



Australian Government

Inspector-General of Taxation

Taxation Ombudsman

Improving the operation of the Small Business Litigation Funding Program

Recommendations to the Australian Taxation Office

By the Inspector-General of Taxation

August 2023

Acknowledgement of country

In the spirit of reconciliation the Australian Government Inspector-General of Taxation acknowledges the Traditional Custodians of country throughout Australia and their connections to land, sea and community. We pay our respect to their Elders past and present and extend that respect to all Aboriginal and Torres Strait Islander peoples today.

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Table of Contents

Table of Contents	ii
EXECUTIVE SUMMARY	iii
Introduction.....	iii
The IGTO’s understanding of the policy objectives and intention of the Program.....	v
What we observed	v
Note about the future of the AAT	vi
IGTO Recommendations.....	vi
1. INTRODUCTION.....	1
OVERVIEW	1
1.1. Purpose of report and summary of recommendations.....	2
2. BACKGROUND.....	4
2.1. The announcement of the program	4
3. LIST OF RECOMMENDATIONS.....	9
3.1. Improved certainty up-front on the funding’s costs basis, type of costs, their calculation and substantiation will improve the administration of the program, mitigate future disputes and ensure policy objectives are realised	9
3.2. The ATO to consider whether additional integrity measures are necessary	11
3.3. A process to be implemented for dealing with confidential information and material that is subject to privilege	11
4. IGTO OBSERVATIONS	13
4.1. Improved certainty up-front on the funding’s costs basis, type of costs, their calculation and substantiation will improve the administration of the program, mitigate future disputes and ensure policy objectives are realised	13
4.2. The ATO to consider whether additional integrity measures are necessary	30
4.3. A process to be implemented for dealing with confidential information and material that is subject to privilege	32
Appendix — Glossary and defined terms	34

EXECUTIVE SUMMARY

INTRODUCTION

On 12 February 20019, the former Government announced that a series of measures would be introduced to assist small businesses in dispute with the Commissioner of Taxation (**the Commissioner**) in the Administrative Appeals Tribunal's (**AAT**) Small Business Taxation Division (**SBTD**). The measures were intended to mitigate the disadvantage to small business taxpayers in dispute with the Commissioner in the AAT SBTD, recognising that proceedings are often complex and costly, and the Australian Taxation Office (**ATO**) is a well-resourced and experienced litigant.

The Inspector-General of Taxation and Taxation Ombudsman (**IGTO**) has a statutory function to investigate unresolved complaints (disputes) of taxpayers and their representatives about the actions and decisions of Tax Officials, and this would include actions and decisions taken in relation to the administration of the Small Business Litigation Funding Program (**the Program**).

This report shares insights and observations, primarily taken from the IGTO investigations of the first two investigations of unresolved complaints (disputes) that were lodged by small businesses and legal practitioners – on or around November 2020. The issues raised in these disputes concern the correctness of the ATO's administration of the Small Business Litigation Funding Program. That is, the ATO's communications and method of funding small business disputes. In these disputes, concerns were expressed that the ATO had attempted to cap the funding to levels below that necessary to run their matter, had calculated reimbursements on a basis which they had not been made aware of when entering the arrangement, and had sent numerous emails questioning the bills which imposed considerable administration and unbillable time in responding to them and detracted from case preparation.

It is important to note at the outset that the IGTO has no role to formally assess the funding provided under the Program. The IGTO does not perform the role of a costs assessor. However, the IGTO does have a role to observe the fairness of the process and make recommendations to improve the Program for the benefit of both the complainants and the tax system overall. With the agreement of both parties, we engaged an external cost assessor or consultant to assist us in resolving the disputes and in distilling guiding principles for future dispute resolution.

Acknowledging that it may not be efficient, practical or cost effective to engage a costs consultant in order to resolve every future dispute, the IGTO asked the costs consultant to give some general advice on matters relevant to the administration of the Program. This general advice has helped to ensure that the IGTO's recommendations are based on an expert understanding of the practice of assessing costs in the Federal jurisdiction.

The ATO financially assisted by reimbursing us for the cost of this engagement. The IGTO thanks the ATO for providing this financial assistance to allow us to engage expert external assistance to complete our investigation.

EXECUTIVE SUMMARY

Since the first draft of this report was finalised (29 November 2021), the IGTO has commenced three (3) further dispute investigations concerning similar issues.

The report is published in accordance with section 35A of the *Ombudsman Act 1976* in the interests of small business litigants, legal practitioners, the ATO, and policy developers. The report is intended to:

- give insight on aspects of the administrative operation of the ATO's funding of litigation in the Program,
- assist with the administrative design of any similar program that is implemented in the new administrative tribunal body (should that be considered desirable), and
- in the interim, improve small business litigants' access to justice by minimising small business disputants', legal practitioners' and the administration's costs as well as avoid unnecessary disputation through improved up-front certainty on the ATO's administration of this program.

Background to the AAT SBTD and the Litigation Funding Program

Over the last two financial years, 2020-21 and 2021-22, a total of 869 applications to appeal ATO decisions were lodged by small businesses in the SBTD of the AAT. Litigants may appear in the AAT without legal representation. However, where the ATO engages a barrister to represent it, unrepresented small business who dispute ATO decisions in the AAT SBTD can face an uneven playing field. If those small businesses engage their own representation in kind, it will likely be at a greater cost than the ATO. This is largely due to the positive evidentiary burden that such businesses bear in tax disputes and that they do not have access to the government rates for barristers that the ATO does.

The Program is one of the former Government's measures that was aimed at leveling the playing field for small businesses in such cases, by making funding available to "cover the cost of providing the small business with "equivalent legal representation".¹ In practice, the ATO gives an up-front commitment to make a specified amount of funding available and to reimburse some of the small business's representation costs. ATO instructions to staff indicate that the payment is calculated, at least in the first instance, with reference to the ATO's own legal representation.² Initially, the ATO estimated more than 30 cases may fall within the Program's scope each year. The ATO recently advised that a total of 65 recipients, represented by 35 different law firms, have received funding since 1 May 2019.

The ATO drew on the IGTO's dispute investigation function when it nominated the IGTO to play a key role in the resolution of disputes relating to the Program and publicly undertook to "comply with any recommendations made by the [IGTO]".³

¹ See former Minister's Media Release dated 12 February 2019, former Assistant Treasurer The Hon Stuart Robert MP, 'Backing small business – simplifying and resolving tax disputes'.

² ATO, 'DR IB 2019/1', section 4, which states, "On agreement with the taxpayer the ATO will prepare a funding deed that specifies the terms and conditions for payment. The payment amount will be based on the cost estimates of the legal representation for the ATO."

³ ATO Fact Sheet

THE IGTO'S UNDERSTANDING OF THE POLICY OBJECTIVES AND INTENTION OF THE PROGRAM

Based on information that was provided to the IGTO by the ATO in July 2022 (after the IGTO had first requested the information be provided in November 2020), the IGTO understands the aim, or 'policy intent', of the Program, is as follows:

Where the ATO decides to engage external counsel in a small business tax division matter, it will fund the unrepresented litigant's reasonable costs for external legal representation (calculated consistent with the calculation of reasonable costs paid under the test case funding program) to the same standard as the ATO's representation, and would include a level of costs that may not always be incurred by the ATO — for example, legal representatives' costs that are associated with the preparation of evidence.

The IGTO also understands that it is inconsistent with the policy intent to limit, or 'cap', the funding to an amount that is equivalent to the ATO's costs. This understanding of the Program's policy intent was previously left unclear. Further details on why this was left unclear are provided in paragraph 4.1.6.

WHAT WE OBSERVED

The IGTO observed that the ATO was administering the Program inconsistently with that intent as we observed that the ATO sought to administer the Program consistent with its test case funding program, which can lead to materially different outcomes in small business tax division cases. In the dispute investigations, we also observed that the ATO also relied on its own costs to discourage rising costs (as a form of 'soft cap') when the litigants' costs began to exceed those initially estimated. While it appears that the ATO administered the Program in this way to mitigate financial risks, it led to perceptions of arbitrary decision making. In the IGTO's view, the ATO could have mitigated its exposure to indeterminate costs more appropriately by:

- seeking specific budgetary appropriation,
- taking steps to reduce the scope of the dispute (consistent with the model litigant rules in the *Legal Services Directions*, Annexure B, Rule 2(d)) and/or
- seeking more finely tuned policy clarification from Treasury and/or Government based on a better appreciation of the ATO's exposure to the financial risks.

We also observed that ATO opacity regarding the policy intent was the key contributing factor to the considerable amount of time, expense and effort that was expended by small business representatives and the ATO (and the IGTO) in clarifying the claimed costs, the supporting evidence, the calculation of reimbursement and the limit applied to the total funding made available. We also observed that most of the disputation could have been avoided if the ATO's guidance and proforma materials that supported the funding arrangements had been consistent with the original policy intent, had been more clearly expressed and had specified key administrative requirements so that both parties had the same understanding of them.

EXECUTIVE SUMMARY

NOTE ABOUT THE FUTURE OF THE AAT

In December 2022, the Australian Government announced that the AAT will be abolished and replaced with a new administrative review body. The design of the new body has not been announced and, at the time of publishing this report, is not clear whether the Program will be replicated for that new body. However, the Issues Paper regarding this new body that has been released recently does raise questions regarding the role that government departments should play (if any) in providing support services to litigants who use the new administrative review body.⁴

The observations and analyses of the issues that are surfaced in this report may assist in shaping future reforms in the event that the Program is to be replicated in the new body.

In the interim, implementation of the IGTO's recommendations will improve the fairness of the existing Program's administration and better realise its aim. That is to level the playing field when the ATO engages external Counsel to represent it in disputes with unrepresented small businesses who challenge the ATO's decision in the AAT SBTD.

IGTO RECOMMENDATIONS

The IGTO has made four (4) recommendations to improve the administration of the Program. Further details are set out in Chapter 3 and section 1.2.1 below. The main recommendation is for the ATO to more clearly communicate how it will administer the Program, including how it will do so in accordance with the original policy intent of the Program. This also includes incorporating the ATO's adherence to the funding agreement as a term in the legally binding agreement, more clearly defining the costs that the ATO will reimburse, more clearly explaining how reimbursements will be calculated and specifying the details on the supporting documentation that litigants will be required to provide the ATO in support of their claims.

The IGTO has also made recommendation for the ATO to consult with the small business community, legal profession and Australian Small Business and Family Enterprise Ombudsman to ensure that they have a common understanding of the ATO's material and, if not, for the ATO to amend the material to achieve that understanding. Recommendations were also made to establish a process to deal with confidential and prejudicial information and to consider whether additional measures were needed to preserve the integrity of the Program.

⁴ Attorney-General's Department, *Administrative Review Reform: Issues Paper* (April 2023) ([Public Issues Paper - a new system of federal administrative review \(ag.gov.au\)](#) last accessed on 14 May 2023) pp 86-88.

Implementation of the IGTO's recommendations will generate notional savings for both Government and the small business community in the form of reduced disputation costs which would free up more time and money that could be put to more productive use in the Australian economy. Based on the information made available to us, we conservatively estimate these notional savings to be at least \$706,000 per year based on the projected time that would be saved and the related cost of that time in salary and lawyers' assessable fees.

Consistent with the IGTO's obligations under subsection 8(5) of the *Ombudsman Act 1976*, the ATO was provided with opportunities to make submissions on the report and the IGTO recommendations included therein. In its final submission, the ATO provided the following overarching general statement with respect to the IGTO's four recommendations:

"The ATO is committed to resolving disputes as soon as possible and at minimal costs to all parties. This includes ensuring the integrity of the Small Business Litigation Program and guarding against any potential misuse of taxpayer funds. The ATO has noted the IGTO's recommendations and intends to consult with stakeholders, including with IGTO, on the administration of the program going forward. The ATO remains committed to supporting unrepresented small business litigants in tax disputes in the AAT or its replacement."

This statement does not directly respond to the IGTO recommendations. It is neither an agreement nor disagreement with the recommendations. However, the IGTO understands that the ATO intends to consult with stakeholders before committing to any improvements and that the IGTO recommendations will be considered as part of this process. The following factors are relevant in this respect:

1. The underlying Budget Measure⁵ for the Program, which provided the ATO with \$29.6m over five years (2018–19 to 2022–23 inclusive), ended on 30 June 2023.
2. A key IGTO recommendation was to improve the up-front certainty on the funding's costs basis, type of costs, their calculation and substantiation. Without this certainty, there is an ongoing risk of disputation about such funding matters.
3. It remains important for such matters to be clarified as part of the ATO consultations.
4. The IGTO encourages stakeholders to consider the issues raised in this report as part of any ATO consultations.
5. The ATO is not legally required to respond directly to IGTO recommendations, with the exception of private reports sent to the Commissioner (and the Minister) regarding unremedied maladministration (see section 15 of the *Ombudsman Act 1976*).

