

**Follow-up review into the Tax Office's  
implementation of agreed  
recommendations included in the six  
reports prepared by the Inspector-General  
of Taxation between August 2003 and  
June 2006**

**A report to the Assistant Treasurer**

**Inspector-General of Taxation  
December 2007**

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ISBN 0 642 74415 7

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19 December 2007

The Hon Chris Bowen MP  
Assistant Treasurer  
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Canberra ACT 2600

Dear Minister

I am pleased to present to you my report in respect of the review into the Tax Office's implementation of agreed recommendations included in the first six reports prepared by my office.

The review was announced on the 29 June 2006. This report has been prepared under section 10 of the *Inspector-General of Taxation Act 2003*.

I have provided the Commissioner of Taxation with the opportunity to respond to the report's findings. The Tax Office's response is in Appendix 3 to the report.

The Tax Office agreed wholly or in part to implement 65 of the 73 recommendations made in the six reports. The main focus of the review was to investigate to what extent the Tax Office has implemented the agreed recommendations. I am pleased to report that the Tax Office has implemented or made significant progress with the vast majority (62 of the 65) of the agreed recommendations.

This outcome is a positive reflection on the valuable contribution of information, time and support by taxpayers and their advisers, the outcomes of the work of my office and fulfilment of my role, and on the Tax Office's own commitment to improving tax administration. This is a true community partnership in seeking to improve Australia's tax administration systems.

This review has taken somewhat longer than I would have liked; but I note that the process has been akin to undertaking six separate reviews — albeit of a smaller scale than the norm. This has tended to multiply the time taken to obtain information, undertake consultation and allow the Tax Office time required under our protocol to comment on draft chapters. Detailed field work has also been undertaken to test implementation status of many recommendations.

This thorough approach has given me confidence in the overall positive findings and also that my reviews have led to significant improvements in tax administration.

In due course I will undertake a follow-up of the five reviews that have been completed since May 2006 (which were therefore outside the scope of this review) and other reviews currently underway.

In the report I have acknowledged the assistance of the many Tax Office staff who provided both time and information in support of the review process.

Yours faithfully

David Vos AM  
Inspector-General of Taxation



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# CHAPTER 1: INTRODUCTION

## INITIATING THE REVIEW

1.1 This is the report on the follow-up review into the Tax Office's implementation of recommendations included in all six publicly released reports prepared by the Inspector-General of Taxation (Inspector-General or IGT) from the Office's inception in August 2003 to June 2006. The review was conducted pursuant to subsection 8(1) of the *Inspector-General of Taxation Act 2003* (IGT Act), being a review conducted on the initiative of the Inspector-General.

1.2 The Inspector-General considered it important and necessary to assess, after a reasonable period, the implementation of improvements to tax administration recommended in his reviews and agreed to by the Tax Office. The extent of implementation is a reflection both on the outcomes of the work of the Inspector-General and on the Tax Office's openness to scrutiny and commitment to making improvements.

1.3 It is also a reflection of the valuable contribution made by accounting, tax, legal and business organisations and their members to the Office of the Inspector-General of Taxation. These organisations have provided submissions and the time, and other material, to the Inspector-General's office to enable particular reviews to be undertaken.

1.4 This review was announced on 29 June 2006. Its terms of reference are reproduced at Appendix 1 to this report. Details of how the review was conducted are provided in Appendix 2. The Second Commissioner's detailed response to the review is in Appendix 3.

## SCOPE AND FOCUS

1.5 As of 30 June 2006, the Inspector-General had completed the following reports on systemic tax administration issues identified through consultation as relevant to stakeholders:

- Review of Tax Office Management of Part IVC Litigation (publicly released 7 August 2006).
- Review into Tax Office Audit Timeframes (publicly released 28 September 2005).
- Review into the Tax Office's Administration of Penalties and Interest Arising from Active Compliance (publicly released 28 September 2005).
- Review into the Tax Office's Small Business Debt Collection Practices (publicly released 24 May 2005).
- Review of Tax Office Administration of GST Refunds Resulting from the Lodgement of Credit BASs (publicly released 24 May 2005).

