under this system, taxpayers shoulder the primary responsibility of correctly applying the tax laws to their circumstances. Previously, under the full assessment system, taxpayers were only responsible for disclosing all the relevant facts to the ATO. The ATO was responsible for correctly applying the law to those facts. The main objective of moving to a self assessment system was to improve efficiency in the use of ATO resources to collect revenue[342].

In this way, the introduction of self assessment changed the balance of costs and risk between the ATO and the taxpayer[343]. This shift raised the question of what the appropriate balance should be, that is, the extent to which taxpayers should bear an additional burden under a self assessment system.

In 2003, the Treasury's review into aspects of income tax self assessment (the ROSA review) examined whether Australia's self assessment system had struck the right balance between 'protecting the rights of individual taxpayers and protecting the revenue for the benefit of the whole Australian community'[344].

The report of the ROSA review (the ROSA report) was published in August 2004. It favoured a self assessment system over a system of full administrative assessment since such a system meant that ATO resources could be used more efficiently, allowing more revenue to be collected for the same administrative cost. At the same time, the report also recognised that it would be appropriate to reduce the costs and risks to

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[342] The Treasury, above n 1, p 4.
[343] Ibid p 2.
[344] Ibid p 1.

taxpayers in certain circumstances, although it stated that such a shift would result in additional costs to the ATO and to the revenue[345].

The ROSA report therefore made a number of recommendations which were intended to refine the operation of the income tax self assessment system in order to 'improve certainty and reduce compliance costs for taxpayers without significantly affecting the capacity of the [ATO] to collect legitimate income tax liabilities'[346]. This included recommendations aimed at:

- providing a better framework for the provision of ATO advice by making advice more accessible, timely and binding in a wider range of cases;
- reducing the periods in which the ATO could amend certain taxpayer assessments;
- providing for future improvements to tax policy, law and administration; and
- mitigating the extent to which taxpayers were subject to interest and penalty consequences arising from uncertainties in the self assessment system.

The recommendations arising from the ROSA review (the ROSA recommendations) required legislative action in some instances and ATO administrative changes in others. Accordingly, two tranches of legislation were enacted in 2005 and the Commissioner of Taxation (the Commissioner) undertook to implement all of the recommended administrative changes as soon as practicable.

During recent consultation on the IGT's work program, many submissions observed that taxpayers now operate in an environment of ever increasing tax complexity and risks. They suggested that although the self assessment system itself had its benefits, there were issues with the current systems and their operation that imposed increased costs and uncertainty.

Submissions generally agreed with the overall aims of the ROSA recommendations and observed that certain recommendations were successful in addressing some issues with the self assessment system. However, they indicated that there was room for further improvement and questioned whether a number of the recommendations were implemented as intended. In particular, a number of questions were raised in relation to:

- the ATO's recent administration of the existing advice framework, such as whether the amount of binding advice produced was sufficient or provided in the areas of most need, whether ATO responses to adverse tribunal and judicial decisions provided sufficient clarity and whether taxpayers faced significant obstacles that hindered them in obtaining certainty about their tax risks in a timely and cost effective manner;

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345 Ibid p 4.
346 Ibid.

- the ATO's approach regarding recent administrative requirements, such as expanded returns with additional disclosure requirements, and whether some of the ATO approaches were moving towards a quasi-full assessment system or a hybrid self assessment/full assessment system entailing increased taxpayer costs without an apparent commensurate reduction in risk; and

- the ATO's ability to administer the law in a practical manner that reduces costs and risks borne by taxpayers without significantly increasing the risk to the revenue.

On the basis of these submissions and in the context of the move from full assessment to self assessment, the IGT will also seek to establish whether aspects of the implemented ROSA recommendations have been successful in achieving their original aims and whether there are any further improvements that can be made.

The IGT has set out his terms of reference below with submission guidelines thereafter to assist you in forming your submission.

TERMS OF REFERENCE

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

The IGT will review aspects of the current self assessment system and consider whether improvements may be made, with a particular focus on:

The self assessment framework

1. *given the program of improvements to self assessment that was recommended in the 2004 ROSA report and other changes to the system which have taken place since then, whether the current self assessment system strikes the right balance of responsibilities between taxpayers and the ATO and whether further improvements could be made;*

2. *whether the current self assessment mechanisms minimise the costs and burdens of these responsibilities for stakeholders, including:*

    a) *in the context of the commercial, legal and administrative complexities that taxpayers experience, what difficulties taxpayers face in fulfilling their self assessment responsibilities;*

    b) *whether the administrative requirements for increased pre-assessment compliance action (such as expanded returns and real-time assessments) are proportionate to the risks they are intended to minimise;*

    c) *whether there is sufficient certainty in what constitutes a reasonably arguable position and reasonable care such that taxpayers are effectively able to manage their compliance risks in a complex environment;*

The ATO advice framework

3. *the extent to which the current ATO advice framework and its administration supports self assessing taxpayers to manage their risks and compliance costs without significantly diminishing the ATO's ability to collect appropriate revenue, including:*

    a) *the extent to which the ATO provides binding and non-binding advice and the issues on which stakeholders consider it should be provided;*

    b) *whether ATO responses to adverse tribunal and judicial decisions are working effectively for stakeholders;*

The role of the tax administrator

4. *the nature and role of the tax administrator, including:*

    a) *the extent to which the ATO makes judgements or take actions which give effect to the object and purpose of the legislation and the degree to which those judgments and actions are made in a transparent manner;*

    b) *the extent to which the ATO takes practical actions or makes practical decisions in situations of legal or administrative uncertainty to support taxpayers to self assess their tax liabilities in a cost-effective manner without significantly increasing the risk to the revenue (for example, through the exercise of various discretions or the powers of general administration);*

    c) *whether the ATO's effectiveness to take such actions or make such decisions could be improved through alternative models or approaches and, if so, the potential implications of adopting those alternatives;*

5. *any other concerns or potential improvements in relation to the self assessment system, including those matters considered by the ROSA review, such as periods for amendment.*

Consultation Process

The IGT welcomes your engagement in the consultation process. To facilitate this action, the IGT will:

- publish a copy of the terms of reference for this review on his website and call for submissions through other channels, such as print media;
- take submissions on this review from members of the public, or from particular associations, industry bodies or organisations; and
- request the Commissioner to provide information and/or documents relevant to this review.

Submissions

The IGT invites you to provide written submissions to assist with this review. The IGT has provided submission guidelines in the section below that you may find of assistance in making your submissions. Submissions should address the terms of reference set out above and the issues and questions outlined in the submission guidelines. It is not expected that each submission will necessarily address all of the issues and questions raised.

The closing date for submissions is 21 July 2011. Submissions can be sent by:

post to: Inspector-General of Taxation
GPO Box 551
SYDNEY NSW 2001

fax to: 02 8239 2100
email to: selfassessment@igt.gov.au

Confidentiality

Submissions provided to the IGT are dealt with in strict confidence (unless you specify otherwise). This means that the identity of the taxpayer, the identity of the adviser and any identifying information contained in such submissions will not be made available to any other person, including the ATO. Sections 23, 26 and 37 of the IGT Act 2003 safeguard the confidentiality and secrecy of such information provided to the IGT — for example, generally the IGT cannot disclose the information as a result of an FOI request, or as a result of a court order. Furthermore, if such information is the subject of client legal privilege (or legal professional privilege), disclosure of that information to the IGT is protected and will not result in a waiver of that privilege.

Submission Guidelines

6.20 In connection with the above terms of reference, we are seeking submissions to this review. We envisage that, broadly, your submission will be divided into two parts: firstly, a detailed account of your experience with the self assessment system, particularly in managing your tax risks; and secondly, your thoughts on any opportunities to improve the system and its performance.