⁵ "Helping Small Business Grow — supporting small businesses with tax disputes" in Australian Government, Federal Budget, *Budget Measures Budget Paper No. 2 2019–20*, p 168–169.

EXECUTIVE SUMMARY

With respect to factor 1 above, the IGTO understands that the ATO considers itself no longer bound by the policy intent for this Program which was set in 2019. With respect to factors 2 - 4 above, the IGTO understands that the ATO continues to confine the findings of this report to the initial two cases investigated, notwithstanding similar ATO actions and decisions that have been the subject of further complaints raised with the IGTO and disputes raised in the Federal Court (see *Commissioner of Taxation v Complete Success Solutions Pty Ltd ATF Complete Success Solutions Trust* [2023] FCAFC 19, [126] – [130]).

Irrespective of the policy basis for which the ATO offers litigation funding into the future, the IGTO's recommendations continue to have relevance. They highlight opportunities for the ATO to mitigate the risks of unnecessary costs and avoidable disputation.

As this report's purpose is to share insights, it does not seek to assess the success of the Program overall. Such an assessment may be conducted at some future time via an IGTO review investigation should disputes continue to be raised with the IGTO for investigation.

1. INTRODUCTION

OVERVIEW

On 12 February 2019, the former Government announced that a series of measures would be introduced to assist small businesses in dispute with the Commissioner in the Administrative Appeals Tribunal's (AAT) Small Business Taxation Division (SBTD).⁶ The measures were intended to mitigate the disadvantage to small business taxpayers in dispute with the Commissioner in the AAT SBTD, recognising that proceedings are often complex and costly, and the ATO is a well-resourced and experienced litigant.

The following context was provided by the former Assistant Treasurer (**Minister**):

“Building on the Prime Minister’s announcement last November, the Government is giving further support to level the playing field for small businesses in these disputes [i.e. small businesses who have a tax dispute with the ATO].

We have been told disputes with the ATO can be stressful and intimidating, and that small businesses often lack the expertise, time and resources to challenge ATO decisions in the Administrative Appeals Tribunal (AAT).”

A specific measure was announced by the Minister with regards to the litigation funding of small businesses in the AAT SBTD. It provided that where the ATO engages external counsel, the ATO will pay the cost of the taxpayer receiving “equivalent legal representation”. In this regard, the Media Release stated the following:

“The general rule is that these hearings in the AAT will be without lawyers. Where the ATO engages external legal counsel in the AAT and the small business does not have legal representation, the ATO will cover the cost of providing the small business with equivalent legal representation.”

To give effect to this measure, the Australian Taxation Office (**ATO**) implemented the AAT SBTD Litigation Funding program (**Program**).

The Inspector-General of Taxation and Taxation Ombudsman (**IGTO**) has a statutory function to investigate actions taken by tax officials relating to administrative matters under taxation laws that are the subject of a complaint.⁷ This includes actions taken by ATO officers with respect to the Program.

⁶ See former Minister’s Media Release dated 12 February 2019, former Assistant Treasurer The Hon Stuart Robert MP, ‘Backing small business – simplifying and resolving tax disputes’.

⁷ *Inspector-General of Taxation Act 2003*, paragraphs 7(1)(a) and 7(1)(f).

INTRODUCTION

The IGTO received (to date) five (5) unresolved complaints (**disputes**) in which concerns were expressed that, broadly, there was substantial uncertainty regarding the ATO's administration of the Program with respect to the ATO's funding methodology and the resulting unfunded costs and out-of-pocket expenses for taxpayers and/or their representatives.

1.1. PURPOSE OF REPORT AND SUMMARY OF RECOMMENDATIONS

The purpose of this report is to set out the IGTO's observations and recommendations in relation to the administration of the Program to avoid or mitigate future disputes and facilitate the efficient resolution of disputes when they arise.

The IGTO draws on observations made during investigations of disputes with ATO actions relating to the Program, especially the investigations that were conducted on the first two disputes which have concluded. These disputes are referred to herein as **Dispute 1** and **Dispute 2** and, collectively, as **the Disputes**.^{8 9}

1.1.1. SUMMARY OF RECOMMENDATIONS

In summary, the IGTO recommends that the ATO:

1. amend the template funding agreement entered into between the ATO and taxpayer applicants in the Tribunal, to:
 - (a) accord with the underlying policy objective of the Program;
 - (b) provide greater up-front clarity to taxpayers as to what expenses will and will not be paid by the ATO; and
 - (c) ensure that relevant terms are incorporated into the contractual agreement; and
2. in consultation with small business community, the legal profession and the Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**), amend its guidance material and internal instructions to provide greater up-front clarity to taxpayer applicants in the Tribunal, their representatives and internal ATO staff; and

⁸ The IGTO adopts the labels complaints and disputes as defined in the Australia and New Zealand Standard 10002:2014 Guidelines for Complaint Management in Organisations. This standard defines 'complaints'; as '[e]xpression of dissatisfaction made to or about an organization, related to its products, services, staff or the handling of a complaint, where a response or resolution is explicitly or implicitly expected or legally required' and 'disputes' as 'unresolved complaints escalated internally or externally, or both'.

⁹ Separate reports will be provided in relation to the issues that are specific to the disputes.

3. consider whether additional steps are necessary to preserve the integrity of the Program, including with respect to:
 - (a) the use of the Program by applicants that are related or otherwise connected to their legal representatives; and
 - (b) applicants' awareness of the fees charged by their legal representatives and the extent to which they are reimbursed by the ATO; andwhere additional steps are necessary, to incorporate them into the funding agreement, guidance materials and internal ATO instructions to the extent necessary to reduce the potential for disputation arising from them; and
4. amend its procedures to establish a process for appropriately dealing with supporting claim documentation that contains information which is confidential, privileged, or the disclosure of which might otherwise prejudice the applicant in active litigation, for example, by engaging a third party to review the material.

The above recommendations are a summary of more fulsome recommendations that are made in the body of the report below. The IGTO's observations supporting these recommendations are explained further below, together with a description of the background and relevant materials considered by the IGTO.

1.1.2. THE FUTURE OF THE AAT

In December 2022, the Australian Government announced that the AAT will be abolished and replaced with a new administrative review body.¹⁰ The design of the new body has not been announced and, at the time of publishing this report, is not clear whether the Program will be replicated for that new body.

The observations and analyses of the issues that are surfaced in this report may assist in shaping future reforms in the event that the Program is to be replicated in the new body.

In the interim, implementation of the IGTO's recommendations will improve the fairness of the existing Program's administration and better realise its aim. That is to level the playing field when the ATO engages external Counsel to represent it in disputes with unrepresented small businesses who challenge the ATO's decision in the AAT SBTD.

¹⁰ See Attorney-General, [Albanese Government to abolish Administrative Appeals Tribunal - Mark Dreyfus KC MP](#) a media release dated 16 December 2022.

BACKGROUND

2. BACKGROUND

2.1. THE ANNOUNCEMENT OF THE PROGRAM

The Program was announced by the former Minister in a Media Release on 12 February 2019 (extracted above) and its operation commenced soon after, that is on 1 March 2019.

The Minister’s Media Release is the key document that provides a public statement on the purpose of the Program. It states that the Program is for the ATO to “cover the cost of providing the small business with equivalent legal representation”. The Media Release indicates that the rationale for this is to mitigate the adverse impact of unequal representation on small businesses engaged in tax disputes in the AAT SBTD.

This mitigation is particularly important in the light of the general rule that hearings are conducted without legal representation in the AAT SBTD. The Commissioner can nevertheless make a unilateral decision to engage counsel. Where such a decision is made, the Program can be utilised to help “level the playing field” for small businesses by covering the cost of equivalent legal representation.

There is no public expression of the Program’s intention either in legislation or extrinsic material. This is because the Program was not established by legislation, but was established administratively pursuant to a government directive. It is funded by way of ATO allocation from the appropriation it receives via the annual Federal Budget process for its departmental expenditure.

2.1.1. THE INVOLVEMENT OF THE IGTO

It is a statutory function¹¹ of the IGTO to investigate actions taken by tax officials relating to administrative matters under a taxation law that are the subject of complaint, and to report on her investigations.

In implementing the Program, the ATO drew on these IGTO functions when it nominated the IGTO to play a particular role in the administration of the Program. In its Fact Sheet titled ‘Small Business Litigation Funding’ (QC 59545), the ATO states the following in relation to disputes arising between AAT SBTD applicants and the Commissioner in connection with the ATO’s administration of the Program:

*“If you do not agree with our reasons and believe we have not dealt with your claim in line with our agreement, contact us first to see if the dispute can be resolved. If you still disagree with our decision, you can refer the disagreement to the Inspector-General of Taxation and Taxation Ombudsman. **For a dispute about the payment of your costs under this agreement, we will comply with any recommendation made by the Inspector-General of Taxation and Taxation Ombudsman.**” (Bolding added.)*

¹¹ See paragraphs 7(1)(a) and 7(1)(f) of the *Inspector-General of Taxation Act 2003*.

This contemplates that the IGTO will play a key ongoing role in the resolution of disputes relating to the Program.

It is important to note that the IGTO has no role in formally assessing the funding provided under the Program. The IGTO does not perform the role of a costs assessor. However, the IGTO does have a role to observe the fairness of the process and make recommendations to improve the Program for the benefit of both complainants and the tax system overall.

The IGTO received the first disputes about the ATO's actions in administering the Program in 2020. The Disputes represent the first two that the IGTO investigated.

The resolution of the Disputes was managed with the assistance of an external costs consultant. Acknowledging that it may not be efficient, practical or cost effective to engage a costs consultant in order to resolve every future dispute, the IGTO asked the costs consultant to give some general advice on matters relevant to the administration of the Program. This general advice has helped to ensure that the IGTO's recommendations are based on an expert understanding of the practice of assessing costs in the Federal jurisdiction.

The Disputes (and others received by the IGTO) have highlighted to the IGTO the importance of the Program being administered in a manner that reconciles the (at times, disparate) needs and priorities of both the ATO and the small business community. The ATO must administer the Program in a manner that:

- (a) maintains the integrity of the revenue, including by ensuring compliance with finance law obligations concerning the commitment and spending of public monies and implementation of appropriate risk management arrangements; and
- (b) is fair and transparent for taxpayers, who may incur very significant legal costs in having their application for review determined by the Tribunal, particularly in the more significant or complex matters where the ATO has briefed external counsel.

These concerns must be viewed in the context of the quantum of costs in respect of which small business taxpayers are seeking reimbursement under the Program.

For example, in one dispute investigation the IGTO observed that the taxpayer's legal costs (prior to completion of the matter) amounted to more than \$400,000 (comprising more than \$200,000 in solicitor's fees and \$120,000 in counsel's fees), of which the ATO paid more than \$250,000 (with the ongoing dispute and IGTO investigation pertaining to some of the balance).

In another dispute investigation, the IGTO observed that the taxpayer had claimed reimbursement of more than \$200,000 in solicitor's fees prior to the AAT's hearing of the matter. The ATO initially paid over 15 per cent of the claimed amount pending the outcome of a costs assessment, as agreed with the representative. Following that assessment, during the IGTO's investigation into the matter, the ATO later paid a further 25 per cent, approximately.

BACKGROUND

These amounts highlight the potential significant financial burden on small business taxpayers if funding is not calculated in a manner that gives effect to the publicly stated purpose — i.e. to “cover the cost of providing the small business with equivalent legal representation”. This furthers the aim of the Program to “level the playing field” in those cases where the ATO elects to engage Counsel in a dispute against an unrepresented small business in the AAT SBTD.

These amounts also underscore the significant exposure to the revenue if the veracity of the funding claims is not appropriately tested. The IGTO notes, in this regard, that the ATO funded 65 matters in the 34 months from the start of the Program until end of February 2023.¹² This number is less than the number the ATO estimated in 2019 which was based on an estimation of the percentage of AAT SBTD cases in which the ATO would engage external legal representation each year.¹³

Against the backdrop of these considerations, the IGTO’s ongoing involvement in the resolution of disputes arising from the program and the general advice received from the costs consultant with respect to the Disputes, the purpose of this report is to set out the IGTO’s observations regarding aspects of the ATO’s administration of the Program and to make recommendations on how the administration may be improved, going forward.

Implementation of these recommendations will benefit both the ATO and small business applicants as well as their representatives by improving the efficiency and clarity with which the Program is administered. As a result, the potential for disputation will be reduced, freeing up more time and money to put towards more productive aims for the benefit of the Australian economy. Implementation of the recommendations will also assist the IGTO to streamline investigation of any future disputes regarding the ATO’s administration of the Program and thereby reduce the substantial impact that litigation funding investigations have on the IGTO’s resources.