- Review of the Remission of the General Interest Charge for Groups of Taxpayers in Dispute with the Tax Office (publicly released 18 November 2004).

1.6 In these reviews the Inspector-General made a total of 73 recommendations for improvement, of which the Tax Office agreed to implement 65, wholly or in part. The following table shows the numbers of recommendations for each review:

IGT Review	Number accepted/total recommendations
Review of Tax Office Management of Part IVC Litigation	27/32
Review into Tax Office Audit Timeframes	4/4
Review into the Tax Office's Administration of Penalties and Interest Arising from Active Compliance	4/4
Review into the Tax Office's Small Business Debt Collection Practices	2/2
Review of Tax Office Administration of GST Refunds Resulting from the Lodgement of Credit BASs	12/12
Review of the Remission of the General Interest Charge for Groups of Taxpayers in Dispute with the Tax Office	16/19*
<b>Total</b>	<b>65/73</b>

\* Findings

1.7 The main focus of this follow-up review was to investigate to what extent the Tax Office has implemented the agreed recommendations. Throughout the review, particular attention was given to:

- evidence of a commitment to timely implementation of agreed recommendations;
- Tax Office policies and procedures in respect of implementing these recommendations, including systems used to monitor implementation and to report progress to senior management;
- processes adopted by the Tax Office where relevant to communicate to taxpayers changes brought about by the implementation of the recommendations; and
- determining whether the Tax Office had addressed systemic issues identified in the reports.

1.8 In assessing the implementation status of particular recommendations, the Inspector-General has used the following terms:

- **Implemented** — this term means that the Tax Office has demonstrated to the Inspector-General that the particular recommendation has been satisfactorily addressed. In some cases this status has been allocated to a recommendation where some work remains to be done, but only where there are detailed plans, actions and commitment to complete implementation in a short timeframe.
- **Partly implemented** — this term means that the Tax Office has not only commenced implementation but has made substantial progress and is actively pursuing completion.
- **Not implemented** — this term means that the Tax Office has, in the Inspector-General's view, not made satisfactory progress and is falling well short of implementing the recommendation.

1.9 During the course of the review, the Tax Office worked with the Inspector-General's office to make changes to some of its implementation work in order to demonstrate an implemented or partly implemented status. This was a very satisfactory and cooperative process. It demonstrated that following up on implementation is not simply an exercise of establishing status but can of itself assist in clarifying expectations and making improvements.

## **ACKNOWLEDGEMENTS**

1.10 The assistance and cooperation provided by the Commissioner of Taxation and his officers to the Inspector-General and his team during the course of the review are gratefully acknowledged. The Inspector-General acknowledges with thanks the staff of the Australian National Audit Office.

## **STRUCTURE OF THE REPORT**

1.11 Chapter 2 of this report provides a summary of what the review found.

1.12 A chapter for each of the Inspector-General's six reviews is provided with a more in-depth analysis of the status of implementation.

1.13 Chapter 9 of this report discusses how the Tax Office:

- monitors and reports on the implementation of IGT recommendations to senior Tax Office management; and
- communicates to taxpayers of the changes brought about by the implementation of recommendations.

1.14 Appendix 1 contains the terms of reference issued upon the announcement of the review.

1.15 Appendix 2 contains a summary of how the review was conducted.

1.16 Appendix 3 is the formal response to the review received from the Second Commissioner of Taxation (Law).

1.17 Appendix 4 lists the meaning of abbreviations used in this report.



## CHAPTER 2: OVERVIEW AND SUMMARY

2.1 The Tax Office has implemented\*\* or partly implemented\*\* 62 of the 65 agreed recommendations made by the Inspector-General in his first six reviews and, in doing so, has made significant improvements to tax administration. A few agreed recommendations have not been implemented, but all have been progressed by the Tax Office to some extent. The following table summarises from a numerical perspective the findings of this review:

### Implementation of IGT recommendations

IGT Review	Number of IGT recommendations in the review	Number accepted by the Tax Office	Number <i>partly</i> implemented**	Number implemented**
Review of Tax Office Management of Part IVC Litigation	32	27	3	23
Review into Tax Office Audit Timeframes	4	4	0	4
Review into the Tax Office's Administration of Penalties and Interest Arising from Active Compliance	4	4	0	4
Review into the Tax Office's Small Business Debt Collection Practices	2	2	0	0
Review of Tax Office Administration of GST Refunds Resulting from the Lodgement of Credit BASs	12	12	1	11
Review of the Remission of the General Interest Charge for Groups of Taxpayers in Dispute with the Tax Office	19*	16	0	16
<b>Total</b>	<b>73</b>	<b>65</b>	<b>4</b>	<b>58</b>

\* Findings \*\* See paragraph 1.8 for explanation of these terms.

2.2 Some of the key improvements which this review has confirmed as implemented by the Tax Office include:

- fairer penalty and interest remission policies both in the broad and in respect of fairer outcomes for people caught up in compliance activity on certain Employee Benefit Arrangements (EBAs);
- establishment of a Tax Office panel of senior officers to determine the appropriateness of widely based settlement offers;
- increased Tax Office capability to differentiate approaches between serial defaulters and debtors who seek to comply but need short-term assistance to do so;
- improved communication during audits including commencement and finalisation notifications and progress reports;

- practical and accessible information for the community and directions to Tax Office staff regarding the remission of interest charges, particularly around interest prior to the issue of an amended assessment;
- significantly reduced amounts of GST refunds that are held up for compliance checking from \$20.48 billion (65 per cent of total GST refunds) in 2003-4 to \$12.94 billion (31 per cent of total GST refunds) in 2006-7, and greater transparency in reporting;
- a new reporting system which monitors not only the processing times of refunds but also reasons for delay;
- correction of Tax Office practices where taxpayers were inappropriately being charged interest for periods of Tax Office-caused delays;
- promptly published *decision impact statements* to inform stakeholders of Tax Office intentions following significant court decisions;
- an independent review process for test case applications rejected by the Tax Office;
- improved reporting of test case program operations and outcomes;
- new management arrangements to bring together overall responsibility and authority for managing litigation;
- senior case management arrangements to intervene where matters appear to be taking too long to resolve or are going off the rails;
- Tax Office adoption of guidelines on what constitutes good administration when it decides to challenge a court interpretation of the law.

2.3 The review has also found significant delay in the implementation of some recommendations. Some recommendations relating to reviews conducted in 2005 have only recently been implemented, demonstrating the direct benefit of this follow-up on agreed recommendations.

2.4 A few recommendations have not been implemented by the Tax Office. This fact remains a concern to the Inspector-General in view of the time that has lapsed since a number of the recommendations were made. However, there are no recommendations that have not at least been progressed to some extent. For example:

- the Tax Office has a prolonged and ongoing process to develop an automated risk profiling capability that will enable debt management strategies to be based on the individual risk profile of the debtor. After more than two years since the recommendation was made, the Tax Office is still working through this process;

- the Tax Office has not provided evidence that it has considered or developed any changes to its own administrative approaches that would assist business to manage cash flows and to meet tax obligations as and when they fall due;
- guidelines for funding respondents' costs in Tax Office appeals against court and tribunal decisions adverse to the Commissioner are yet to be published.<sup>1</sup>

2.5 There have also been continuing delays, although more understandable, to the development of new systems, processes and procedures in line with a variety of the Inspector-General's recommendations, arising in part because of the prolonged Tax Office Change Program<sup>2</sup>. The Inspector-General notes that the Change Program is a massive undertaking that requires old systems to be locked down and strict prioritisation of new system capabilities that will inevitably stall some desirable changes.