Your experience with the self assessment system

In the first part of your submission, you should provide detailed accounts of experiences in complying with the tax laws under the self assessment system (including any ATO requirements), and the costs you bore in dealing with your tax risks, particularly in relation to:

- the factors that gave rise to the tax risks or uncertainty you experienced;
- the steps you took to minimise those risks or uncertainty (such as whether you obtained and used advice from the ATO and/or external service providers to help you manage tax risks), and the costs and impacts of these steps;

- the steps you took to minimise the adverse effects of the ATO disagreeing with your tax position (such as steps you took to establish that reasonable care was taken and that you have a reasonably arguable position);
- if the Commissioner exercised, or could have exercised, his general power of administration or other discretions in relation to your circumstances, whether you considered the exercise or otherwise to be appropriate and any impacts of that exercise or otherwise;
- the impact of, and costs involved in, fulfilling your responsibilities under the tax laws and related administrative requirements;
- the degree to which these costs and impacts were minimised by the tax laws and existing ATO advice and ATO action; and
- any other experience that you consider relevant.

Specific examples arising from your experiences would greatly assist us to both identify and examine potential systemic issues more efficiently and effectively. These accounts of your experiences should take into consideration the terms of reference above.

For these examples, it would be useful to provide a time line of events outlining your key interactions with the ATO including information requests, key meetings, the issuing of ATO documents and ATO amended assessments (if relevant).

It is important to provide details of specific factors, including the ATO practices and behaviours that, in your view, impact upon taxpayer certainty and the risks and costs that taxpayers must bear in a self assessment environment.

Any adverse or detrimental impacts of particular aspects of the self assessment system, including the ATO's practices and behaviours, should be set out and, if possible, the costs quantified. These might include unanticipated tax liabilities raised in amended assessments (including tax, penalties and interest) for prior years, increased compliance costs in dealing with the ATO directly, increased ongoing income tax risk and compliance costs thereafter, potential restructuring of significant commercial arrangements and opportunity costs.

The IGT also seeks examples of positive factors that contribute to taxpayer certainty and reduce costs.

Opportunities for improvement

In the second part of your submission, we invite you to identify opportunities to improve the self assessment system and its performance. Your submission may outline alternative frameworks, actions, practices or behaviours which, in your view, could minimise any adverse or detrimental impacts arising from the current system and its operation. This may include experiences you have had in other foreign tax jurisdictions.

The following is provided to give some background to the issues raised in the terms of reference and assist you in developing this part of your submission.

Responsibilities under the self assessment system and their implications

As stated in the background above, under the self assessment system, taxpayers shoulder the primary responsibility of correctly applying the tax laws to their circumstances. Although Parliament has given this responsibility to taxpayers, it has entrusted the Commissioner to ensure compliance with those laws. Any disputes involving the liability to pay taxes may, ultimately, be resolved by the judiciary, who are entrusted to interpret the laws raising those taxes.

The application of the tax laws to particular circumstances may involve a degree of complexity, such as that arising from the interaction of the tax laws with other laws or their application to complex facts. In these circumstances, there is an increased risk that within the available time period a taxpayer may not correctly assess their liability.

Previously, under the full assessment system, taxpayers were only responsible for disclosing all the relevant facts to the ATO. The ATO was responsible for correctly applying the law to those facts.

The ROSA report indicated that while the move from a full assessment system to a self assessment system led to the more efficient use of ATO resources to collect revenue, it also led to a shift of the burden of costs and risks of income tax compliance from the ATO to the taxpayer. The ROSA report's recommendations were not intended to remove these costs and risks altogether, but to minimise them to the extent possible while still allowing the ATO to collect legitimate income tax liabilities[347].

In your submission, you should reflect upon whether the current balance operates effectively to protect the rights of, and minimise the costs incurred by, taxpayers while still assuring the protection of revenue collections for the benefit of the Australian community as a whole. On the one hand, if the administrator was obliged to collect all liabilities without regard to taxpayers' costs and rights, it may create economic distortions and deter commercial innovation. On the other hand, if the administrator was obliged to minimise taxpayers' costs in proportion with the amount of revenue in question, it may make tax a negotiable debt and reduce funding for public policies.

In considering this issue, you may wish to consider the extent to which mechanisms that are designed to ease the cost and risk burden are effective in doing so. For example, do pre-assessment agreements achieve their stated purpose of giving taxpayers certainty regarding the ATO's satisfaction with an assessment for a particular year?

You may also wish to discuss the implications of the penalty mitigation and remission structure, particularly where there is disagreement over whether a taxpayer has taken reasonable care, or adopted a reasonably arguable position.

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[347] Ibid.

In considering any improvements to the current framework, you should specifically discuss what the aims of improvements to the self assessment framework could be in this context. That is, whether there are other outcomes that the balance of responsibilities between taxpayers and the administrator might seek to achieve. You should provide reasons for your views.

Having considered the existing self assessment framework, you should also consider the following specific areas.

ATO advice framework

The current ATO advice framework, subsequent to the recommendations made in the ROSA report, was designed to support self assessing taxpayers in managing their risks in a complex commercial and legal environment by making advice more timely, accessible, accurate and binding in a wider array of circumstances.

The ROSA review's discussion paper stated that it is possible to reduce taxpayer uncertainty by assuring taxpayers that they are assessing their income tax liabilities in accordance with the ATO's interpretation of the law, as communicated through rulings and other ATO advice[348]. Moreover, the ROSA report suggested that where taxpayers have acted in good faith, they should not suffer adverse consequences as a result of having relied on incorrect ATO advice. The cost of this protection, according to the report, should instead be borne by the community as a whole[349].

In your submission, consider the extent to which the ATO provides enough timely, clear and applicable binding advice to taxpayers within the requisite timeframe, such that they are able to assess their liabilities in accordance with the ATO's interpretation of the law, particularly where there are legal and commercial complexities or where adverse judicial decisions exist.

In considering these aspects of the current framework, you should address the question of whether these aspects support taxpayers in assessing and mitigating their risks in complying with the law. In doing so, you may wish to reflect on whether there are ways in which the ATO advice framework itself may be improved.

An issue raised in consultation was that while taxpayers are not charged directly by the ATO for advice (for example private rulings or other guidance) they may incur significant costs in seeking or obtaining ATO advice in meeting their tax law obligations.

You may wish to consider and detail the direct, indirect and opportunity costs incurred in seeking ATO advice. For taxpayers such costs may include the engagement of external tax advisors or agents. For tax advisers or tax agents it may include costs they experience in dealings with the ATO that are not charged to taxpayer clients for various reasons. To what extent do you believe these costs deter people from seeking ATO advice?

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348 The Treasury, above n 63, p 8.
349 The Treasury, above n 1, p 9.

The role of the administrator

The ATO's approach to the administration of the self assessment system may play a role in supporting taxpayers to self assess in a cost-effective manner without disproportionate risk to the revenue.

In areas of legal and practical uncertainty, one of the ways the ATO is able to impact on taxpayer certainty is through the operation of the Commissioner's powers of general administration. For instance, section 8 of the *Income Tax Assessment Act 1936* (ITAA 1936) gives the Commissioner the 'general administration of this act' for the purposes of administering income tax laws. Similar provisions exist in relation to other taxes administered by the ATO. The ATO has interpreted the purpose of this and other general administration provisions as placing the day to day administration of various taxation laws in the hands of a statutory office holder, the Commissioner[350]. The Commissioner's view of the scope of this power is set out in his practice statement, PSLA 2009/4 (available from www.ato.gov.au).

Your submission should reflect on whether you agree that the role of the administrator is to make judgements or take actions which give effect to the object and purpose of the legislation and the degree to which those judgments and actions should be made in a transparent manner.

You may also wish to reflect on whether taxpayers' abilities to manage their risks and self assess in a cost effective manner would be assisted if the ATO was able to take practical actions or make practical decisions which may draw more upon the object and purpose of the legislation, but which do not expose the revenue collection to significant risk. Are there areas where the ATO could take such action? Should such action only be taken in areas of low risk, but high levels of impracticality or cost? If such action could be taken, should the ATO engage with the taxpaying community in designing these approaches?

You may also wish to consider whether there are alternative legal models or approaches which may offer improvements. If so, you should also consider the tradeoffs that such alternatives might require.

Other issues

Having addressed the above, your submission may raise other issues that you wish us to consider in relation to the self assessment system. This may include the key themes arising from the ROSA review: improving taxpayer certainty and reducing compliance costs without significantly impacting on the ATO's ability to collect legitimate tax liabilities[351]. For instance, the complexity of the law or the commercial environment may impact on the operation of the self assessment system. You may wish to comment on whether there are other ways to improve certainty and reduce compliance costs for taxpayers in such an environment.