2.1.2. RELEVANT MATERIALS

In forming the views outlined in this report, the IGTO has considered the following two categories of materials:

- (a) documents that the ATO made available to the IGTO on 29 July 2022, which pertain to the ATO’s administration of the Program — they generally include a bundle of documents comprising contemporaneous records of communications between the ATO and others in relation to the policy intent and administration of the Program around the time of its design and implementation (**Program Design and Implementation Communications**); and
- (b) documents made available during the IGTO’s dispute investigations, including those relating to the Disputes which were the subject of the IGTO’s initial investigations (**Dispute Documents**).

¹² ATO, written response to IGTO request, 19 November 2020. These figures have not been independently verified by the IGTO.

¹³ The AAT’s annual report for the 2021-22 year indicates that in that year, a total of 1,155 applications were lodged in the ‘Taxation and Commercial’ and ‘Small Business Taxation’ Divisions, combined. Of this total, 317 were lodged in the Small Business Taxation Division.

The Dispute Documents include the opinions of a costs consultant (the **Costs Consultant**), who was engaged, with the agreement of the small business litigants and the ATO, to assist the IGTO to provide general advice, including in relation to the following:

- (a) any uplift factors that reasonably apply, including to reflect a difference in the parties' respective access to resources and corporate knowledge;
- (b) the type and level of detail required on invoices to enable the ATO to determine if a cost is reasonable;
- (c) whether, in the context of the Program and in the light of the contractual agreements entered into between the parties, the reasonable costs of the ATO can be used as a benchmark for calculating the reasonable costs of the applicant.

The Costs Consultant provided her responses to these queries in:

- her opinion in relation to Dispute 1 dated 27 July 2021 (**Dispute 1 Opinion**);
- a letter dated 4 June 2021 relating to Dispute 2 (**Dispute 2 Letter**); and
- her opinion in relation to Dispute 2 dated 5 July 2021 (**Dispute 2 Opinion**).

Both the ATO and the small business litigants were given opportunities to comment on drafts of the cost consultant's opinions before they were finalised. We also considered the following documents:

- **Annexure A** - ATO Fact Sheet, 'Small business litigation funding', QC 59545 (last accessed 31 August 2021) (**ATO Fact Sheet**);
- **Annexure B** - Media Release dated 12 February 2019, former Assistant Treasurer The Hon Stuart Robert MP (**Minister**), 'Backing small business – simplifying and resolving tax disputes' (Media Release);
- **Annexure C** - Funding agreements entered into between the Commissioner of Taxation and the two small businesses who raised the Disputes, dated 11 February 2020 and 7 September 2020, respectively (**Funding Agreements**); and
- **Annexure D** - Dispute Resolution Instruction Bulletin DR IB 2019/1 Small Business Taxation Division, AAT (**DR IB 2019/1**).

BACKGROUND

2.1.3. ATO SUBMISSIONS

On 29 November 2021, the IGTO provided the ATO with prior version of this report and recommendations and offered opportunity for the ATO to make submissions, in accordance with the IGTO's statutory obligation to do so.¹⁴

The IGTO made changes to that prior draft report and its recommendations following the IGTO's consideration of:

- the Program Design and Implementation Communications, which the ATO made available to the IGTO seven months after the 29 November 2021 draft report had been furnished; and
- ATO submissions which were provided both in writing and orally.

¹⁴ *Ombudsman Act 1976*, s.8(5) (which is incorporated into the *Inspector-General of Taxation Act 2003* by virtue of section 15 of that latter Act.

3. LIST OF RECOMMENDATIONS

The IGTO makes four recommendations as set out below and which are discussed in further detail and explained in Chapter 4 - IGTO Observations. The ATO gave an overarching general statement in response to these recommendations, which is also provided below.

3.1. IMPROVED CERTAINTY UP-FRONT ON THE FUNDING'S COSTS BASIS, TYPE OF COSTS, THEIR CALCULATION AND SUBSTANTIATION WILL IMPROVE THE ADMINISTRATION OF THE PROGRAM, MITIGATE FUTURE DISPUTES AND ENSURE POLICY OBJECTIVES ARE REALISED

RECOMMENDATION 1

The IGTO recommends the ATO amend its funding agreement entered into between the ATO and taxpayer applicants in the Tribunal, to:

- (a) *accord with the underlying policy objective of the Program;*
- (b) *provide greater up-front clarity to taxpayers as to what expenses will and will not be paid by the ATO, including by:*
 - i. *clearly defining the costs that the ATO will reimburse with reference to the nominated benchmark (e.g. Schedule 3 to the Federal Court Rules 2011 and the National Guide to Counsel Fees);*
 - ii. *explaining how the reimbursement will be calculated, including by identifying the relevant materials and how they may be accessed (e.g. identifying Schedule 3 to the Federal Court Rules 2011 and the National Guide to Counsel Fees and providing links to their location on the Internet);*
 - iii. *if the reimbursement will be assessed in accordance with Schedule 3 of the Federal Court Rules 2011 and the National Guide to Counsel Fees, making taxpayers and their advisers aware that often, when costs are assessed on this basis, there is a margin of costs that is not paid or reimbursed;*
 - iv. *listing the supporting documentation taxpayers or their representatives will be required to provide to support their funding claim, including the detail to be included on tax invoices, so that they can generate/retain the necessary documentation as they progress through the course of the proceedings;*

LIST OF RECOMMENDATIONS

- v. *explaining the processes for claiming and verifying costs to improve the ease and efficiency of making and paying claims, for the benefit of taxpayers and their representatives; and*
- vi. *describing in detail what costs will not be reimbursed;*
- (c) *incorporate the following into it, so that they forms part of the contractual agreement between the Commissioner and the applicant:*
 - i. *the ATO's adherence to funding commitment;*
 - ii. *a term that the ATO may require supporting documentation to substantiate litigation funding claims and that gives an indication of the nature of the documentation; and*
 - iii. *a term that specifies what must be contained in the tax invoices that are submitted to the ATO for verification of costs claimed.*

RECOMMENDATION 2

The IGTO recommends that, in consultation with small business community, the legal profession and the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) the ATO amend its guidance material and internal instructions, including its Fact Sheet on 'Small Business Litigation Funding' and DR IB 2019/1 'Small Business Taxation Division, AAT' to provide greater up-front clarity to taxpayer applicants in the Tribunal, their representatives and internal ATO staff, by:

- (a) *incorporating the clarifications in the preceding recommendations and give further explanation where appropriate, including with respect to:*
 - i. *how the reimbursement will be calculated;*
 - ii. *what supporting material will be required; and*
 - iii. *what detail the applicant will be required to provide in its litigation funding claims; and*
- (b) *removing any reference to the ATO basing the calculation of the taxpayer's "reasonable costs" on the cost estimates of the legal representation of the ATO, including in DR IB 2019/1; and*
- (c) *issuing directions to ATO staff that they are not to use the ATO's own costs in calculating the funding, or any caps on that funding, to be provided to small business litigants.*

3.2. THE ATO TO CONSIDER WHETHER ADDITIONAL INTEGRITY MEASURES ARE NECESSARY

RECOMMENDATION 3

The IGTO recommends the ATO consider whether additional steps are necessary to preserve the integrity of the Program, including with respect to:

- (a) the use of the Program by applicants that are related or otherwise connected to their legal representatives; and*
- (b) applicants' awareness of the fees charged by their legal representatives and the extent to which they are reimbursed by the ATO, and*

where additional steps are necessary, to incorporate them into the funding agreement, guidance materials and internal ATO instructions to the extent necessary to reduce the potential for dispute arising from them.

3.3. A PROCESS TO BE IMPLEMENTED FOR DEALING WITH CONFIDENTIAL INFORMATION AND MATERIAL THAT IS SUBJECT TO PRIVILEGE

RECOMMENDATION 4

The IGTO recommends that the ATO amend its procedures to establish a process for dealing with supporting claim documentation that contains information which is confidential, privileged, or the disclosure of which might otherwise prejudice the applicant in active litigation, for example, engaging a third party to review the material.

ATO RESPONSE

The ATO has provided the following overarching general statement with respect to the IGTO's four recommendations:

"The ATO is committed to resolving disputes as soon as possible and at minimal costs to all parties. This includes ensuring the integrity of the Small Business Litigation Program and guarding against any potential misuse of taxpayer funds. The ATO has noted the IGTO's recommendations and intends to consult with stakeholders, including with IGTO, on the administration of the program going forward. The ATO remains committed to supporting unrepresented small business litigants in tax disputes in the AAT or its replacement."

LIST OF RECOMMENDATIONS

IGTO COMMENT ON ATO RESPONSE

This statement does not directly respond to the IGTO recommendations. It is neither an agreement nor disagreement with the recommendations. However, the IGTO understands that the ATO intends to consult with stakeholders before committing to any improvements and that the IGTO recommendations will be considered as part of this process. The following factors are relevant in this respect:

1. The underlying Budget Measure for the Program, which provided the ATO with \$29.6m over five years (2018–19 to 2022–23 inclusive), ended on 30 June 2023.
2. A key IGTO recommendation was to improve the up-front certainty on the funding's costs basis, type of costs, their calculation and substantiation. Without this certainty, there is an ongoing risk of disputation about such funding matters.
3. It remains important for such matters to be clarified as part of the ATO consultations.
4. The IGTO encourages stakeholders to consider the issues raised in this report as part of any ATO consultations.
5. The ATO is not legally required to respond directly to IGTO recommendations, with the exception of private reports sent to the Commissioner (and the Minister) regarding unremedied maladministration (see section 15 of the *Ombudsman Act 1976*).

With respect to factor 1 above, the IGTO understands that the ATO considers itself no longer bound by the policy intent for this Program which was set in 2019. With respect to factors 2 - 4 above, the IGTO understands that the ATO continues to confine the findings of this report to the initial two cases investigated, notwithstanding similar ATO actions and decisions that have been the subject of further complaints raised with the IGTO and disputes raised in the Federal Court (see *Commissioner of Taxation v Complete Success Solutions Pty Ltd ATF Complete Success Solutions Trust* [2023] FCAFC 19, [126] – [130]).

Irrespective of the policy basis for which the ATO offers litigation funding into the future, the IGTO's recommendations continue to have relevance. They highlight opportunities for the ATO to mitigate the risks of unnecessary costs and avoidable disputation.

4. IGTO OBSERVATIONS

Based on the materials made available to the IGTO and relevant IGTO investigations, the IGTO makes the following observations and recommendations on aspects of the ATO's administration of the Program.

4.1. IMPROVED CERTAINTY UP-FRONT ON THE FUNDING'S COSTS BASIS, TYPE OF COSTS, THEIR CALCULATION AND SUBSTANTIATION WILL IMPROVE THE ADMINISTRATION OF THE PROGRAM, MITIGATE FUTURE DISPUTES AND ENSURE POLICY OBJECTIVES ARE REALISED

In the dispute investigations conducted by the IGTO, a considerable amount of time, expense and effort was expended in obtaining certainty on the limits and requirements of the Program.

In the IGTO's view, greater up-front clarity would have minimised the risk and reduced the scope of disputation in these cases and would have avoided:

- a considerable amount of the legal practitioner's unbillable time obtaining clarity; and
- a considerable amount of public expense in allocating ATO and IGTO resources to clarify expectations and in engaging an external service provider to provide independent advice.

For example, the IGTO observed in the Disputes that:

- approximately 800 emails were sent between the ATO, legal practitioner, IGTO and/or the Costs Consultant, in which the IGTO was included as a recipient; and
- approximately 280 hours of IGTO officers' time was allocated to these investigations, including 120 hrs of senior executive's time.

The IGTO observed that most of this time, correspondence and expense was directed towards obtaining clarity on what type of costs were covered by the Funding Agreement, how much of those costs would be paid, the verification of those costs and the process to resolve disputes where there was a difference of opinion. A significant proportion was directed towards or generated by the ATO's requests for greater detail and evidence to support the costs which were claimed.

IGTO OBSERVATIONS

4.1.1. THE SMALL BUSINESS' LEGAL REPRESENTATIVE SOUGHT TO CLARIFY UNEXPRESSED ATO EXPECTATIONS AND THE RATIONALE FOR REQUESTS

There is a risk, that the objective of “levelling the playing field” for small businesses in dispute with the ATO will not be achieved where the Program’s administration itself is creating undue additional burden for small businesses and their legal representatives. Such a risk is likely to increase where there is a lack of clarity with respect to the amounts the Commissioner is willing to fund, the types of costs covered and/or what is required from the applicants or their representatives to substantiate litigation funding claims.