2.6 Although these examples indicate that the Tax Office has more to do in order to fully address a few of the Inspector-General's recommendations, the Inspector-General knows from his more recent reviews that the Tax Office continues with its own significant agenda of improvements to tax administration.

2.7 A welcome aspect of this review has been the general willingness of the Tax Office to work with the Inspector-General's office to make changes to some of its implementation work in order to demonstrate an implemented or partly implemented status. This was a very satisfactory and cooperative process and has been facilitated with the deployment of senior executive Tax Office staff to ensure that assistance has been appropriately provided.

2.8 Other matters observed during the review included a review of the monitoring and reporting of the implementation of recommendations to senior Tax Office management. Monitoring of the progress with recommendations from all external scrutineers of the Tax Office is undertaken quarterly by the Tax Office's Audit Committee based on reports prepared by the Tax Office's Internal Audit Branch (IAB) from input by business lines. The IAB updates the Tax Office's Audit Committee as to the status of implementation. On the evidence of reports sampled, the Inspector-General found these reports to be patchy and they contained very limited analysis. The Tax Office has referred to a recently instigated project to improve and streamline the reporting process.

2.9 The second ancillary matter considered by the Inspector-General was how well the Tax Office has communicated to taxpayers about the implementation of the recommendations. As discussed later, the Tax Office has been quite proactive in undertaking appropriate forms of communication. These efforts must continue in view of the significant amount of change resulting from the implementation of the recommendations.

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1 The Tax Office continues to work with the Treasury and the Attorney-General's Department in the development of such guidelines.

2 The Tax Office Change Program is an extended update and improvement of online, phone and paper products, services and experiences for taxpayers. The Change Program comprises a number of stages and is proposed to continue through 2008 and 2009.

2.10 In summary, this follow-up review has demonstrated that the Tax Office has responded to reviews conducted by the Inspector-General. This is evidenced through the number of recommendations that have been implemented as well as through the corresponding improvements in Tax Office administrative practices and approaches. Given the number of recommendations involved, this represents a very positive outcome. Although work needs to be done to complete implementation of some recommendations, it is clear that the issues raised in the first six reviews of the Inspector-General's tenure are being addressed by the Tax Office.

2.11 In due course, the Inspector-General will follow-up Tax Office progress with implementation of agreed recommendations of the five<sup>3</sup> further reviews that have already been completed since May 2006 and any of the current reviews<sup>4</sup> that are completed and ready for follow-up at that time.

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- 3 Three Case Study Reviews into Research and Development Syndicates, Service Entities, and Living-Away-From-Home-Allowances; Review of the Potential Revenue Bias in Private Binding Rulings Involving Large Complex Matters (awaiting final response from the Tax Office); and Review into the Tax Office's Administration of GST Audits (awaiting final response from the Tax Office).
- 4 Four reviews are currently under way: Review into Aspects of the Australian Tax Office's Settlement of Active Compliance Activities; Review into the Non-lodgement of Income Tax Returns; Review into the Underlying Causes and the Management of Objections to Tax Office Decisions; and Review into the Tax Office's Administration of Public Binding Advice.

## CHAPTER 3: REVIEW OF TAX OFFICE MANAGEMENT OF PART IVC LITIGATION

### OVERVIEW OF THE APRIL 2006 IGT REVIEW

3.1 The 2006 review was conducted by the Inspector-General following a request made by the then Minister for Revenue and Assistant Treasurer for an evaluation of the test case litigation program. The remainder of the review was conducted by the Inspector-General following concerns raised by industry and tax practitioners about the Tax Office's administration of tax litigation arising from the appeal procedures of Part IVC of the *Taxation Administration Act 1953* (which deals with taxation objections, reviews and appeals).