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[350] Quigley, above n 303.
[351] The Treasury, above n 1, p 4.

In addition to the advice framework, pre-assessment agreements and the role of the tax administrator, the ROSA review addressed a number of other issues of concern such as the length of amendment periods, law design and policy development, nil assessments and penalties and interest changes. Various recommendations were made and implemented in relation to these concerns. In your submission, you may wish to consider whether any further scope for improvement exists in these areas.

For instance, your submission may wish to consider the extent to which the current lengths of periods of amendment are adequate in allowing both taxpayers and the ATO the opportunity to correct errors. By the same token, you should consider whether there are areas where there may be opportunities to further shorten amendment periods, resulting in greater certainty to taxpayers, without significantly impacting on the ATO's ability to collect appropriate revenue.

You should note that the IGT listed a 'Review into ATO use of early and alternative dispute resolution (ADR)' as a separate review in his work program announcement. The ROSA recommendations that are related to ADR will be considered in the context of that review.

Lastly, your submission may wish to address any other specific points that you consider important in the context of the self assessment system.

APPENDIX 2 — HISTORY OF SELECTED EVENTS AND REVIEWS ON THE ADVICE FRAMEWORK

1930s – 1985

A.2.1 From as early as the 1930s, the Commissioner of Taxation has issued advice on his interpretation of the tax laws.[352] At this time, the administrator had developed a system of disseminating information within its organisation on interpretative matters as a means to assist officers to apply the law consistently — Income Tax Orders.

A.2.2 There have been calls for all of this information to be made publicly available, see for example, the 1975 Asprey Report of the Taxation Review Committee. However, it was not until the enactment of the Freedom of Information regime in 1982 that the taxation rulings system was formalised and rulings published. At this time, these rulings were issued under the Commissioner's general power of administration and were only administratively binding on the Commissioner. [353]

1986 – Self assessment

A.2.3 With the introduction of the self assessment system in 1986, taxpayers were also provided with an additional means to raise questions to be considered by the ATO at the time of lodgement of their tax returns — section 169A of the *Income Tax Assessment Act 1936*. This section was designed to facilitate self assessment by making it clear that the ATO may issue an assessment solely in reliance on the information in the taxpayer's return.[354] Although the ATO could also undertake a post-assessment review to amend the liability to reflect the amount of tax that should have been paid, it would consider itself administratively bound if it did not challenge the view on lodgement. The ATO reported significant usage of these requests, of up to 50,000 in any one year.[355]

A.2.4 By the early 1990s, concerns were raised with the balance of protections under the fledgling self assessment system and the need to provide greater taxpayer certainty. For example, concerns were raised with the extent of protection that these administratively binding rulings provided. For example, in one case the ATO departed from a 30-year old practice and successfully litigated the issue in the Federal Court (*David Jones Finance* v *Commissioner of Taxation* (1990) 12 ATR 1506).

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[352] Australian National Audit Office (ANAO), *The Australian Taxation Office's Administration of Taxation Rulings, Audit Report No. 3 2001–02* (2001) p 174.
[353] Joint Committee of Public Accounts, above n 27, pp 106–108.
[354] Explanatory Memorandum, House of Representatives, Taxation Laws Amendment Bill 1986, cl 19.
[355] Joint Committee of Public Accounts and Audit, above n 6, p 91.

1991 – Priority tasks

A.2.5 Following this, the government reviewed the self assessment system and published its intended action in the *1991 Priority Tasks information paper*. In this paper, the Government proposed a system of rulings that would bind the Commissioner in law:

> 8.3 Although Taxation Rulings will be binding in law, they will not have the status of law. A Ruling gives the Commissioner's interpretation of the law. Even if the interpretation is later found to be incorrect, the Commissioner will be estopped from increasing a taxpayer's liability where it has been calculated in accordance with the Ruling. This is similar to the form of estoppel which operated before 1986 to prevent the Commissioner from increasing a tax liability where there had been a full and true disclosure. There have been some representations that Rulings should not be able to take the place of the law nor override the decisions of the courts. However, there is strong support on certainty grounds, for the notion that if the Tax Office has all the facts it should be to say what the tax liability is and the taxpayer should be able to rely on that advice.[356]

A.2.6 Pursuant to this proposal, the *Taxation Laws Amendment (Self Assessment) Act 1992* was enacted. It introduced a legislative regime of two types of rulings: public and private. Both types of rulings were legally binding on the ATO with the result that the ATO could not levy additional primary tax, penalties and interest if the advice in the ruling was wrong and a taxpayer had followed that advice. Taxpayer rights of appeal to the Administrative Appeals Tribunal and the Federal Court were provided. Section 169A was also amended to prevent its usage where a private ruling could be requested.

A.2.7 Non-ruling forms of advice provided protection from penalties where taxpayers treated the law in a particular way that agreed with:

> (i) advice given to the taxpayer or their agent on or behalf of the Commissioner; or
>
> (ii) general administrative practice under that law; or
>
> (iii) a statement in a publication approved in writing by the Commissioner.[357]

1993 – Joint Committee of Public Account's review

A.2.8 The Joint Committee of Public Account's (JCPA) 1993 review of the ATO examined a number of aspects of the self assessment system, including the Commissioner's role as a rulings administrator. The JCPA observed that, notwithstanding the theoretical correctness of rulings being the Commissioner's statement of the view of the law, they practically equated to quasi-law:

> 6.42 … The ATO urged the Committee to consider Rulings as statements of the Commissioner's view of the law formed against the background of information from many sources. …

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[356] Kerin, above n 324, p 44.
[357] *Taxation Administration Act 1953* sch 1 s 284-215.

> 6.43 While acknowledging the theoretical accuracy of the ATO's position, the Committee noted the general perception in the community that Rulings were in fact quasi-law. That is, Rulings had to be followed if taxpayers did not want to be penalised.[358]

A.2.9 As a result the JCPA recommended that not following rulings should not, of itself, be a basis of a penalty.[359] The Government did not support these recommendations. However, as a result of a recommendation in a later report (recommendation 4.3 in the Report on aspects of income tax self assessment — discussed below), penalties for failing to follow private rulings were removed.

A.2.10 The JCPA recommended a number of other improvements to rulings which were supported by the ATO, including:

- improving access to the public and private rulings' databases (recommendations 34, para. 6.36, recommendation 36, para. 6.70); and
- providing alternate views in public rulings (recommendations 28, 29, para. 6.26).

A.2.11 The JCPA also recommended that the ATO should refrain from ruling in circumstances where there are serious doubts of the validity of the ATO's interpretation (recommendation 30, para. 6.26). The ATO responded that it would never adopt a position that is contrary to the law. However, it would seek clarification in Courts where the application of the law was unclear and different (but equally tenable positions) are taken. Where the policy of the law was unclear the ATO or the ATO view of the law was inconsistent with the policy intention, the ATO would bring that to the attention of Government.[360]

1998 – Product rulings, the Ralph review and the Government's *Tax reform — not a new tax, a new tax system* policy

A.2.12 In response to increased mass-marketing of claimed tax effective investment products, the ATO introduced a particular type of public ruling — 'product rulings'. Product rulings were introduced to focus ATO views on claimed tax benefits in 'products', such as an investment arrangement, a tax-effective arrangement, a financial arrangement, or an insurance arrangement. So long as the product was implemented as stated and there were no material omissions, taxpayers were protected from any additional tax, penalties or interest if the ATO's view was wrong.

A.2.13 The Ralph review proposed a number of improvements to the advice framework, including expanding the scope of matters on which private rulings could be obtained, default issue of private rulings, and charging fees for selected private rulings. It also concluded that the rulings function should be retained within the ATO.[361]

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[358] Joint Committee of Public Accounts, above n 27, p 110.
[359] Ibid 108, 114.
[360] Minister for Finance, JCPA, *Executive Minutes & Government Responses* (1993) paras [20]–[21].
[361] Review of Business Taxation, above n 28, pp 137–145.