It is also understandable that a legal representative would expect that all ATO requirements and conditions for payments made pursuant to a contractual agreement would be clearly expressed in that agreement.

4.1.2. IF GREATER UP-FRONT CLARITY WAS PROVIDED IN THE ATO’S FUNDING AGREEMENT AND PUBLISHED GUIDANCE, UNNECESSARY DISPUTATION, TIME, COSTS AND ADVERSE PERCEPTIONS WOULD LIKELY HAVE BEEN MINIMISED

In the IGTO’s view, the risks to the efficient and effective delivery of the Program can be mitigated by providing sufficient up-front certainty regarding the ATO’s requirements. It would be unrealistic to expect every such requirement and condition to be precisely expressed for every potential scenario. However, sufficient certainty regarding how the Program will be administered is needed so that:

- sufficient evidence is obtained by the ATO to support the claimed costs and minimise the risk of non-compliance with its finance law obligations; and
- sufficient certainty is provided up-front to allow the small business and legal representative to reasonably estimate the costs that the ATO will pay and to establish efficient administrative systems which minimise the risk of the Program imposing an undue administrative burden.

The ATO’s funding agreement (which incorporates the ATO’s Fact Sheet) seeks to provide certainty by relying in part on terms that are well understood by the legal practitioner, such as ‘reasonable expenses’.

In the IGTO’s view, however, the funding agreement provides insufficient certainty regarding:

- the costs that will be covered by the Program,
- their calculation,
- their substantiation, and
- the related processes for claiming and verifying those costs.

In the IGTO's view, providing greater clarity on these aspects in the ATO's funding agreement and supporting material would minimise the risk of disputation, particularly the time and expense in managing these disputes and resulting perceptions of unfair and arbitrary ATO decision making which may be formed. These areas are detailed below.

4.1.3. THE FUNDING AGREEMENT STATES THAT FUNDING WILL BE PROVIDED FOR 'REASONABLE EXPENSES FOR LEGAL REPRESENTATION, AS SET OUT IN THE ATO'S FACT SHEET'

In the Disputes, each of the Funding Agreements contained a contractual agreement between the parties which set out the terms and conditions of funding. (See Funding Agreements, recitals.)

Each of the Funding Agreements stated:

"Funding is provided only to pay your reasonable expenses for legal representation. Reasonable expenses are described in the [ATO's] Fact Sheet."

The ATO's Fact Sheet states:

"Where you are self-represented in the Small Business Taxation Division of the Administrative Appeals Tribunal (SBTD AAT), and the ATO engages external legal representation, the ATO will cover reasonable costs to engage an equivalent level of legal representation to act on your behalf in the SBTD AAT."

The Fact Sheet goes on to state that, with respect to work undertaken by a solicitor, reasonable costs are calculated with reference to the Federal Court Rules 2011 (**FCRs**) and with respect to counsel rates, funding is capped at a rate under the most recent National Guide to Counsel Fees (**NGCF**).

4.1.4. IN PRACTICAL TERMS, A PARTY THAT IS AWARDED COSTS AS CALCULATED WITH REFERENCE TO THE FCRS AND NGCF DOES NOT USUALLY RECOVER THE TOTALITY OF LITIGATION COSTS INCURRED IN THE PROCEEDINGS.

At the time of conducting its investigation into the Disputes, it was not clear to the IGTO why the FCRs and NGCF are utilised by the ATO as a basis for determining reasonable costs, given the stated policy intention of the Program.

In the Federal Court Costs Practice Note, prepared by Chief Justice Allsop and published on 24 October 2016 (**GPN-Costs**), it is noted that "the purpose of a costs order is to compensate a successful party" in proceedings. In this context, the quantum of costs is determined – and in most circumstances, limited – by the FCRs and the Federal Court Scale (**FCS**) set out therein.

In practical terms, a party that is awarded costs as calculated with reference to the FCRs and NGCF does not usually recover the totality of litigation costs incurred in the proceedings.

The NGCF has not been updated since 2013 and is unlikely to reflect current commercial rates.

IGTO OBSERVATIONS

The calculation of costs under the FCRs can be approached in a number of different ways, depending on the type of matter and the nature of the costs order that has been made. There is some discussion of this in the GPN-Costs.

There are, for example, “party and party costs” which are dealt with in r. 40.01 of the FCRs. Specifically, r. 40.01 provides that:

“If an order is made that a party or person pay costs or be paid costs, without any further description of the costs, the costs are to be costs as between party and party”.

‘Costs as between party and party’ is defined in the Dictionary in Schedule 1 to the FCRs to mean:

“only the costs that have been fairly and reasonably incurred by the party in the conduct of the litigation.”

The GPN-Costs also provides that, as an alternative to “party and party” costs, costs may be awarded on an “indemnity basis”. Pursuant to r. 40.02 of the FCRs, the Court may order that costs be paid on a basis other than as between party and party, and the note to r. 40.02 provides, “The Court may order that costs be paid on an indemnity basis”.

‘Costs on an indemnity basis’ is defined in the Dictionary in Schedule 1 to the FCRs as:

“costs as a complete indemnity against the costs incurred by the party in the proceeding, provided that they do not include any amount shown by the party liable to pay them to have been incurred unreasonably in the interests of the party incurring them.”

The IGTO understands that an award of party and party costs, which is calculated under Schedule 3 to the FCRs (Schedule 3 contains that is, the Federal Court Scale or FCS), often does not result in a reimbursement of all costs of legal representation typically incurred. That is, it is not a complete indemnity for the loss, outgoings or costs incurred.

For example, the Federal Circuit Court has published a fact sheet on Legal Costs in General Federal Law Matters, which states:

*“In general federal law proceedings the court normally awards costs to a successful party. They are intended to reimburse a party (usually the successful one) for their legal costs. **The costs awarded are normally only part of the costs incurred.** These are referred to as party-party costs.”¹⁵ (Bolding added.)*

¹⁵ Federal Circuit Court, [Legal Costs in General Federal Law Matters - Federal Circuit Court of Australia](#) last accessed 31 August 2021

In the Civil Trials Bench Book, which is published by the Judicial Commission of New South Wales, remarks are made which acknowledge that costs are typically only partly recovered pursuant to party and party costs orders and explain the reasons why:

“A discount (typically in the order of 10–20% in the case of an indemnity order, and 30–35% in the case of a party/party order) is usually applied when calculating a gross sum costs order, for two main reasons: first, because on assessment, even on the indemnity basis, a successful party invariably recovers something less than its actual costs...”
(Bolding added.)¹⁶

Whilst these have not been relied on in forming the recommendations, the IGTO notes that there are numerous articles published by legal practitioners and experts which also confirm that, in both Federal and State jurisdictions, party and party costs orders generally result in recovery of anywhere between 40% and 70% of costs typically incurred.¹⁷ The ATO no doubt has its own extensive experience and knowledge in this area as a frequent party to litigation

4.1.5. THE UNDERLYING PURPOSES OF COURT-AWARDED COST ORDERS AND THE PROGRAM’S LITIGATION FUNDING ARE DIFFERENT

The general notion of justice that underpins a Court awarded costs order is that “justice to a successful party is not achieved if it comes at the price of being out-of-pocket”.¹⁸ Accordingly, the general rule is that ‘costs follow the event’, as compensation for a party who is forced to litigate to press their rightful claims.¹⁹

Costs follow the event generally because, if a plaintiff wins, the incurring of costs was the defendant’s responsibility because the plaintiff was caused to incur costs by the defendant’s failure otherwise to accord to the plaintiff that to which the plaintiff was entitled; while if a defendant wins, the defendant was caused to incur costs in resisting a claim for something to which the plaintiff was not entitled: Commonwealth of Australia v Gretton [2008] NSWCA 117 at [121]; Ohn v Walton (1995) 36 NSWLR 77 at 79.

In contrast, the IGTO understands that the rationale for the ATO’s funding under the Program is to compensate a small business litigant for the costs incurred to address the inequity arising from the ATO’s decision to engage external counsel – that is, a barrister. This is because the AAT was established as a

¹⁶ Judicial Commission of New South Wales, [Civil Trials Bench Book \(nsw.gov.au\)](#) last accessed 16 November 2021

¹⁷ Lawpath, [Party/Party Costs vs Solicitor/Client Costs: What's Different? - Lawpath](#) last accessed 31 August 2021, [Costs Explained | Mercantile Legal](#) last accessed 31 August 2021, [Standard Costs and Indemnity Costs \(Qld\) | Armstrong Legal](#) last accessed 31 August 2021, [Indemnity Costs: Applicable Principles and Considerations | Irish Bentley Lawyers](#) last accessed 31 August 2021,

¹⁸ Lawpath, [Party/Party Costs vs Solicitor/Client Costs: What's Different? - Lawpath](#) last accessed 31 August 2021, [Costs Explained | Mercantile Legal](#) last accessed 31 August 2021, [Standard Costs and Indemnity Costs \(Qld\) | Armstrong Legal](#) last accessed 31 August 2021, [Indemnity Costs: Applicable Principles and Considerations | Irish Bentley Lawyers](#) last accessed 31 August 2021,

¹⁹ As cited in the Civil Trials Bench Book, [Costs \(nsw.gov.au\)](#), [8-0020]

IGTO OBSERVATIONS

forum that provided independent informal merits review without parties having to engage legal practitioners. Inequity may arise as a small business litigant is unlikely to have the same advocacy and litigation expertise and experience as a barrister and unlikely to have the same resources as the ATO to engage Counsel to assist them in pressing their claims.

Costs are reimbursed under the Program because the ATO has departed **from the general rule which is that the ATO will not be represented by external legal counsel in the Small Business Taxation Division of the AAT.**²⁰ This promotes the overall objective of the Program which is, as per the Minister's announcement, to make the tax dispute process fairer.

As the underlying purposes of Court-awarded cost orders and the Program's litigation funding are different, it follows that the approach taken to calculate 'reasonable costs' for FCR purposes may not be the same as that taken for the Program's purposes.

4.1.6. CONTEMPORANEOUS RECORDS OF COMMUNICATIONS THAT EVIDENCE A COMMON UNDERSTANDING OF THE 'POLICY INTENT' OF THE PROGRAM AS WELL AS THE KEY ADMINISTRATIVE FEATURES AND RISKS

After we had finalised the first two investigations and provided the ATO with opportunity to make submission on an earlier draft of this report, it became apparent during a meeting with the ATO and ASBFEO in June 2022 that documents existed which evidenced the policy intent of the Program. The existence of these documents was contrary to the response the ATO gave to the IGTO's request for such documents in November 2020. Further, after the IGTO asked the ATO to provide the documents that were identified at the June 2022 meeting, the ATO asserted that some did not exist, some were not relevant, and that the IGTO may need to exercise formal powers to compel production of others.

Notwithstanding this, on 24 July 2022, the ATO made available to the IGTO records of 2 relevant communications, an incomplete record of another communication, an email chain with little relevance to the issue in question, and selected extracts from and paraphrasing of other selected communications. This has significantly delayed publication of this report and the IGTO has little means to independently access ATO systems to verify the information that has been provided or their context.

The IGTO's review of these documents revealed correspondence that was contemporaneous with the design and implementation of the Program. They recorded communications between the ATO and others with respect to the purpose of the Program, key features of its administration and, in particular, the basis on which funding under the Program was to be calculated.

These documents evidence a common understanding between the ATO and others regarding the intention for the Program and the term "funding for equivalent representation" in the DR IB 2019/1. Generally, this understanding was that the Program **was to reimburse small business litigants' costs for**

²⁰ ATO, 'DR IB 2019/1', section 3

legal representatives who were of a similar standard as those engaged by the ATO, with three qualifications.

- (c) First, the costs of small business litigants' barristers and instructing solicitors would be covered by the Program, even though the ATO did not normally use instructing solicitors itself in AAT cases as it usually instructed its barristers directly.
- (d) Second, a level of costs which were not always incurred by the ATO were covered, such as the costs of legal representatives that are associated with the preparation of evidence.
- (e) Third, the ATO would calculate the funding amount consistent with the calculation of reasonable costs that the ATO already used to pay costs under the ATO's Test Case Litigation Program. The ATO advised that these calculations were performed by reference to the FCRs or High Court rules, and for counsel rates, by reference to the NGCF.

As a result, reimbursement under the Program would be calculated on rates lower than those which small business litigants would actually incur and could commercially access. The ATO considered it relevant that the AAT was a no costs jurisdiction and that reimbursement of litigant representatives' costs at commercial rates would provide incentive for representatives to pursue claims in the AAT.

The documents that the ATO made available to the IGTO also reveal that it was considered inconsistent with the policy intent for the Program if funding was limited to the amount expended by the ATO on its external legal service providers.