3.2 The importance of tax litigation cannot be understated and is magnified in the overall tax system for a number of reasons:

- Litigation is part of the operation of the broader system of government at a higher level than the tax system itself. As both the practical and symbolic interface between the administrators of the laws and the judiciary in its role of determining how the laws apply, it brings into sharper focus foundational concepts of the broader system such as the right of those affected by government administrative decisions to have those decisions reviewed by a body which is independent of the original decision maker, and other principles of the rule of law.
- As well as resolving particular disputes, litigation contributes directly to the basis of ongoing administration of the laws, and may lead to the shaping (or re-shaping) of the laws in Parliament.
- Litigation often involves the more contentious, higher profile issues and engages significant players in adversarial positions. Some cases may be, or have been, perceived as having a flow-on financial impact to large numbers of people in the community.

3.3 The 2006 review found that the principles (or philosophy) which guide the Tax Office's involvement in litigation were not clear nor were they set out in any single Tax Office document. Tax Office statements on litigation indicated that it regarded litigation as an important part of its overall compliance program. The review found that the Tax Office's actual conduct in litigation indicated that its principal philosophy on litigation was that it is a means of validating the Tax Office view and ensuring that taxpayers comply with its view of the law. The review found that this compliance aim for litigation was also, in certain circumstances, overriding Tax Office involvement in activities which might lead to law clarification through objectively testing what the legislation means.

3.4 The review also noted Tax Office statements on litigation indicating that it sees litigation as having a role in clarifying the law in accordance with the Tax Office's view of the underlying policy of the law.

3.5 During the course of the 2006 review, the Inspector-General raised questions regarding the Tax Office's conduct in applying the outcomes of finalised court decisions. An

example of such conduct was surrounding the case of *Essenbourne*<sup>5</sup> where the Tax Office publicly stated that the Federal Court's construction of the fringe benefits tax provisions was not correct and was inconsistent with the Tax Office's understanding of the intent of the fringe benefits tax law.

3.6 Just prior to the finalisation of the 2006 review, the Tax Office provided the Inspector-General with opinions it had sought from the Solicitor-General and the Australian Government Solicitor's Chief General Counsel on this issue.<sup>6</sup> These opinions are on what constitutes good administration, rather than a matter of strict law. They refer to the rules of precedent and note that it would usually be inappropriate and unwise for an administrative decision maker to depart from decisions of single judges or of higher courts. In these opinions, the Solicitor-General and Australian Government Solicitor's Chief General Counsel set out some clear guidance for the Tax Office on what basis it is entitled to challenge a court decision and how it should proceed if it does so.

3.7 The 2006 review also found that funds available to the Tax Office for its test case litigation program had been significantly underspent over the 10 years of the program. It concluded there was scope to improve the management of the test case litigation program.

3.8 Overall the review concluded that there were a number of systemic deficiencies which confirmed the concerns held by industry and tax practitioners. To overcome these problems, the Inspector-General made a number of key and subsidiary recommendations. The Tax Office agreed with most of the recommendations. Some recommendations were only agreed in principle (such as Key Recommendation 5) and some required consideration by government rather than the Tax Office.

3.9 Of the reports that are the subject of this wider follow-up review, the report into the Tax Office's management of Part IVC litigation is the most recent (finalised in April 2006). Nonetheless, the Tax Office has had well over a year to finalise the implementation of the agreed recommendations.

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5 *Essenbourne Pty Limited v Commissioner of Taxation* (2002) FCA 1577.

6 These opinions are included in Appendix 4 of the Review of Tax Office Management of Part IVC Litigation (2006) — Inspector-General of Taxation.