A.2.14 Also in 1998, the government released its taxation policy document, *Tax reform – not a new tax, a new tax system*.[362] In relation to the advice framework it proposed certain measures to improve the certainty and reliability of ATO advice. These included a system of oral binding rulings for taxpayers with simple affairs and expanding the scope of matters on which private rulings could be obtained. The document also proposed to charge for private rulings on complex matters.[363]

2001 – Sherman, class rulings and the Auditor-General's performance audit

A.2.15 In continuing to use the power to issue public rulings in innovative ways, the ATO in 2001, started to issue public rulings to a specific class of persons, in relation to a particular matter — 'class rulings'.

A.2.16 Following concerns with the private ruling system, the ATO commissioned a review of the private rulings system. A number of recommendations to improve the integrity and case management of the system arose from that review including the publication of edited private rulings and improved case management systems and internal scrutiny.[364]

A.2.17 The Auditor-General also completed a performance audit on the ATO's management of the taxation rulings system. It observed room to improve in a number of areas and made twelve recommendations as a result.[365]

2004 – Treasury's review of aspects of income tax self assessment (ROSA)

A.2.18 In 2004, the Treasury conducted a review of aspects of income tax self assessment (ROSA review). This review was carried out in response to community concerns that the self assessment system did not have the right balance between protecting the rights of individuals and protecting the revenue for the benefit of the Australian community.

A.2.19 The discussion paper for the ROSA review recognised that:

> Tax Office rulings and other advice are important for taxpayer certainty. Taxpayers who self assess in line with the Tax Office's interpretation of the law have confidence that they will not be liable to pay additional primary tax, interest or penalties. Taxpayers who do not follow Tax Office advice or do not know the Tax Office position, run the risk that the Tax Office will amend their assessments and they will be liable to pay additional amounts.[366]

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[362] Costello, above n 177.
[363] Ibid pp 146–147.
[364] Michael Carmody, 'The Integrity of the Private Binding Rulings System' (Speech delivered at Melbourne, 15 November 2000) <www.ato.gov.au>.
[365] ANAO, above n 352.
[366] The Treasury, above n 63, p 13.

A.2.20 The report to the ROSA review (ROSA report) also observed that:

> [O]ne way to reduce the uncertainty faced by taxpayers under the self assessment system would be through taxpayers being confident that they were assessing their income tax liabilities in line with the Tax Office's interpretation of the law (through rulings and other advice).[367]

A.2.21 To this end, the ROSA report made 25 recommendations relating to the framework for ATO advice. Broadly, the recommendations were aimed at:

> improv[ing] certainty through providing a better framework for the provision of Tax Office advice and introducing ways to make that advice more accessible and timely, and binding in a wider range of cases.[368]

A.2.22 Upon release of the ROSA report, the Government agreed to all of the legislative recommendations (13 of which related to ATO advice and its framework). Accordingly, in 2005, two tranches of legislation were enacted to give effect to this agreement. In effect, the legislative provisions dealing with public and private rulings were completely replaced. With regards to advice, the new laws were intended to:

> [make] advice in the form of rulings by the Commissioner available to many taxpayers on a wide range of matters;
>
> [ensure] that the Commissioner provides rulings in a timely manner;
>
> [enable] the Commissioner to obtain, and make rulings based on, relevant information;
>
> [protect] taxpayers from increases in tax and from penalties and interest where they rely on rulings;
>
> [limit] the ways the Commissioner can alter rulings to a taxpayer's detriment; and
>
> [give] protection from interest charges where a taxpayer relies on other advice from the Commissioner, or on the Commissioner's general administrative practice.[369]

A.2.23 According to the Explanatory Memorandum to the Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005, the overall object of the new advice legislation was to:

> provide improved ways for taxpayers to find out the Commissioner's view about how certain laws apply to them, so that the risks of uncertainty when self assessing, or working out the tax obligations or entitlements, are reduced.[370]

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[367] The Treasury, above n 1, pp 3–4.
[368] Ibid p 4.
[369] Explanatory Memorandum, House of Representatives, Tax Laws Amendment (Improvements to Self Assessment) Bill (No 2) 2005, para [3.20].
[370] Ibid para [3.19].

A.2.24 Eleven of the remaining twelve advice recommendations were directed towards the ATO.[371] The Commissioner of Taxation undertook to implement these recommendations as soon as practicable.

2006 – 2011 IGT reviews on the advice framework

A.2.25 The IGT has also previously reviewed a number of aspects of the advice framework:

- *Review of Tax Office management of Part IVC litigation*, May 2006 — part of the review dealt with changes in the ATO view following adverse Tribunal and court decisions;
- *Review of the potential revenue bias in private binding rulings involving large complex matters,* February 2008 — dealt with the underlying causes of perceptions of ATO revenue bias in interpretative matters, such as the ATO's use of 'policy intent' in its approach to statutory interpretation, delays and costs of ruling applications and refusals to rule;
- *Review of the Tax Office's administration of public binding rulings*, April 2009 — dealt with the ATO's implementation of aspects of the ROSA recommendations, such as those relating to public binding rulings, other guidance providing lower levels of protection and general administrative practice;
- *Review into the implications of any delayed or changed ATO advice on significant issues*, March 2010 — dealt with issues such as the ATO's approach to changes in view, retrospective application and the manner in which the ATO engages the community on technical issues;
- *Review of aspects of the Australian Taxation Office's administration of private binding rulings*, May 2010 — dealt with issues such as the quality, consistency and timeliness of private rulings; and
- *Review into the Australian Taxation Office's administration of class rulings*, September 2011 — dealt with issues such as the timeliness, communication and transparency of the ATO's work in providing class rulings.

A.2.26 The overarching themes arising from these reviews were that, within the existing advice framework, there was scope for the ATO to reduce compliance costs, delays and taxpayer uncertainty.

[371] The remaining recommendation was directed at the IGT to review whether there was a potential revenue bias in ATO rulings. This review was completed in February 2008.

2009 – Australia's future tax system — the Henry review

A.2.27 The Henry review made a comprehensive examination of Australia's tax and transfer system, including some issues arising in tax administration. In relation to ATO advice, the Henry review considered calls for the ruling function to be carried out by a separate organisation. It rejected those calls and concluded that:

> the ATO should continue to execute that role in a way that builds community trust in the fairness of its approach. The ATO should continue to bring a practical administrative perspective to the purposive interpretation of tax laws. Greater transparency about the policy objective of the tax laws will support a purposive approach to interpretation. A principles-based design of the law will help make the policy objectives more explicit (see Recommendation 112). Transparency would also be enhanced by publishing information or advice provided by Treasury to assist the ATO in determining the purpose or object of the law, or materials used by the ATO to determine policy intent (see Recommendation 114).[372]

[372] Australia's Future Tax System, above n 6, Part 2 vol 2 p 659.

APPENDIX 3 — SUMMARY OF ATO MATERIAL AND LEVELS OF PROTECTION

ATO assistance – level of protection summary

Various levels of protection against tax shortfall, false or misleading statement penalty and interest charges exist if ATO assistance is incorrect.

CATEGORIES	LEVELS OF PROTECTION			
	Protection from tax shortfall?	Protection from false or misleading statement penalty?[1]	Protection from interest charges?	Related practice statement paragraph numbers
Legally binding advice				
• Public Ruling - Division 359	YES	YES	YES[2]	29 - 45
• Product Ruling	YES	YES	YES[2]	51 - 59
• Class Ruling	YES	YES	YES[2]	60 - 65
• Private Ruling – Division 359	YES	YES	YES[2]	80 - 123
• Oral Ruling – Division 360	YES	YES	YES[2]	145 - 182
Administratively binding advice	*^ Level of protection is subject to conditions set out in paragraph 199 of this practice statement*			
• Administratively binding advice	YES^	YES	YES[2]	190 - 204
Guidance	**Statement penalty and interest charges may be remitted in individual cases for reasons unrelated to the guidance relied on*			
• Published speeches and minutes of consultative forums	NO	YES	YES[2]	216 - 218
• Decision impact statements	NO	YES	YES[2]	222 - 223
• Media releases	NO	YES	YES[2]	219 - 221
• Internal publications:				
– ATO interpretative decisions	NO	YES	YES[2]	224 - 228
– Law administration practice statements	NO	YES	YES[2]	229 - 234
– Technical skilling material	NO	YES	YES[2]	235 - 238
• ATO communications not intended to be relied on	NO	NO*	NO*	239 -242
• Edited versions	NO	NO*	NO*	243 - 244
• Technical discussion papers	NO	NO*	NO*	245 – 246
• Oral guidance	NO	YES[3]	YES[2]	247 - 260

[1] Notwithstanding that a publication is labelled non-binding, protection against false or misleading statement penalty will be available if it is a publication that has been approved in writing by the Commissioner. [2] Protection against interest on the shortfall is available where the taxpayer acted reasonably and in good faith. It does not cover the general interest charge for late payment of the tax shortfall, that is, after 21 days of the Commissioner notifying the taxpayer of the correct position. For superannuation guarantee charge matters, the protection does not extend to the nominal interest component of a superannuation guarantee shortfall under section 31 of the *Superannuation Guarantee (Administration) Act 1992*. [3] Only if taxpayer has made a full and true disclosure of the material facts relevant to their enquiry

Misleading statement Sometimes a statement in an ATO publication might be correct, but a particular taxpayer may have been misled by it on reasonable grounds. Taxpayers who rely on ATO publications (except those labelled as non-binding) that are relevant to their circumstances but are misleading to their intended audience, and who make a mistake by relying on that publication, will be protected from false or misleading statement penalty and interest charges.