Importantly, those documents also evidence an ATO concern with its capacity to adequately fund the Program at that time. Essentially this concern arose because the budgetary allocation that was agreed to be provided to the ATO for the Program was calculated on the basis of the ATO's own costs in engaging barristers in the AAT, \$10,500 per case (plus amounts for appeals to the Federal Court), and not the agreed basis of the 'reasonable costs' of the small business litigants, which was thought to be a substantial multiple of the ATO's costs. The reasons for the disparity between the two costs was due to:

- taxpayers having to engage Counsel at commercial rates and not the Government rates which the ATO can access;
- taxpayers needing to engage an instructing solicitor in addition to a barrister, unlike the ATO which did not normally have a need for an instructing solicitor as it engaged barristers directly; and
- taxpayers' representatives having to do substantially more work in the AAT than the ATO's representatives, as the taxpayer bears the burden of proof and has to demonstrate a positive case on the evidence (due to the taxpayer's onus of proof).

Notwithstanding this disparity, the ATO could monitor the actual expenditure to fund the Program and had the option of seeking additional funding from Government if that expenditure exceeded the budgetary allocation.

IGTO OBSERVATIONS

The IGTO notes that funding calculated in accordance with the FCRs or High Court Rules, and the NGCF fees, which are utilised for the Test Case Litigation Funding Program, can still be less than the commercial rates charged by many legal practitioners. This is consistent with the comments in the Federal Circuit Court Fact Sheet, Civil Trials Bench Book and other materials, referred to above – that is costs reimbursed with reference to the rules do not fund the costs of representation and generally result in a shortfall of between 30% and 40%.

The IGTO also observes that there is no evidence that consideration was given to whether there are reasons to approach the administration of the Program in a different way to the Test Case Litigation Funding Program, such as differences in the taxpayer demographic or the very different objectives of the respective programs.

Nevertheless, the documents made available to the IGTO evidence a common understanding of the policy objective for the Program, the key features of its administration and ATO's departmental funding risks.

4.1.7. IF COSTS ARE CALCULATED UNDER THE FCRS FOR THE PURPOSES OF THE PROGRAM, CLARIFICATION IS NEEDED AS TO THE BASIS ON WHICH THE CALCULATION IS MADE

A lack of up-front clarity on the costs that will be funded increases the risk of perceptions that the ATO's administration of the Program is arbitrary.

If the types of costs that will be paid for are not specified up-front, there is also a risk that the ATO will be exposed to claims for excessive costs. The IGTO observed that this lack of sufficient up-front clarity was a major driver for extensive and avoidable disputation.

These risks can be reduced by explaining in the funding agreement that funding on the basis of reasonable costs, by reference to the FCRs (or on any similar basis), will often result in a margin between costs incurred by the applicant and costs that are funded by the ATO. This will enable applicants and their representatives to plan and manage the margin of costs accordingly.

These risks will also be reduced by the ATO providing greater up-front clarity on:

- (a) the types of work that the ATO will fund and the conditions attached – for example, whether it will fund claims for delegation and supervision, having regard to the extent of supervision required with respect to the seniority of the lawyer, or whether it will determine that such claims are to be absorbed as overhead costs;
- (b) whether the GST component of costs will only be funded where the taxpayer is not entitled to an input tax credit;
- (c) whether it will permit claims for a skill, care and responsibility loading and, if so, the maximum percentage that would be applied; and
- (d) whether it limits its funding to 75% of the FCR scale for items with non-discretionary amounts.

This will ensure that applicants are clearly informed that they may be required to pay certain costs charged by the legal representatives which are not reimbursed by the ATO. It will also put legal representatives on notice that if they do not have an agreement in place requiring the applicant to pay any costs that the ATO declines to pay, the costs will not be recoverable. The Costs Consultant's opinions also support the need for clarity on these issues.²¹

Clearly communicating the basis for calculating reasonable costs will help to mitigate the risk that applicants and their legal representatives will perceive the refusal of a claim as arbitrary, unfair or as an allegation that the representative has acted unreasonably. Depending on the basis of calculation that is adopted by the ATO, this may include an explanation that the technical process of calculating costs (for example, pursuant to the FCS) will often result in a margin between costs incurred and costs that the ATO will reimburse.

In the IGTO's experience in liaising with the legal representatives in the Disputes, a breakdown in trust between the parties can quickly arise where the ATO's approach to funding is not clarified. Further, where the ATO refuses to pay certain costs and gives its reasons as the legal representative's costs are "not reasonable", this may trigger defensive behaviours on the part of the legal representatives and disputation.

4.1.8. THE ATO TO ALSO BE CLEARER ABOUT THE TYPES OF COSTS THAT IT WILL NOT REIMBURSE

It is also important to set clear parameters around the types of claims that the ATO will not reimburse and the limits to reimbursement. Again, this need for greater clarity is supported by the Costs Consultant's opinion, for example:²²

"2. We have concerns, that the nature of the funding of costs, i.e. on the basis of the Federal Court Scale (without limitations), may lead to excessive costs being claimed. A substantial proportion of the work may be claimable on the basis of item 1.1 of the Scale. The maximum amount chargeable under this item is \$650.00 per hour. A law firm could determine to do all work at this rate which would be well above market rate, depending upon the circumstances. We would recommend that consideration be given to limiting the hourly rate where items are chargeable on the basis of item 1.1 as follows:

Work reasonably undertaken by a partner - \$650.00 per hour

Work reasonably undertaken by a solicitor with 5 – 10 years post qualification experience (PQE) - \$500.00 per hour.

Work reasonably undertaken by a solicitor with < 5 years PQE - \$250.00 - \$350.00 per hour.

²¹ Costs Consultant, Dispute 2 Letter, p 4 [8].

²² Costs Consultant, Dispute 2 Letter, pp 3-4.

IGTO OBSERVATIONS

Consideration to be given to requiring that work is required to be allocated to a fee earner at an appropriate level.

3. The ATO may wish to determine whether it will fund claims for delegation and supervision or whether it will determine that such claims are to be absorbed as overhead costs. The Scale provides at item 4.1 for reasonable allowances in this regard. In this matter we consider that the extent of partner supervision and inter-office liaison was excessive relative to the seniority of [Legal Representative]. Although we have made certain reductions, it is difficult to challenge the extent of supervisory claims on the face of invoices presented.

4. It would assist to clarify to the taxpayer that the Federal Court Scale only permits GST to be claimed where a taxpayer is not entitled to an input credit for GST and further that GST may only be claimed on items claimable in accordance with Scale item 1.1, where to do so would not exceed the cap rate for that item. Disbursements are not subject to this restriction and GST is generally recoverable on all disbursements if the taxpayer is not entitled to an input credit.

5. The ATO may wish to consider whether it limits its funding commitment to 75% of the Federal Court Scale for items with non-discretionary amounts which is the basis upon which successful applicants in the AAT can recover costs where an order for costs is obtained in their favour: see paragraph 3.1 (b)(iii) of the attached AAT Practice Direction.

6. The ATO may wish to consider whether it will permit claims under Scale item 11.1 (the skill care and responsibility loading item) at all, and if so to specify the maximum percentage rate that will be paid in each matter based on the evaluation by the ATO of the complexity of the matter. This will eliminate an area where there may be some dispute in each case as to whether the matter is of sufficient complexity to warrant this loading at all and, if so, what percentage loading would be appropriate.”

Consideration of these matters, and revisions to the Fact Sheet, future funding agreements and other guidance material (as appropriate) to address them, would provide a more detailed understanding to applicants and their legal representatives of the costs that will and will not be funded. It will also enhance the integrity of the Program by setting parameters around “reasonable costs” where appropriate.

4.1.9. CLARIFICATION AND GUIDANCE IS NEEDED WITH REGARD TO THE DETAIL AND SUPPORTING DOCUMENTATION REQUIRED TO SUBSTANTIATE LITIGATION FUNDING CLAIMS

4.1.9.1. No guidance is given to applicants on the information that must be included in invoices submitted for ATO payment

The ATO has not made available to the IGTO any up-front guidance that it provides to applicants or their legal representatives as to what information must be included in the tax invoices that are submitted for funding.

If the tax invoice requirements are not specified up-front, the legal representative and applicant will incur unnecessary administrative expenses as significant unbillable time may be needed to clarify invoice details with the ATO, having impact on the time available to prepare the applicant's case.

Communicating the requirements up-front, (for example, in the form of guidelines), also provides opportunities for the legal practitioner to establish appropriate systems to capture and compile information the ATO requires to support invoices. The risks arising from the ATO not communicating the requirements up-front include that:

- (a) perceptions of arbitrary ATO administration will be formed where there is a mismatch of expectations regarding what documentation is sufficient;
- (b) ATO officers may obtain insufficient evidence on which to commit public monies; and
- (c) the ATO will incur unnecessary administrative expense in determining payment amounts where invoices are provided for composite items that require the application of different scale items.

Where at the outset of the arrangement, the ATO provides detail on the supporting documentation that litigants will be required to provide to the ATO to substantiate litigation funding claims, this will allow legal representatives to contemporaneously prepare their tax invoices in accordance with the guidelines. This will help legal practitioners to avoid expending significant unbillable and unclaimable time (and the ATO's administrative costs) clarifying these matters with the ATO when the tax invoices are deemed to contain insufficient information. This unbillable time in dealing with the ATO on administrative work was a key source of frustration for the legal representatives in the Disputes.

Communicating guidelines up front will also provide assurance that there is an established process for requiring additional information to be provided. This will help to mitigate perceptions of arbitrary ATO decision making - for example, that it is not a case of an individual ATO officer choosing to target a particular applicant or legal representative so as to put them to a higher burden of proof. The tendency of applicants and their representatives to assume they are being targeted may be exacerbated where they are parties in active litigation against the Commissioner. This can be mitigated by establishing clear guidelines up front.

IGTO OBSERVATIONS

The guidelines will also help to provide greater assurance to the Commissioner, as the accountable authority, that ATO officers are managing this initiative in a manner that promotes proper use of public resources²³ as it clearly identifies the evidence that would be critical to substantiate the funding claims.

This need for greater clarity extends to the specific information that must be contained in tax invoices submitted to the ATO. For example, the Costs Consultant indicated that tax invoices must contain the following information:²⁴

- (a) The date of each item of work;
- (b) The item number pursuant to which the claim is made;
- (c) The fee earner who undertook the work;
- (d) A description of the work sufficient to enable the reasonableness of the claim to be evaluated;
- (e) For work claimed on the basis of items 2.1 to 2.4 and 3.1 to 3.3 of the Federal Court scale, the word count of the document pertaining to the substantive drafted material;
- (f) A column containing any GST that is claimable on any scale item.

Clarity is also required in relation to composite claims. The Costs Consultant noted that composite claims should not be made, as they make it difficult to apply different scale items to the work included in each composite item.

Incorporating the tax invoice requirements into each funding agreement will ensure that the requirement to provide this information in each tax invoice is a term of the contractual arrangement.

²³ See for example section 15 of the Public Governance, Performance and Accountability Act 2013 which provides:

15 Duty to govern the Commonwealth entity

- (1) The accountable authority of a Commonwealth entity must govern the entity in a way that: (a) promotes the proper use and management of public resources for which the authority is responsible; and
- (b) promotes the achievement of the purposes of the entity; and
- (c) promotes the financial sustainability of the entity.

(2) In making decisions for the purposes of subsection (1), the accountable authority must take into account the effect of those decisions on public resources generally.

²⁴ Costs Consultant, Dispute 2 Letter, p 4 [10]

4.1.10. ADDITIONAL INFORMATION TO SUBSTANTIATE CLAIMS

4.1.10.1. Insufficient up-front guidance to applicants on the nature of additional information that may be needed to substantiate claims

The ATO's Fact Sheet states that the ATO may request additional information. However, the nature of the information that may be required is not set out with clarity and may not be obvious to applicants and their representatives.

Insufficient clarity about what substantiating documentation the ATO may require raises similar risks to those arising from the absence of guidance on information required on invoices.

It would assist AAT SBTD applicants if the funding agreements, and the guidance material, clearly indicated what additional supporting material may be requested by the ATO in order to substantiate costs claims.

As with the tax invoice guidelines, knowing what is required up front will allow the legal representatives to collate the information as the matter progresses, rather than having to incur significant unrecoverable/unclaimable costs in pulling the information together at a later point in time.

Also, knowing at the outset what supporting documentation is required will assure applicants and their legal advisers that, by requesting the provision of supporting documentation, the ATO is adhering to an established process, and not unfairly targeting a particular party.

Including in the funding agreement that supporting documentation may be requested, and the nature of that supporting documentation, will make it clear to applicants and their legal representatives that the requirement to provide supporting documentation is a term of the contractual agreement.