## IMPLEMENTATION OF RECOMMENDATIONS

### KEY RECOMMENDATION 1

***The Tax Office should clearly articulate its corporate philosophy and approach to litigation in a formal and consolidated published policy or guidelines on tax litigation, such as a Litigation Charter.***

***The Inspector-General considers that this document should state that the primary aim of litigation for the Tax Office is to resolve disputes in a fair, timely and cost-effective manner, consistent with the rule of law.***

***There should also be community consultation in the development of a published policy or guidelines on tax litigation.***

***In this document the Tax Office should also affirm its commitment to administer the tax laws, as enacted by Parliament and interpreted by the courts, in an impartial and transparent manner. The Tax Office should also affirm that it will follow the results of finalised court decisions in other similar cases.***

***There should be wide community consultation in the development of any policy by the Tax Office on whether it should challenge finalised court decisions in certain circumstances. If the result of this process is that the Tax Office still considers that it will challenge finalised court decisions in certain circumstances, then the Tax Office should clearly and fully articulate those circumstances and its associated processes in its formal published policy or guidelines on litigation.***

***Pending the development of any such policy regarding challenging finalised court decisions, and its publication in a formal consolidated set of guidelines on litigation, the Tax Office should publicly affirm that it will follow the results of finalised court decisions in accordance with the criteria which have been formulated by the Commonwealth Solicitor-General and Chief General Counsel.***

### Subsidiary Recommendation 7.1

***The Tax Office should include, in its comprehensive published policy or guidelines on tax litigation, its philosophy and approach in applying and communicating to taxpayers and the community the outcome of finalised decisions.***

### Subsidiary Recommendation 7.2

***The Tax Office's philosophy and approach in applying and communicating to taxpayers and the community the outcome of finalised decisions should be consistent with its role of administering the tax laws in a fair, timely and cost-effective manner, consistent with the rule of law.***

## Tax Office Position

3.10 On 21 June 2007 the Tax Office issued a law administration practice statement (PS LA 2007/12 *Conduct of Tax Office Litigation in Courts and Tribunals*) on its approach to, and conduct of, litigation.

3.11 On 15 February 2007 the Tax Office issued practice statement (PS LA 2007/2 *Management of Decisions of Courts and Tribunals*) which outlines the procedures for managing all court and tribunal decisions and risks arising from those decisions.

3.12 The Tax Office is also moving to build a 'body' of law administration practice statements which together will form a consolidated published policy or set of guidelines on tax litigation.<sup>7</sup>

## IGT Analysis

3.13 As outlined above, the Tax Office is moving towards a consolidated 'body' of practice statements as its implementation response to Key Recommendation 1. The Tax Office has recently released a practice statement (PS LA 2007/12) on its approach to, and conduct of, litigation.

3.14 The Inspector-General regards full implementation of Key Recommendation 1 as a most important building block for the future management of Tax Office litigation and its role as a fair administrator in the eyes of the community.

3.15 Following the 2006 review, the Full Federal Court in its *Indooroopilly* decision<sup>8</sup> found cause to sternly criticise the Tax Office in relation to its basic role in administration as set by the Constitution. Such criticism is also now part of the context for this recommendation. These criticisms increase the need for the Tax Office to make a clear statement, similar to that set out by Allsop J in the *Indooroopilly* decision, on its approach to litigation that starts with understanding and accepting its role as distinct from the roles of government, Parliament and the judiciary.

3.16 The Inspector-General's analysis of the progress and quality of the Tax Office's implementation of Key Recommendation 1 should be seen in this context.

3.17 In response to this recommendation, the Tax Office agreed to produce only a practice statement rather than a more substantive publication in the mode of the Taxpayers' Charter. On this point the Inspector-General maintains the view expressed in his 2006 report that:

***2.49 The Inspector-General considers that a document of higher status than a practice statement is needed to promote community confidence in the Tax Office's philosophy on litigation. The Inspector-General also believes that this document needs to contain a formal affirmation of the Tax Office's role in relation to litigation as distinct from the roles of Government, Parliament and the Judiciary. Consultation processes for this document (and any accompanying practice statement) also need to embrace the views of the wider community as well as those of the professional bodies.***

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7 Tax Office report on the implementation of Inspector-General recommendations — June 2007.