Genuine effort to follow ATO assistance Taxpayers that take reasonable care to follow ATO assistance but make an honest mistake will be protected from false or misleading statement penalty and interest charges.

APPENDIX 4 — EXTRACTS FROM *TAXPACK 2008*, *TAXPACK 2011* AND THE 2011 VERSION OF *E-TAX*

TAXPACK 2008

A.4.1 The following is extracted from the inside cover of *TaxPack 2008* and the *TaxPack supplement 2008*:

> Our commitment to you
>
> TaxPack 2008 is a public ruling for individuals who use it reasonably and in good faith to complete their 2008 personal tax return. This means that if we state the law incorrectly, or our advice on the application of the law is incorrect and as a result you do not pay enough tax, we will not ask you to pay the extra tax.
>
> TaxPack 2008 also contains guidance to help you complete your tax return. If any of our guidance in TaxPack 2008 is incorrect or misleading and as a result you do not pay enough tax, we may ask you to pay the extra tax, but we will not charge you a penalty. Also, if you acted reasonably and in good faith we will not charge you interest.
>
> If our advice in TaxPack 2008 is misleading and you make a mistake as a result, we must still apply the law correctly. If that means you owe us money, we must ask you to pay it, but we will not charge you a penalty. Also, if you acted reasonably and in good faith we will not charge you interest.
>
> If you make an honest mistake when you try to follow our advice and guidance in TaxPack 2008 and you owe us money as a result, we will not charge you a penalty. However, we will ask you to pay the money, and we may also charge you interest. If correcting the mistake means we owe you money, we will pay it to you. We will also pay you any interest you are entitled to.

TAXPACK 2011 AND *E-TAX*

A.4.2 The following is extracted from *TaxPack 2011* at page 126 and the *TaxPack supplement 2011* on the inside cover and the *e-tax* 'welcome' screens:

> OUR COMMITMENT TO YOU
>
> We are committed to providing you with accurate, consistent and clear information to help you understand your rights and entitlements and meet your obligations.
>
> If you follow our information in this publication and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we must still apply the law correctly. If that means you owe us money, we must ask you to pay it but we will not charge you a penalty. Also, if you acted reasonably and in good faith we will not charge you interest.

> If you make an honest mistake in trying to follow our information in this publication and you owe us money as a result, we will not charge you a penalty. However, we will ask you to pay the money, and we may also charge you interest. If correcting the mistake means we owe you money, we will pay it to you. We will also pay you any interest you are entitled to.
>
> If you feel this publication does not fully cover your circumstances, or you are unsure how it applies to you, you can seek further assistance from us.
>
> We regularly revise our publications to take account of any changes to the law, so make sure that you have the latest information. If you are unsure, you can check for more recent information on our website at www.ato.gov.au or contact us.
>
> This publication was current at May 2011.

A.4.3 *TaxPack 2011* states that the special circumstances and glossary section (pp. 117–125) is a public ruling. This section covers:

- Non-resident Withholding Tax on gross interest and dividends;
- Foreign employment termination payment
- The holding period rule and the related payments rule for claiming dividends and franking credits;
- Deductions for leased luxury cars;
- Rules for certain types of gifts or donations;
- deductions for contributions or gifts to registered political parties, independent members of parliament (state or Commonwealth) or independent candidates in an election for Parliament;
- Tax-free government pensions or benefits that are taken into account in the income tests; and
- Definitions of certain terms such as 'spouse', 'transitional termination payment' and 'interdependency relationship'.

A.4.4 *E-tax* provides some of the questions and the help files are declared as public rulings:

> PUBLIC RULING PROTECTION
>
> The public ruling protection applies to advice contained within the following parts of *e-tax 2011*. Advice is a statement of the application of the law.

Income
Item 4 - Employment termination payments ■ The question and help file for item 4.
Item 8 - Australian superannuation lump sum payments ■ The definitions of 'Death benefits dependant', 'Interdependency relationship', 'Terminal medical condition', 'Low rate cap for taxable components' and 'Untaxed-plan cap for untaxed elements' contained in the help file for item 8.
Item 11 - Dividends ■ The question and help file for item 11.
Deductions
Item D9 - Gifts and donations ■ The question and help file for item D9.
Tax Offsets
Item T4 - Australian superannuation income streams ■ The question and help file for item T4.
Income Tests
Item IT3 - Tax-free government pensions ■ The list of 'tax-free government pensions or benefits' contained in the help file for item IT3.
Spouse details
■ The definition of 'spouse' contained in the help file for items M1, M2, Spouse details, T1, T2, T3, T7, T9 and T10.

Any material you access from hyperlinks within public ruling parts of *e-tax 2011* is not a public ruling unless the material is within a help file for one of the questions above. To identify if the help content you are reading is a public ruling, check the title at the top of the help file against the above list; if it does not appear on the list – it is not a public ruling.

APPENDIX 5 — THE ATO'S EARLY ENGAGEMENT MODEL FOR LARGE TAXPAYERS

Implementation of the Early Engagement Model for Large Market Taxpayers

Background

The Early Engagement Model (EEM) was implemented on 1 July 2010 for all private and class rulings received from large market taxpayers. EEM aims to identify and engage the relevant internal stakeholders early in the rulings process to improve timely resolution.

A joint review of the EEM was conducted at the nine month mark to consider what benefits have been realised in the large market areas of the ATO.

The EEM initiative supports the Commissioner of Taxation's Office Minute to SES 'Investment in our future' 17 January 2011 as it:

- brings together the right specialist knowledge early
- strengthens case planning of high priority advice
- is responsive to taxpayer's commercial urgency
- enhances the relationship we are seeking to build with large business.

Taxpayer experience

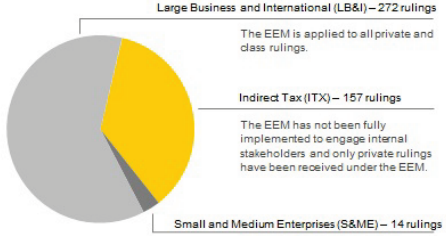
Client feedback about the EEM gathered from questionnaires and direct contact with taxpayers and their advisors have been very positive, particularly in relation to professionalism, communication, our ability to understand the issues and timeliness.

"The staff involved were technically proficient, responsive and focused on deadlines. The professionalism was outstanding and a credit to the organisation."

"A pre-lodgment workshop allowed us and the ATO officers to develop a clear understanding of the project, the roles each had to play, and a common commitment to early and regular communication."

"The commitment of the ATO to meeting timetables (often dictated by regulatory processes outside the group's control) to work through interpretational issues in a collaborative fashion and communicate early exceeded my expectations, and reinforced my view of the ATO's professionalism and responsiveness."

Large market rulings received under EEM

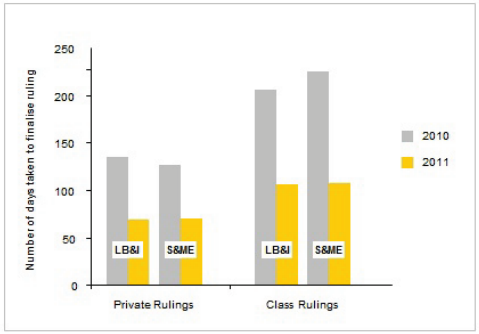


Has the timeliness of rulings improved?