4.1.11. A 'FUNDING COMMITMENT' HELPS TO PROVIDE UP-FRONT CERTAINTY FOR BENEFICIARIES OF THE PROGRAM – AND SHOULD INCLUDE AN UPFRONT ESTIMATE OF COSTS

The ATO's current administration of the Program involves the making of a "funding commitment" to the AAT SBTD applicant which is reflected in DR IB 2019/1.

However, the funding commitment does not appear to have been incorporated into the contractual arrangement entered into in connection with the Program. DR IB 2019/1 is not referred to in the Funding Agreements. Unlike DR IB 2013/1 and 2013/14, DR IB 2019/1 is also not referred to in the ATO's Fact Sheet which is referenced in the Funding Agreements.

The legal representatives in the Disputes shared this understanding.

Furthermore, in both the Dispute 1 Opinion and the Dispute 2 Opinion, the Costs Consultant expressed uncertainty regarding the legal status of the funding commitment.

IGTO OBSERVATIONS

There must not be an inconsistency between what is agreed to in a funding agreement and what steps ATO officers are required to take in order to comply with DR IB 2019/1. This potentially places ATO officers in a difficult position of risking breach of contract or breach of the Commissioner's legally enforceable direction that amounts to a breach of the APS Code of Conduct.

4.1.11.1. There is to be flexibility in the application of the funding commitment

In order to ensure that the ATO complies with its contractual obligation to pay reasonable costs, there must be scope for increasing the funding commitment where it would be reasonable to do so.

The IGTO is aware that the ATO has increased its funding commitments in cases. However, we query whether there is a clear, transparent, consistent approach to doing so. The process is not outlined in DR IB 2019/1 or in any other materials that the ATO made available to the IGTO.

A funding commitment provides up-front certainty to an applicant on payment of estimated costs. It minimises the risk of the applicant's resourcing capability interfering with the Tribunal's proper consideration of issues and helps to ensure an efficient and effective administration of justice.

Additionally, a funding commitment allows the ATO to budget (in compliance with finance laws) as it provides a corroborative data point for the ATO to estimate the amount of potential liability for decision making purposes under the Public Governance, Performance and Accountability Act 2013 (**PGPA Act**).

In this respect, the Costs Consultant relevantly stated the following:

... the extent to which the initial estimate was increased from the inception of the funding indicates that unless some control is exerted in respect of costs to be paid under the funding agreement, extensive and disproportionate costs may be incurred."

Accordingly, the IGTO considers that up-front certainty regarding the estimated total amount of funding available is of fundamental importance to achieve the objectives of the Program.

4.1.12. ATO USE OF ITS OWN ESTIMATED COSTS AS A CAP TO THE FUNDING PROVIDED IS INCONSISTENT WITH THE ATO'S OWN UNDERSTANDING OF THE INTENDED OPERATION OF THE PROGRAM

The IGTO observed that the ATO's calculation of the "funding commitment" was based, at least partly, on the ATO's estimate of its own costs in the proceeding. This is reflected in DR IB 2019/1, which states:

"The RDR case funding team will then inform the taxpayer and the AAT:

that the ATO is engaging a legal service provider to represent the ATO in the Small Business Taxation Division matter

the quoted cost estimate of 'the ATO's legal service provider

the amount of costs the ATO will commit to pay for the taxpayer's legal representation, and

that ASBFEO maintains a list of legal services providers vetted by ASBFEO, but that the taxpayer is not limited to using providers on this list.

On agreement with the taxpayer the ATO will prepare a funding deed that specifies the terms and conditions for payment. The payment amount will be based on the cost estimates of the legal representation for the ATO. If a taxpayer disagrees with the amount of costs that the ATO is willing to commit to pay for the taxpayer's legal representation, the dispute may be referred to the Inspector-General of Taxation (the IGT) for dispute resolution by either of the parties."

DR IB 2019/1 contemplates that the ATO will inform the taxpayer and the AAT of "the amount of costs the ATO will commit to pay for the taxpayer's legal representation" (see extract above).

In the Disputes, the ATO provided evidence of having communicated the cap amount to the applicants, however, the ATO did not seek to enforce the cap amounts.

Notwithstanding this, the IGTO is concerned with these ATO statements that assert a funding cap calculated by reference to the ATO's own costs. Effectively, the statements attempt to erroneously equate "equivalent representation" with "equivalent costs".

Based on the information that the ATO has made available to the IGTO after receiving an earlier draft of this report and making submissions in response to it, statements which assert that the funding cap is to be calculated by reference to the ATO's own costs are also contrary to the ATO's own understanding of the policy intent of the Program.

IGTO OBSERVATIONS

Further, at the time of implementing the Program, the ATO acknowledged that there is likely to be a significant difference between costs incurred by the Commissioner and costs incurred by the taxpayer, including because:

- (a) the ATO negotiates discounts on commercial rates of legal representatives;
- (b) the taxpayer always bears the onus of proof and the burden of proof and generally incurs the costs of preparing evidence; and
- (c) the taxpayer does not have the experience, expertise and resources of the ATO.

This disparity is supported by the Costs Consultant's opinion, who was asked to and specifically advised on this issue:²⁵

i) "In reference to paragraph 1 (iv) [of the scope of work] I do not consider that it would be reasonable to utilise the legal costs incurred by the ATO as a benchmark for calculating the reasonable costs of the taxpayer for the following reasons:

ii) ...it is likely that the ATO would have the expertise "in house" to undertake a significant proportion of the work and/or provide instructions at a highly sophisticated level and

iii) The ATO as a large user of legal services would be in a position to obtain such services externally at more competitive rates than those available to a taxpayer."

The Cost Consultant also gave relevant comment when examining the Disputes in question: ²⁶

"1. The costs of the use of external legal advisors by the ATO cannot necessarily be utilised as a benchmark for calculating the reasonable costs. This is because:

Large users of external legal services are afforded rates of charge which may not be available to the taxpayer.

The ATO may have considerable in-house accounting and legal expertise which would result in clear and precise instructions being given to the external provider and also a significant portion of the underlying work, calculations and analyses can be undertaken inhouse.

The taxpayer's legal advisors are frequently dealing with incomplete records, lay clients and will experience difficulties and delays in obtaining precise instructions and documentation which would not ordinarily be experienced by the ATO's legal advisers. ...

²⁵ Costs Consultant, Dispute 1 Opinion [76(d)]

²⁶ Costs Consultant, Dispute 2 Letter

The Costs Consultant went on to state:

“It is also generally the case that the moving party will be required to undertake additional work relative to the party defending the matter, particularly where the defendant may elect to rely on research and arguments which it has previously formulated. I have no information as to the work done and previously completed by the ATO in forming its precedential views. It may be the case that the work required to develop much of the material upon which the ATO relied had already been undertaken prior to the commencement of the Appeal, such that the work required to be undertaken by the ATO for the purposes of the proceedings may be substantially reduced thereby. In my opinion, for this reason and others, the costs incurred by the ATO would not be an appropriate measure of the reasonable costs of the taxpayer.”²⁷

In the IGTO’s view, any ATO decisions which cap the amount of funding to that equating the ATO’s own costs are likely to be unreasonable decisions. As set out above, such a basis for funding decisions is contrary to the intended operation of the Program (which was commonly understood at the time of the Program’s implementation, based on the ATO-provided documentation) and is unlikely to resemble the costs that an applicant would reasonably incur. Calculating the cap with reference to the applicant’s anticipated legal costs is an approach more consistent with the aims of the Program and would better address the risks.

The ATO use of its own costs to cap funding exposes the ATO to the risk of reasonably-based allegations of arbitrary, unfair and/or unreasonable ATO funding decisions, which are likely to erode the legal profession and small business community’s confidence in the ATO’s administration of the Program.

ATO staff require clarity that the ATO’s own costs are irrelevant to the funding offered and paid.

Given the material which the ATO has made available to the IGTO, the IGTO considers that there is need for the ATO to provide clear and explicit direction to its staff that the ATO’s own costs are not the relevant benchmark to the determination of funding offered and paid.

4.1.13. CONSULTATION TO BETTER UNDERSTAND THE EXPERIENCE OF TAXPAYERS AND THEIR REPRESENTATIVES WILL IDENTIFY THE RANGE OF OPPORTUNITIES TO IMPROVE ATO GUIDANCE

The IGTO considers it important that the small business community and their representatives (which includes the legal profession) have input into these issues through appropriate consultation. Specifically, the ATO would benefit from obtaining feedback on the experience of taxpayers and their representatives with the Program to date. This would allow the ATO to better understand how its guidance material might be improved going forward, to ensure that applicants in the AAT SBTD have a thorough understanding of the litigation funding process at the earliest opportunity.

²⁷ Costs Consultant, Dispute 1 Opinion, [72(c)]

4.2. THE ATO TO CONSIDER WHETHER ADDITIONAL INTEGRITY MEASURES ARE NECESSARY

4.2.1. THE ATO IS REQUIRED TO ASSURE ITSELF THAT IT IS COMPLIANT WITH FINANCE LAW OBLIGATIONS CONCERNING THE COMMITMENT AND SPENDING OF PUBLIC MONIES

In providing litigation funding, the ATO must adhere to statutory obligations with respect to the commitment and spending of public resources. These include:

- (a) the Commissioner's obligation to "promote the proper use and management of public resources for which he is responsible" (section 15 of the PGPA Act) as well as other relevant provisions of the PGPA Act and the Public Governance, Performance and Accountability Rule 2014 regarding the use and management of public resources; and
- (b) relevant provisions of the Public Service Act 1999, including the APS Code of Conduct provided by section 13 of that Act, which requires that an "APS employee must use Commonwealth resources in a proper manner and for a proper purpose."

In dealing with public monies the ATO is required to have sufficient assurance of the basis for the amounts paid. There is a risk of non-compliance with the finance laws where the ATO provides an unlimited amount of funding or pays unreasonable claims. This risk is likely to increase where there are insufficient checks and balances regarding the amounts and types of costs that will be funded under the Program.

4.2.2. THE ATO TO CLARIFY ITS APPROACH TO FUNDING WHERE THE APPLICANT AND LEGAL REPRESENTATIVES ARE RELATED OR OTHERWISE CONNECTED ENTITIES

In the Dispute 1 Opinion, the Costs Consultant provides some commentary about the recovery of costs by self-represented applicants, as follows:

"RECOVERY OF COSTS BY SELF REPRESENTED APPLICANTS"

77. This report has not considered whether the costs are claimable at all having regard to the authority of Bell Lawyers Pty Ltd v Pentelow [2019] HCA 29. That case determined that solicitors and barristers who represent themselves are not able to recover their own professional costs for that work. The principles in that case have been further extended in United Petroleum Australia Pty Ltd & Ors v Herbert Smith Freehills [2020] VSCA 15 in which the Victorian Court of Appeal held that a legal firm could not recover costs of their employed solicitors for acting for the firm as to do so would undermine the findings in Bell and that costs were not recoverable for the time spent by a legal practice's own employees. We recommend that counsel's advice be sought in this regard should any consideration of this

issue, in the context of a circumstance where a taxpayer is being represented by its director who is also a legal practitioner, is required.” [Emphasis added]

An area of clarification to consider is whether the Program is intended to apply where the applicant is a self-represented lawyer or otherwise related or connected to their representative. If the ATO considers that the applicant must be represented by a third party in order to access the scheme, or if there are additional requirements for substantiating costs incurred by related legal representatives who are related or otherwise connected parties, a fair and transparent approach would be to communicate this to the applicant and their legal representative at the outset of the arrangement.

4.2.3. THE ATO TO ASSURE ITSELF THAT ANY COSTS CLAIMED ARE INCURRED BY THE APPLICANT, PARTICULARLY WHERE IT CORRESPONDS EXCLUSIVELY WITH THE APPLICANT’S LEGAL REPRESENTATIVE AND REIMBURSES THE LEGAL REPRESENTATIVE DIRECTLY

The purpose of the Program is to assist small businesses by covering the legal costs of applicants in the AAT SBTD. If the ATO communicates exclusively with the applicants’ legal representatives, and reimburses the legal representatives directly, it may not be possible to verify whether the legal costs were ever actually incurred by the applicant, or if the applicant was ever aware of the amounts charged to them by the legal representatives and reimbursed.

There is also a risk that funding to which the applicant is entitled will be received by the legal representative without the applicant’s knowledge. The Costs Consultant highlights this risk at paragraph 7 of the Dispute 2 Opinion, stating:

“We are concerned as to issues which may arise with the direct submission of invoices (although addressed to the taxpayer), to the ATO. In the event that the ATO makes payment in whole or in part of the costs direct to the law firm, in circumstances where the entitlement to reimbursement is that of the taxpayer. We recommend consideration be given to obtaining an authority to do so and release from the taxpayer.”