Yes – the EEM concept of using the 'risk rating' system to classify rulings and engage key stakeholders has reduced cycle times and met the taxpayer's commercial urgency.

There is a general trend that cycle times decrease where the complexity/risk of the ruling classification decreases. An exception has been some lower risk rulings which do not require the involvement of stakeholders outside of LB&I – further investigation is underway to identify improvements.

A comparison of the number of days taken to finalise private and class rulings for the first nine months of 2010 and 2011 for LB&I and third quarter of 2010 and 2011 for S&ME is provided below. As the EEM has not been fully implemented in ITX, ITX results have not been included.



ATO staff experience

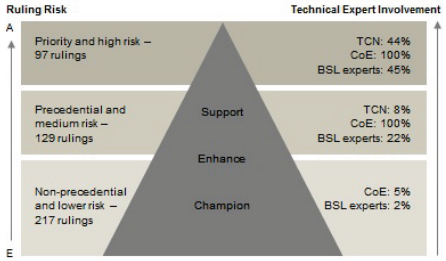
Consultation with Interpretative Assistance stakeholders shows a strong commitment to come together early to identify issues and progress the timely resolution of a ruling.

In a number of high risk / significant transactions where taxpayer contact had been initiated with a senior ATO leader, there were very high levels of co-operation to meet the taxpayer's urgent commercial needs. While this level of engagement is not sustainable for all cases, the EEM brings direction to ensure the right people come together early and there is discipline around active case planning and management.

LB&I has undertaken 78 pre-lodgment meetings with taxpayers over the last nine months. Staff were of the view that pre-lodgments lead to a more efficient ruling process with better quality of ruling requests, reducing the need for requests for further information.

Bringing together skills available to us

The EEM has shown to have significantly improved relationships between the different internal stakeholders with a more efficient process of engagement for rulings. It also provides the opportunity to build collective capability by bringing people together to discuss the issues in rulings where each participant can benefit from the technical expertise/experience and industry knowledge others bring to bear.



What is the role of EEM in the broader ATO context?

The EEM seeks to align with the Risk Differentiation Framework by identifying the taxpayer's quadrant and engage LB&I Active Compliance teams where rulings are lodged by quadrant 1 and 2 taxpayers.

The EEM team is a central hub for identifying intelligence and risks from the rulings process.

What is the future of the EEM?

- ITX and Law and Practice (L&P) are working together to achieve full implementation by 1 July 2011.
- EEM to be expanded to other markets by 31 January 2012.
- EEM to be integrated under the design for the Transforming Tax Technical Decision Making (TTTDM) project built around the early engagement of BSL expertise to resolve all interpretative issues and the continued prioritisation of the higher risk issues to L&P. Moving towards TTTDM there will be a strong focus on building the BSL technical networks and expertise.

APPENDIX 6 — LIST OF RECOMMENDATIONS FROM TREASURY'S REPORT ON ASPECTS OF INCOME TAX SELF ASSESSMENT

Improving the framework, reliability, accessibility, accuracy and timeliness of ATO advice

	Recommendation	Implementation
1	Taxpayers who reasonably rely on Tax Office advice should receive a level of protection as follows: • For all legally binding advice, taxpayers will be protected from amendments raising additional primary tax, penalties and interest charges. • For all other written advice (unless that advice is clearly labelled non-binding), and oral advice provided by formal enquiry centres, taxpayers will be protected from penalty and interest charges. • No penalties or interest will apply where taxpayers follow long standing Tax Office administrative practice.	Legislative
2	The category of legally binding public rulings should be expanded to cover matters of administration, procedure, collection, and ultimate conclusions of fact involved in the application of a tax law.	Legislative
3	The Commissioner should be empowered to declare that advice provided for the general information of non-business individual self preparers (for example, TaxPack) is legally binding upon the Tax Office.	Legislative
4	All aspects of a public ruling that are capable of binding the Tax Office (including for example, worked examples) should be collected together and clearly labelled as binding. In public rulings, alternative views need not be addressed if these are likely to confuse the reader. Where competing views are raised in consultation and not addressed in the ruling, the Tax Office should provide feedback directly to people contributing those views.	Administrative
5	The Tax Office should take all steps necessary to ensure that an appropriate instruction or product replaces any public ruling as soon as practicable after it is withdrawn.	Administrative
6	Where the Tax Office changes a public interpretation or long standing practice to the detriment of taxpayers, that change should become effective prospectively and, where necessary, from a future date that allows affected taxpayers reasonable time to become aware of, and act upon, that new interpretation.	Legislative
7	Where taxpayers rely on public rulings while they are in draft form they should be protected from penalties and receive full remission of any interest charges in the event that the final ruling is issued in different terms, to their detriment.	Legislative

	Recommendation	Implementation
8	Wherever possible, Tax Office general written advice, including public rulings, should be written in plain language, with a minimum of qualifying statements so that it is accessible to the general public.	Administrative
9	The Tax Office should continue to replace large 'mail-outs' to tax agents with more targeted electronic contacts, and a 'whole-of-agency' view should be applied to volumes of information distributed.	Administrative
10	The Tax Office should update and consolidate its guidance on the way it interprets and administers Part IVA of the *Income Tax Assessment Act 1936* into a single comprehensive Ruling or Practice Statement.	Administrative
11	The category of private binding rulings (PBRs) should be expanded to cover matters of administration, procedure, collection, and ultimate conclusions of fact involved in the application of a tax law. However, the Commissioner should not be obliged to rule where to do so would prejudice or unduly restrict the administration of the tax law.	Legislative
12	In PBRs where Part IVA could apply having regard to the facts provided in the PBR application, the Tax Office should indicate whether Part IVA has been considered. This indication may be by way of substantive comment on Part IVA's application, or by disclaimer. Where Part IVA has been substantively addressed and there has been a full and true disclosure of all material facts, the Tax Office should be prevented from reopening an assessment. Taxpayers can advise in their PBR application that Part IVA need not be considered.	Administrative
13	The Government should request the Inspector-General of Taxation to evaluate whether the pattern of PBRs indicates a pro-revenue bias.	Administrative
14	The Tax Office should enhance its published performance reporting on PBRs to distinguish response times to individuals and very small business from those for larger businesses, and separately report agent and non-agent case statistics.	Administrative
15	For PBR applications that are older than 60 days, taxpayers who have supplied all information required by the Tax Office should be able to request that the Tax Office determine their application within 30 days. If the Tax Office does not make a determination within 30 days, the taxpayer will be taken to have received a negative response to their application, thus triggering their objection and appeal rights.	Legislative
16	The Tax Office should refrain from ruling on issues not directly raised in PBR applications without the taxpayer's agreement. In cases where other aspects of the tax law could impact on the accuracy of the Tax Office's response, the response should contain appropriate caveats or statements that the advice is issued subject to certain assumptions or limitations. When making a PBR, the Commissioner should be empowered to consider information other than that supplied by the applicant, provided that such information is made known to the applicant before being used.	Legislative
17	When making a PBR, the Commissioner should be empowered to consider information other than that supplied by the applicant, provided that such information is made known to the applicant before being used.	Legislative

	Recommendation	Implementation
18	The Tax Office should continue to modify its PBR application forms and processes to reduce the need for taxpayers to conform to complex procedures, or for the Tax Office to seek additional information from taxpayers.	Administrative
19	If neither the transaction nor the income year to which a PBR relates has begun, the PBR may be withdrawn by either: • notifying the affected taxpayer directly through a revised PBR; or • issuing a public ruling, provided that ruling applies to the taxpayer as if it was issued immediately before the taxpayer's next income year.	Legislative
20	PBRs should contain an answer written in plain language, with a minimum of qualifying statements. In addition to the plain explanation, the Tax Office may provide a more detailed or technical statement of its position, where it is necessary to do so.	Administrative
21	In responding to a request for a private ruling, or determining an objection to a PBR request, the Commissioner, Tribunal or Court (as the case may be) should be able to take into account additional facts and particulars provided by taxpayers after they have lodged their PBR application. Where the additional facts mean that the arrangement is materially different from that in the original PBR request, a taxpayer must make a fresh PBR application.	Legislative
22	Where the Tax Office has provided a PBR to a trustee of a trust estate, the PBR should be able to be relied upon by future trustees of the trust estate for the same income years on the same terms as the original PBR.	Legislative
23	The eligibility for oral rulings should be expanded to cover all non-business individual taxpayers who are self preparers unless, in the opinion of the Commissioner of Taxation, the question being asked is complex and would require the question to be set out and answered in writing.	Legislative
24	The Tax Office should explore ways to record oral advice as suggested by the Ombudsman.	Administrative
25	The Tax Office should work with tax agents to identify improved ways or new systems to assist tax agents with responsive and timely advice on low risk enquiries.	Administrative