Ensuring that costs claimed under the Program are costs legitimately incurred by the applicant, and that the applicant is aware of the costs, will protect the integrity of the Program and will help to ensure that the purpose of the Program is realised, which is to provide assistance to applicants in the AAT SBTD.

4.3. A PROCESS TO BE IMPLEMENTED FOR DEALING WITH CONFIDENTIAL INFORMATION AND MATERIAL THAT IS SUBJECT TO PRIVILEGE

The Funding Agreements do not specify a process for dealing with supporting documentation in a manner that:

- maintains any privilege attached to information contained in the documentation; and
- mitigates the risk that disclosure breaches confidentiality or otherwise prejudices the applicant.

The absence of such a process increases the risk of unnecessary costs, perceptions of unfair administration, ATO exposure to non-compliance with finance laws and unnecessary disputation.

Setting expectations up front will help to mitigate:

- (a) unnecessary costs of both the applicant and the ATO in dealing with the issue and establishing a process for providing the information;
- (b) perceptions of unfair administration, if the ATO requests information to substantiate claims which might prejudice the applicant in the litigation if disclosed;
- (c) ATO officers not obtaining information that may be needed to support a decision to make payment, because there is no clear basis in the funding agreement for requesting it; and
- (d) unnecessary disputation – for example, many of the disputes lodged with the IGTO were precipitated when the ATO requested additional information to substantiate the applicants' claims.

Applicants and their legal representatives will have legitimate concerns about providing supporting documentation that contains information which might prejudice the applicant in the litigation, particularly if the proceeding is ongoing. This is particularly likely to be the case where the documentation contains information that is confidential or privileged.

4.3.1. CONCERNS MAY BE MITIGATED BY ENGAGING INDEPENDENT EXTERNAL COSTS CONSULTANT

Any concerns applicants may have about providing confidential or privileged information to support their funding claims might be mitigated by establishing a process whereby the material is received and reviewed by an independent third party.

In respect of the Disputes, the Costs Consultant was engaged to review file material and to form an opinion with respect to reasonable costs. The applicants were prepared to provide the file material to the Costs Consultant, notwithstanding that the proceedings were still active.

Adopting this approach going forward, particularly where the applicant or their legal representative raises concerns about confidential or privileged information, will ensure that the underlying purpose of the Program is not frustrated by the imposition of a requirement that will further prejudice the applicant in the AAT SBTD proceedings.

Once again, the risk of adverse perception which drives behaviour can be appropriately mitigated by providing up-front certainty regarding the engagement of the third party, together with communication protocols and proformas of the undertakings that will be given.

Appendix — Glossary and defined terms

Abbreviation	Defined term
AAT	Administrative Appeals Tribunal
ATO	Australian Taxation Office
ATO Fact Sheet	ATO publication, 'Small business litigation funding', QC 59545 available from the ATO's website (last accessed 31 August 2021)
Commissioner	Commissioner of Taxation
Complaint	<p>A complaint is defined AS/NZS 10002:2014 Guidelines for complaint management in organizations</p> <p><i>Expression of dissatisfaction made to or about an organization, related to its products, services, staff or the handling of a complaint, where a response or resolution is explicitly or implicitly expected or legally required.</i></p> <p><i>Disputes - Unresolved complaints escalated internally or externally, or both.</i></p> <p><i>Feedback - Opinions, comments and expressions of interest or concern, made directly or indirectly, explicitly or implicitly to or about the organization, its products, services, staff or its handling of a complaint. Organizations may choose to manage such feedback as a complaint.</i></p>
Costs Consultant	the costs consultant who was engaged to assist the IGTO with the resolution of each of the Disputes
Dispute Documents	documents specific to the two Disputes which were the subject of the IGTO's initial investigations regarding the Program
the Disputes	two disputes of the initial unresolved complaints (disputes) lodged with the IGTO about the ATO's actions in administering the Program
Dispute 1/Dispute 2	One of the Disputes
Dispute 2 Letter	the Cost Consultant's opinions in a correspondence pertaining to Dispute 2 that were given to the IGTO in response to requests for general advice
Dispute 1/2 Opinion	the Cost Consultant's opinions given to the IGTO in response to requests for general advice
DR IB 2019/1	ATO's <i>Dispute Resolution Instruction Bulletin DR IB 2019/1 Small Business Taxation Division</i> , AAT which is reproduced in Annexure D
FCR	<i>Federal Court Rules 2011</i>
FCS	Federal Court Scale, as set out in Schedule 3 to the <i>Federal Court Rules 2011</i>
Funding Agreements	Legally binding agreements entered into between the Commissioner of Taxation and small businesses litigants where the ATO agrees to reimburse certain litigation costs
GPN-Costs	The Federal Court Costs Practice Note, prepared by Chief Justice Allsop and published on 24 October 2016
GST	Goods and Services Tax

Abbreviation	Defined term
IGT Act 2003	<i>Inspector-General of Taxation Act 2003</i>
IGTO	Inspector-General of Taxation and Taxation Ombudsman. The acronym “IGTO” is used throughout the report to denote both the “Inspector-General of Taxation”, as named in the enabling legislation, and “Inspector-General of Taxation and Taxation Ombudsman” as recently adopted due to recent calls for greater understanding and awareness of our dispute investigation function.
Minister	The former Assistant Treasurer
Media Release	Media Release dated 12 February 2019, issued by the former Assistant Treasurer The Hon Stuart Robert MP, ‘Backing small business – simplifying and resolving tax disputes’
NGCF	National Guide to Counsel Fees
PGPA Act 2013	<i>Public Governance, Performance and Accountability Act 2013</i>
Program Design and Implementation Communications	Documents that the ATO made available to the IGTO on 29 July 2022, which pertain to the ATO’s administration of the Program, generally, including a bundle of documents comprising communications between the ATO and others in relation to the policy intent and administration of the program
SBTD	Small Business Tax Division of the AAT
TAA 1953	<i>Taxation Administration Act 1953</i>
Tax Official	<p>The term ‘tax official’ is defined in section 4 of the IGT Act 2003 to mean:</p> <ul style="list-style-type: none"> (a) an ATO official; or (b) a Board member of the Tax Practitioners Board; or (c) an APS employee assisting the Tax Practitioners Board as described in section 60-80 of the <i>Tax Agent Services Act 2009</i>; or (d) a person engaged on behalf of the Commonwealth by another tax official (other than an ATO official) to provide services related to the administration of taxation laws; or (e) a person who: <ul style="list-style-type: none"> (i) is a member of a body established for the sole purpose of assisting the Tax Practitioners Board in the administration of an aspect of taxation laws; and (ii) receives, or is entitled to receive, remuneration (but not merely allowances) from the Commonwealth in respect of his or her membership of the body. <p>For the purpose of this submission, the term ‘tax official’ is also used to refer to a ‘taxation officer’ to whom subdivision 355-B of Schedule 1 to the TAA 1953 applies.</p>
The Program	The Administrative Appeals Tribunal Small Business Tax Division Litigation Funding program which is administered by the ATO



Fact Sheet – Small Business Litigation Funding

This fact sheet contains guidance on the payment of reasonable legal costs under small business litigation funding

Where you are self-represented in the Small Business Taxation Division of the Administrative Appeals Tribunal (SBTD AAT), and the ATO engages external legal representation, the ATO will cover reasonable costs to engage an equivalent level of legal representation to act on your behalf in the SBTD AAT.

For the purposes of small business litigation funding, reasonable costs are determined by reference to the [Federal Court Rules 2011](#).

Reasonable legal costs

Solicitor's Fees

The reasonable costs of your solicitor will be paid even if the ATO only engages counsel. Funding for work undertaken by a solicitor, such as attendances, preparing of documents and reading, is capped at the amounts set out in the [Federal Court Rules 2011](#).

We will also pay other reasonable costs relating to your solicitor by reference to the [Federal Court Rules 2011](#).

These costs may include:

- a. more than one lawyer where it is appropriate
- b. research of a legal question that is not procedural in nature
- c. electronic document management
- d. masking documents
- e. collation, pagination and indexing
- f. copying documents
- g. disbursements
- h. out-of-pocket or expert witness expenses.

To establish that these costs are reasonable we may require further information from you or your legal representative. We may also require further information on legal costs not specifically provided for in the [Federal Court Rules 2011](#).

Counsel's Fees

Funding for work of counsel retained by you is calculated by reference to the equivalent number of

counsel (junior or senior) retained by the Commissioner. For example, if the Commissioner retains one senior counsel and one junior counsel and you engage the same the level of counsel, you will be funded for one senior counsel and one junior counsel.

For counsel rates, funding is capped at a rate under the most recent [National Guide to Counsel Fees](#) published by the Federal Court of Australia.

Costs not covered by funding

Under the [Federal Court Rules 2011](#), the rates specified for preparing documents include costs for typing, printing, posting, faxing, emailing and other administrative tasks relating to the preparing or sending documents.

Examples of other costs that may not be considered reasonable and therefore not covered under funding include:

- a. administration of the funding, including:
 - i. preparing, negotiating or executing the Letter of Agreement
 - ii. preparing invoices or bill of costs, and any information or documents required to accompany invoices or bill of costs
 - iii. preparing any other communications with the Commissioner on issues arising out of the funding
- b. time spent providing instructions or directions to administrative staff
- c. administrative work such as:
 - i. typing
 - ii. booking airline flights
 - iii. booking taxis or ride-sharing services
 - iv. recording details of the time spent on legal work
 - v. paying disbursements
 - vi. any other work that is customarily performed by a legal or other secretary, accounting or legal support person.
- d. services for which funding has already been provided

- e. expenses relating to any work done after the AAT proceedings have concluded
- f. expenses relating to the commencement and conduct of any appeal from the decision in the AAT proceedings.

While we would not ordinarily fund these types of expenses, if you consider a cost is reasonable and ought to be funded, you should request the Commissioner's written agreement to fund the expense prior to incurring the cost.

How to claim

After executing the Letter of Agreement you can commence submitting invoices from your legal representatives for funding. The invoices should be sent to the RDR funding team by [email](#) or post.

The invoice from your legal representative must contain the following information:

- a. a description of the work undertaken on each task or item
- b. the date the work was performed
- c. the amount of time spent on each task
- d. the name of the person who undertook each task, their position and their hourly rate or amount payable under the [Federal Court Rules 2011](#).

Where an invoice does not contain sufficient information, we will work with you and your legal representative to obtain the relevant information.

Payment

We will pay funding directly on your behalf to your legal representative. We will tell you the amount of funding to be paid and this amount will be paid in 30 days of us receiving the invoices and any additional information that we require.

If we do not pay an amount, we will contact you to discuss our reasons for non-payment. We will also provide our reasons in writing.

Disputes

If you do not agree with our reasons and believe we have not dealt with your claim in line with our agreement, contact us first to see if the dispute can be resolved.

If you still disagree with our decision, you can refer the disagreement to the [Inspector-General of Taxation](#). For a dispute about the payment of your costs under this agreement, we will comply with any recommendation made by the [Inspector-General of Taxation](#).

More information

For more information, related Practice Statements and relevant legislative references, see:

- [AAT Practice directions, guides and guidelines](#)
- [Guide to the Small Business Taxation Division \(AAT\)](#)
- [Administrative Appeals Tribunal Amendment \(Small Business Taxation Division\) Regulations 2019](#)
- [ASBFEO Concierge Service](#)
- [DR IB 2013/1 Role of Dispute Resolution Information Bulletins](#)
- [DR IB 2013/14 Test Case Litigation](#)
- [Federal Court Rules 2011- Costs Allowable for Work Done and Services Performed](#)
- [Inspector-General of Taxation Making a Complaint](#)
- [National Guide to Counsel Fees](#)
- [PS LA 2009/9 Conduct of ATO litigation and engagement of ATO Dispute Resolution](#)

[Home \(/\)](#) / [Ministers \(/ministers\)](#)

/ [The Hon Stuart Robert MP \(/ministers/stuart-robert-2018\)](#)

/ [Media Releases \(/ministers/stuart-robert-2018/media-releases\)](#)

/ [Backing small business - simplifying and resolving tax disputes](#)

[The Hon Stuart Robert MP \(/ministers/stuart-robert-2018\)](#)

[Media Releases \(/ministers/stuart-robert-2018/media-releases\)](#)

[Speeches \(/ministers/stuart-robert-2018/speeches\)](#)

[Transcripts \(/ministers/stuart-robert-2018/transcripts\)](#)

12 February 2019

Backing small business - simplifying and resolving tax disputes

The Morrison Government is making it simpler for small businesses to resolve tax disputes with the Australian Taxation Office (ATO).

Building on the Prime Minister's announcement last November, the Government is giving further support to level the playing field for small businesses in these disputes.

We have been told disputes with the ATO can be stressful and intimidating, and that small businesses often lack the expertise, time and resources to challenge ATO decisions in the Administrative Appeals Tribunal (AAT).

The Government has listened to these concerns and is creating a small business concierge service within the Australian Small Business and Family Enterprise Ombudsman's office that will support small businesses without legal representation. Additional features to those announced earlier include:

- Prior to applying to the AAT, unrepresented small business can receive one hour of legal advice on payment of a \$100 co-payment.
- After paying the AAT a reduced application fee to review an adverse ATO decision, such as affirming an audit or cancelling an ABN registration, the small business will have a dedicated case manager throughout the process. Unrepresented small businesses may receive an additional hour of free legal advice to be administered by the Australian Small Business and Family Enterprise Ombudsman's office.

The general rule is that these hearings in the AAT will be without lawyers. Where the ATO engages external legal counsel in the AAT and the small business does not have legal representation, the ATO will cover the cost of providing the small business with equivalent legal representation. The AAT's decision will be made within 28 days of the hearing.

Annexure B

In addition to the Small Business Concierge Service and the creation of the Small Business Taxation Division within the AAT, the Government is making the entire tax dispute process fairer for small business. This package will commence on 1 March 2019.

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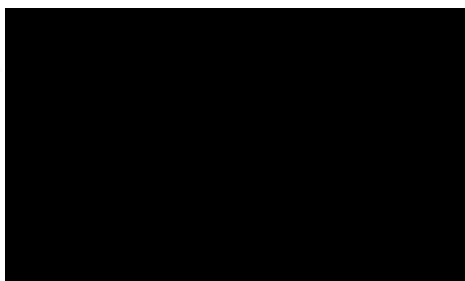
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GPO BOX 9990 SYDNEY NSW 2001



Australian Government
Australian Taxation Office



Contact Officer: [REDACTED]

Telephone: [REDACTED]

Email: [REDACTED]

Issue Date: [REDACTED]

Dear [REDACTED]

Letter of Agreement – [REDACTED]

I am writing to offer you litigation funding under the Small Business Litigation Program for Administrative Appeals Tribunal application [REDACTED]

Small business litigation funding covers the reasonable costs you may incur for legal representation in this matter. The attached Fact Sheet provides guidance on the types of expenses paid under this funding agreement.

To accept this offer and enter into an agreement for funding, please sign the attached Funding Schedule and send or email a scanned copy to the address below by [REDACTED] 2020:

Attention: [REDACTED]
Australian Taxation Office
PO Box 9977
SYDNEY NSW 2000

or by email to [REDACTED]

If you have any questions about this offer, please contact [REDACTED]

Yours sincerely,

[REDACTED]
Deputy Commissioner
Review and Dispute Resolution



Funding schedule

Funding details

Parties	Name	Commissioner of Taxation of the Commonwealth of Australia
	Name	[REDACTED]
	ABN	[REDACTED]
Background	The Taxpayer is a party to AAT Proceedings being conducted in the Small Business Taxation Division of the Administrative Appeals Tribunal. The Commissioner has agreed to provide funding to the Taxpayer for the AAT Proceedings from the Funding Date on the terms set out in this agreement. The Taxpayer accepts that funding on the terms and conditions set out in this agreement.	
Funding Date	[REDACTED]	
AAT Proceedings	Administrative Appeals Tribunal [REDACTED]	

Agreed Terms

Obligation to provide cost estimate

You agree to provide us with:

1. an estimate of the costs of legal representation you expect to incur for the AAT proceedings, within 30 days of the date of this agreement; and
2. an updated estimate if the costs of legal representation are likely to exceed the current estimate, to be provided as soon as practicable.

Funding only for legal representation

Funding is provided only to pay your reasonable expenses for legal representation. Reasonable expenses are described in the attached Fact Sheet.

This funding for legal expenses incurred will stop after the AAT Proceedings conclude.

Payment of funding

We will pay funding as described in the attached Fact Sheet.

GST

Where you are registered for GST and entitled to claim an input tax credit on the costs of your legal representatives, we will not pay the GST included in this cost. You will need to pay the GST amount directly to your legal representative.

If you are not registered for GST or not entitled to an input tax credit on the costs of your legal representative, funding under this agreement will include any GST payable on your reasonable costs.

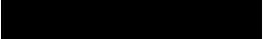
Compliant invoices

You will submit a request for payment in accordance with the attached Fact Sheet. We will only cover the costs described in the Fact Sheet.


Dispute resolution

Direct all disputes about this agreement or funding arrangements to the Inspector-General of Taxation.

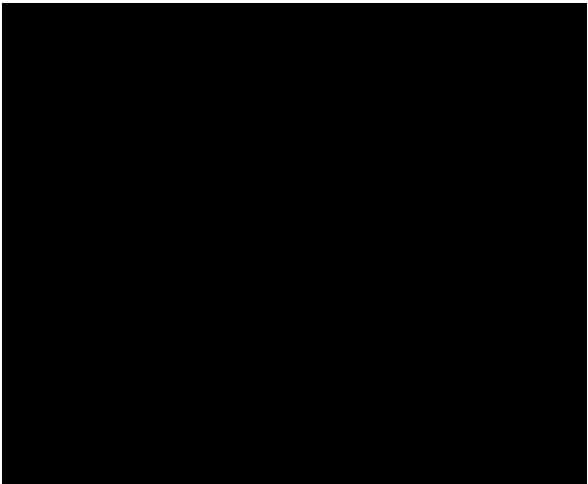
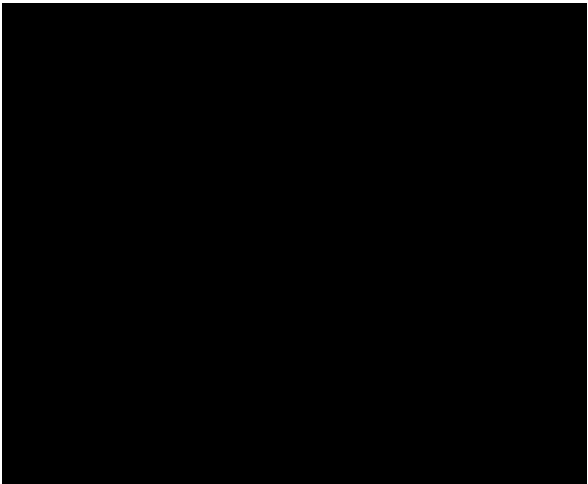
Signatures**Executed as an agreement:**

 (the 'Taxpayer') agrees to use the funding in accordance with this Letter of Agreement, the attached Funding Schedule and the enclosed Fact Sheet. These documents collectively form the agreement between the Taxpayer and the Commissioner in relation to the funding.

Taxpayer:

Full legal name of Taxpayer:	
Director's name: (print)	
Signature and date:	
Director/Company Secretary name: (print)	
Signature and date:	

Commissioner:

Signed for and on behalf of the Commissioner of Taxation	
Name: (print)	
Position: (print)	
Signature and date:	
Witness Name: (print)	
Signature and date:	



DR IB 2019/1 Small Business Taxation Division, AAT

This Dispute Resolution Instruction Bulletin provides the ATO policy on conducting litigation in the Small Business Taxation Division of the AAT.

This Instruction Bulletin is an internal ATO document, and is an instruction to ATO staff.

Instruction Bulletins are authorised by SES officers in Review and Dispute Resolution business line. It is important that all litigation staff note that this bulletin constitutes directions issued under the authority of the Commissioner.

1. Purpose

This Bulletin sets out our policy and principles on conducting litigation in the Small Business Taxation Division of the Administrative Appeals Tribunal (AAT).

The ATO is committed to working with all taxpayers to resolve disputes as fairly, quickly, economically and cooperatively as possible.

2. Background

The Small Business Taxation Division was created in 2019 as part of broader government policy to improve access to justice for small businesses appealing the outcome of a dispute with the ATO.

Unrepresented small businesses also benefit from additional support through the Small Business Concierge Service, which provides subsidised legal advice arranged by the [Australian Small Business and Family Enterprise Ombudsman \(ASBFEO\)](#).

Cases in this Division that could satisfy the criteria for the [Test Case Litigation Program](#) should be referred to the Test Case Funding team.

3. Engagement of external legal service providers

As a general rule the ATO will not be represented by external legal counsel in the Small Business Taxation Division of the AAT.

Engagement of external legal service providers in this Division should be the exception and considered by the ATO in circumstances only where a case features:

- significant technical or factual complexity
- issues of significance or high sensitivity, or
- a precedential ATO view is being challenged.

A decision by the ATO to engage external legal service providers must be notified to the taxpayer and the AAT within 2 days of that decision being made.

4. Administration and payment of costs

Where the ATO engages an external legal service provider and the taxpayer does not have legal representation then the ATO will provide to the taxpayer funding for equivalent legal representation.

The amount of funding will be equal to the taxpayer's reasonable costs of its legal practitioners. The reasonable costs will be calculated consistent with the calculation of reasonable costs already paid by the ATO under the ATO's Test Case Litigation Program.

It will include the reasonable costs of the taxpayer's solicitor, even if the ATO only engages counsel. As the funding is intended to be equivalent funding, where the Commissioner only engages junior counsel, funding for counsel will be limited to funding of junior counsel only.

Accessing legal advice through the ASBFEO Concierge Service does not constitute legal representation for the purposes of this Bulletin. Additionally, a tax agent who is not also a practicing lawyer is not considered a legal representative.

The RDR case funding team within Review and Dispute Resolution (RDR) will be responsible for administering the payment of costs relating to legal representation for taxpayers.

Any litigation officer engaging an external legal service provider must promptly inform the RDR case funding team and the officer must:

- email the RDR case funding team to advise of the matter, and
 - provide the latest version of any case management plan
 - provide the details of the type or nature of counsel engaged by the ATO and quoted costs for service
 - ensure that ATO external service provider cost estimates are quoted as accurately as possible.

- ensure that any changes regarding costs and billing are communicated in a timely manner to the RDR case funding area.

The RDR case funding team will then inform the taxpayer and the AAT:

- that the ATO is engaging a legal service provider to represent the ATO in the Small Business Taxation Division matter
- the quoted cost estimate of the ATO's legal service provider
- the amount of costs the ATO will commit to pay for the taxpayer's legal representation, and
- that ASBFEO maintains a list of legal services providers vetted by ASBFEO, but that the taxpayer is not limited to using providers on this list.

On agreement with the taxpayer the ATO will prepare a funding deed that specifies the terms and conditions for payment. The payment amount will be based on the cost estimates of the legal representation for the ATO. If a taxpayer disagrees with the amount of costs that the ATO is willing to commit to pay for the taxpayer's legal representation, the dispute may be referred to the Inspector-General of Taxation (the IGT) for dispute resolution by either of the parties.

Payment of a taxpayer's costs should be made directly to the taxpayer. The payment would be subject to the terms and conditions of payment under the funding deed. The payment process would follow similar procedures as is administered by the [Test Case Litigation Program](#).

Where a decision made by the Small Business Taxation Division is appealed by the ATO to the Federal Court, the ATO will fund the taxpayer's legal representation in the Federal Court on a reasonable costs basis.

There may be tax consequences in relation to payments made to taxpayers as reimbursement of expenditure, or payments made to third parties in respect of services provided to the taxpayer. We recommend that taxpayers obtain advice on this from their legal representative.

5. Test Case Litigation Program

Cases in this Division with the potential to create precedent should be referred to the Test Case Litigation Program. Where the case is eligible for test case funding the taxpayer's reasonable costs of legal

representation will be paid regardless of whether the Commissioner is represented by external legal counsel.

6. Other matters

The ATO will not enforce recovery of the tax debt in dispute before the Small Business Taxation Division other than in exceptional circumstances.

More information

For more information, related Practice Statements and relevant legislative references see:

- [Legal Services Directions 2017](#)
- [Attorney General's Department website](#)
- [Office of Legal Services Coordination \(Attorney General's Department\)](#)
- [AAT Practice directions, guides and guidelines](#)
- [Guide to the Small Business Taxation Division \(AAT\)](#)
- [Administrative Appeals Tribunal Amendment \(Small Business Taxation Division\) Regulations 2019](#)
- [ASBFEO Concierge Service](#)
- [DR IB 2013/1 Role of Dispute Resolution Information Bulletins](#)
- [DR IB 2013/14 Test Case Litigation](#)
- [PS LA 2009/9 Conduct of ATO litigation and engagement of ATO Dispute Resolution](#)

Approved by: Grahame Tanna
Assistant Commissioner, Dispute Resolution

Date of publication: 20 March 2019