Reducing the period during which there can be uncertainty about the finality of an assessment

	Recommendation	Implementation
26	The amendment period for increasing the liability of individuals and very small businesses should be reduced from four years to two years, subject to certain exclusions dealt with in Recommendation 28.	Legislative
27	For the purposes of the proposed two year amendment rule, a business should be treated as a very small business if it has elected to participate in the Simplified Tax System.	Legislative

	Recommendation	Implementation
28	The two year amendment period for individuals and very small businesses should exclude: • partners in partnerships and beneficiaries or trustees of trusts where the partnership or trust has not elected into the Simplified Tax System; • taxpayers who get a tax benefit from a scheme entered into or carried out with the dominant purpose that they (or someone else) get a tax benefit. The two year amendment period may also exclude other high-risk cases by regulation.	Legislative
29	From the 2004-05 income year, the period of review for loss and nil liability cases should be equivalent to the period for the Tax Office to amend assessments creating liabilities.	Legislative
30	Where a taxpayer's 2004-05 return discloses relevant loss information about any earlier loss years, the Tax Office should have six years from lodgment of that return to issue an assessment for those prior loss years. For other (non-loss) nil liability returns for years ended 30 June 2004 and earlier, the Tax Office should have until 31 October 2008 (or four years from the date of lodgment, whichever is later) to issue an assessment.	Legislative
31	The present six year period for the Tax Office to amend using the anti-avoidance provisions should be abolished, so that a four year amendment period applies to arrangements entered into or carried out to obtain a tax benefit.	Legislative
32	Treasury should conduct a detailed review of the specific provisions with unlimited amendment periods to identify those that could have a set amendment period. Such set periods could be in line with the current general rules, or longer with good reason. This Review should identify appropriate transitional arrangements so that the issues from earlier income years (for which there is currently an unlimited amendment period) become final where a finite amendment period is adopted.	Legislative
33	The unlimited amendment periods should be abolished for the substantiation and car expenses provisions, so that the normal amendment limits apply.	Legislative
34	The Tax Office should generally accept a request for an extension of time to lodge an objection from individual or very small business taxpayers where the request is received within four years of the original assessment and the taxpayer has at least an arguable case for the objection to be allowed in whole or in part. However, such extensions would not usually be granted where the Commissioner is out of time to amend an assessment of an associated taxpayer to include income which was incorrectly included in the first taxpayer's assessment.	Legislative
35	The Tax Office should extend its practice of entering into pre-assessment agreements to a wider range of transactions or circumstances, wherever it is cost effective to do so.	Administrative

Achieving more balanced penalty arrangements

	Recommendation	Implementation
36	The Tax Office should revise its rulings on reasonable care and reasonably arguable position, with a view to providing clearer guidance and further examples as to what conduct will, or will not, attract a penalty.	Administrative
37	The definition of when a matter is 'reasonably arguable' should be amended to confirm that the relevant standard is about as likely to be correct as incorrect (or more likely to be correct than incorrect) — not as likely to be correct as incorrect.	Legislative
38	The penalty for a tax shortfall resulting from a failure to follow a private ruling should be abolished.	Legislative
39	The Tax Office should explain more fully, for example in a Ruling or Practice Statement, how it exercises the discretion to remit tax shortfall penalties, including in Part IVA cases.	Administrative
40	Where the Tax Office decides that a tax penalty applies and should not be remitted in full, the Tax Office should provide an explanation of why the penalty has been imposed (for example, why the taxpayer has not taken reasonable care or does not have a reasonably arguable position) and why the penalty has not been remitted in full.	Legislative
41	The Tax Office should further explain in a Ruling or Practice Statement what understatements of liability it regards as immaterial for tax shortfall purposes.	Administrative

Introducing a replacement for the General Interest Charge (GIC) in tax shortfall cases

	Recommendation	Implementation
42	From the 2004-05 income year, the standard interest charge applying to income tax shortfalls (that is, the tax difference between the original and amended assessment) should be lower than the GIC rate, reflecting the benchmark cost of finance for a business.	Legislative
43	The new lower uplift factor should be implemented by a separate pre-amendment shortfall interest charge, in lieu of the GIC. GIC will continue to apply to crystallised debts from the new due date.	Legislative
44	The Commissioner should have a broad discretion to remit the new shortfall interest charge, where he considers it fair and reasonable. Without limiting the generality of the above: • Remission should have regard to the broad intention that shortfall interest be imposed at a uniform rate, rather than being tailored to the circumstances of particular taxpayers. • Remission should generally occur where circumstances justify the revenue-bearing part of the cost of delayed receipt of taxes.	Legislative
45	Where unremitted shortfall interest exceeds 20 per cent of the tax shortfall, the taxpayer should be entitled to object to the decision not to remit. Objection decisions should be subject to review and appeal where the shortfall interest remaining after determination of the objection exceeds 20 per cent of the tax shortfall.	Legislative

	Recommendation	Implementation
46	When notifying taxpayers of a shortfall interest liability, the Tax Office should advise taxpayers on how to seek remission.	Administrative
47	The Tax Office should provide reasons for rejecting requests for remission of shortfall interest.	Legislative

Ensuring that taxpayers have a better understanding of their obligations under self assessment

	Recommendation	Implementation
48	The Tax Office should take further steps to make it clear that a notice of assessment can be reviewed and amended. These steps could include: • changing the notice of assessment title or description to reflect that it is an assessment based on the face value of the return; • requiring tax agents to inform their clients of the applicable review periods that apply to their returns.	Legislative

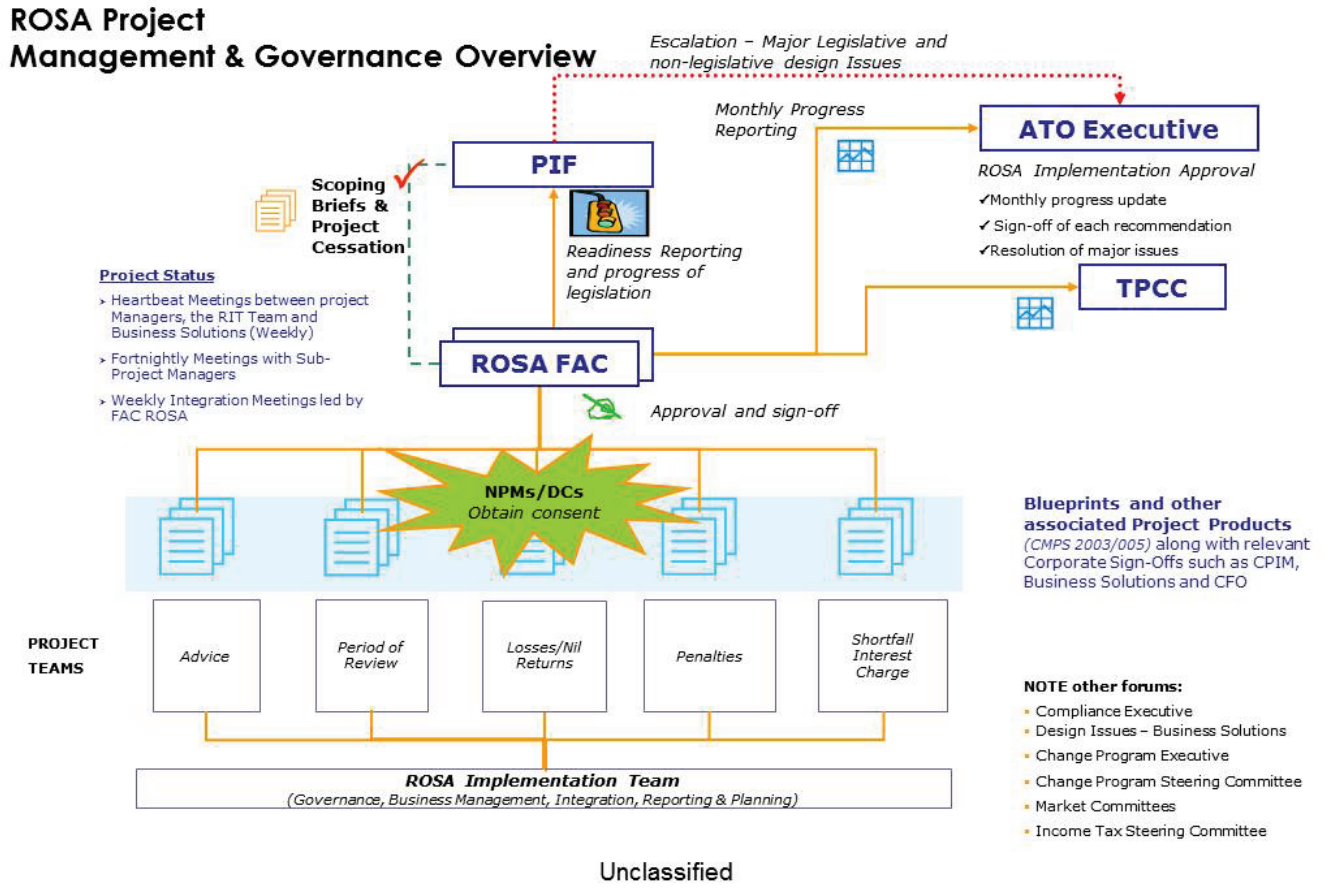
Improving the transparency and objectivity of the ATO's Test Case Litigation Program

	Recommendation	Implementation
49	The government should request the Inspector-General of Taxation to evaluate the operation of the Tax Office's Test Case Litigation Program, with particular focus on: • the suitability and application of the criteria used to select test cases; • the transparency of reasons given to applicants where funding is rejected.	Administrative

Improving the processes associated with the development of tax policy and law design

	Recommendation	Implementation
50	Treasury should conduct a detailed review of discretions that go to the determination of a taxpayer's liability and recommend replacement tests, wherever practical, that a taxpayer can apply at the time of lodgment.	Administrative
51	Treasury should conduct a review of the design of elections in the law and establish guidelines for framing those elections in the future.	Administrative
52	The Board of Taxation (in conjunction with Treasury) should review international consultation processes with a view to identifying any improvements to the Australian system, especially in respect of non-controversial minor policy or technical amendments, and report to Government.	Administrative
53	Treasury should review the possible application of the recommendations contained in this report to all federal taxes.	Administrative
54	Treasury should examine the possibility of reducing the volume of law that needs to be accessed by individuals and small businesses with very simple affairs.	Administrative

APPENDIX 7 — ATO'S GOVERNANCE FRAMEWORK FOR IMPLEMENTATION OF ROSA RECOMMENDATIONS



APPENDIX 8 — EXTRACT FROM IGT'S SUBMISSION TO THE TAX FORUM

5.2.2 THE ROLE AND FUNCTIONS OF THE ADDITIONAL SECOND COMMISSIONERS

The additional Second Commissioners should be full-time roles. They would be both members of the ATO management executive and be part of the day-to-day management team.

These Second Commissioners may serve the system best by having specific responsibility for particularly critical or contentious areas of tax administration. These areas may be those where the ATO's approaches, views and actions may be enhanced by having informed business perspectives and taxpayer experiences.

One such area is the ATO's objection and litigation sections. Stakeholders, by way of example, perceive that there is a lack of independent review where an ATO objection officer is located within the same business line as the original decision-maker, albeit a different section. The original decision-maker is perceived by taxpayers to have some kind of input or influence on the objection determination, either directly or indirectly, due to factors such as organisational, behavioural or social considerations.

The Joint Standing Committee of Public Accounts also reflected on this independence concern noting that it was difficult to characterise the objections process as an 'independent review' where objections officers were subject to the same culture, corporate goals and values as the rest of the ATO.

The IGT's *report into the Underlying Causes and Management of Objections to Tax Office Decisions* found that in relatively simple matters, there was independent review but in larger, more complex, objections the line between the objections officer and original decision-maker was blurred. The IGT's report into Large Business Audit and Risk reviews considered similar concerns regarding the ATO's technical decision making review, where recommendation was made and accepted by the ATO for improvement.

An innovation, suggested by a wide range of stakeholders, is that the ATO should have a strong independent internal appeals or review area. The IGT sees considerable merit in this idea. While increasing the independence of review of original ATO decisions, the IGT believes that a separate appeals area would empower the ATO's in-house legal section to independently assess the evidence and prospects of a case before progressing the matter to litigation. The ATO's litigation arm would, like the Director of Public Prosecutions in criminal matters, have ultimate discretion as to which matters the ATO would litigate, which would be conceded and which should otherwise be settled. This would ensure that only genuine and fundamental disputes on interpretation or application of the law are litigated, resulting in cost savings for both government and taxpayers.

To achieve such an outcome, one of the additional Second Commissioners would head up this new appeals and review area, providing stakeholders with stronger assurance of independence.

The IGT notes that such a model currently exists in the IRS in the United States, with its Appeals area being empowered to separately and independently settle and pursue matters arising out of original IRS decisions.

It is appreciated that this approach may on occasions give rise to internal tensions within the ATO. The IGT considers that tensions of this nature are desirable in ensuring appropriate outcomes are achieved, thereby reducing the overall level of taxpayer disputes and the cost to the broader tax system.[373]

[373] Inspector-General of Taxation, above n 341, pp 17-18.

APPENDIX 9 — ATO RESPONSE TO THE REVIEW

Pages 3 to 8, attachment A of the ATO's response, contain the ATO's response to the IGT's recommendations.

These responses have been moved into the body of the report to remove duplication.

Australian Government
Australian Taxation Office

SECOND COMMISSIONER OF TAXATION

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

Dear Ali,

Review into improving the self-assessment system

Thank you for the opportunity to comment on your report on the Review into improving the self-assessment system.

Australia's self-assessment system relies on the willing participation and voluntary compliance of taxpayers with their tax obligations.

Your report recognises the link between high levels of tax compliance and administrative assistance that is appropriately targeted to the needs of users. I welcome your acknowledgement of the wide range of material that the ATO publishes in furtherance of this objective. We also welcome the feedback of stakeholders and note that a number of your recommendations are aimed at assisting us in improving the quality and useability of our support products.

Our response to your recommendations is attached at Annexure 1.

17 of the 33 recommendations are matters of policy or relate to areas within the responsibility of the Treasury. 2 recommendations include both policy and administrative matters - we agree with the administrative aspects of both of these recommendations. Of the remaining 14 recommendations, we agree either fully, in principle or in part with 13 and disagree with 1.

We believe that within the context of the self-assessment system, the current advice and guidance framework strikes the right balance between appropriate levels of guidance for all taxpayers and appropriately graduated levels of protection. It follows that we do not agree with your recommendation 2.7 that Tax Pack be reinstated and given Public Ruling status. We believe that the new Individual Tax Return Instructions, which were developed following extensive consultation meet the needs of individual taxpayers who lodge paper returns and feedback to date supports this view. We will continue to monitor that feedback and will undertake a review at the end of the lodgment season.

We have agreed with the majority of the remaining recommendations for administrative change. These will assist us to continue to enhance our levels of transparency and consultation in providing additional advice, support and greater certainty to taxpayers,

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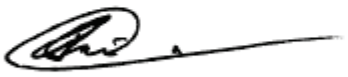
advisers and the community. We note that this extends beyond our technical views. It also encompasses, for example, communication about the operation of our risk differentiation framework (RDF), formalising regular consultations about the information we collect in tax returns and publishing more information about our penalty decisions.

Finally, I would like to acknowledge the efforts of all involved in the undertaking of this review.

If you require further information on this matter, please contact Annette Chooi, Assistant Deputy Commissioner.

Yours sincerely,



Bruce Quigley
Second Commissioner Compliance

21 August 2012

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