8 Commissioner of Taxation v Indooroopilly Childrens Services Pty Ltd [2007] FCFA 16.

3.18 Perhaps exemplifying the procedural pitch of a practice statement rather than a more substantive publication, the opening title ‘Tax Office approach and philosophy to litigation’ is limited to one paragraph in PS LA 2007/12 as follows:

***1 The Tax Office conducts and manages its litigation in accordance with its obligations under the law, the Attorney-General’s Legal Services Directions 2005 (in particular the Model Litigant Guidelines), relevant Court and Tribunal rules and directions, and other relevant internal and external policies and guidelines. The Tax Office strives to have all disputes brought to finality in a fair, timely and equitable manner consistent with the law. In taxation disputes, the Tax Office argues its cases consistently with its published view of the tax law. The Tax Office recognises that recourse to the Courts and Tribunals not only provides final, fair and independent resolution of disputes, it will in some cases, achieve law clarification benefits for Government and the community.***

3.19 The Inspector-General considers that this brief statement of itself does not satisfy the first part of Key Recommendation 1 which sought a clear articulation of the Tax Office’s corporate philosophy and approach to litigation.

3.20 However, following discussions with the Inspector-General during this follow-up review, the ‘Principles that guide our conduct’ section of PS LA 2007/12 and PS LA 2007/2 now contains useful clarifications, commitments and consolidations on important points that were missing at the time of the 2006 review. The Inspector-General also notes that the Tax Office has not yet brought together its approach to litigation in a consolidated statement, but that it intends to do so.

3.21 Taken together, these principles express the key Tax Office corporate approaches to litigation and substantially satisfy the Inspector-General’s recommendation. In this context, the Inspector-General has also noted a recent strengthening of the Tax Office’s public expression of its commitment to the rule of law.<sup>9</sup>

3.22 The last two paragraphs of Key Recommendation 1 concern the issue of the Tax Office challenging finalised court decisions. As stated above, the Tax Office has issued PS LA 2007/2 outlining procedures for managing all court and tribunal decisions as well as the risks arising from those decisions. The practice statement contains a section (starting at paragraph 83) on the controversial issue of ‘Challenging a final court decision’. The section provides that:

***... there will be rare instances where the Tax Office will maintain a position that is contrary to an existing Court or Tribunal decision.***<sup>10</sup>

3.23 PS LA 2007/2 states that a decision to not follow a prior interpretation of a court that was not appealed will rest with the Chief Tax Counsel or Second Commissioner (Law).<sup>11</sup> The practice statement also outlines the Tax Office view as to the circumstances that must be present and the processes that must be followed before the Tax Office can challenge a finalised decision. The practice statements are consistent with the advice given to the Tax

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9 ‘The rule of law: a corporate value’, speech by Michael D’Ascenzo, Commissioner of Taxation, to the Law Council of Australia rule of law conference, Brisbane, 1 September 2007; and updated corporate Tax Office publications.

10 PS LA 2007/2 (at para 83).

11 Ibid.

Office on this issue by the Solicitor-General and the Australian Government Solicitor's Chief General Counsel which was provided during the Inspector-General's review.

#### **Implementation Status: Implemented**

The Tax Office has done as it agreed and produced two law administration practice statements as its way of implementing the recommendation.

The Inspector-General has examined the content of these practice statements and has discussed them with the Tax Office. The Inspector-General considers that their content substantially covers the issues that he sought to be clarified publicly by the Tax Office.

The Inspector-General remains of the view expressed in his original report that a consolidated publication of a higher profile than law administration practice statements is needed that contains more analysis and discussion of the foundations of the Tax Office's approaches to litigation. The Inspector-General notes that the Tax Office is committed to consolidating the two practice statements in due course and that this will provide another opportunity to produce a more substantial document.

#### **KEY RECOMMENDATION 2**

*The Tax Office should establish management arrangements which give a single area of the Tax Office overall responsibility and authority for the management of all aspects of litigated cases.*

#### **Tax Office Position**

3.24 The decision to move the 'final say' on litigation from the business lines to the new Law Sub-plan was communicated to Tax Office staff in July 2006. Within the Law Sub-plan, the Law & Practice business line is the single area that has overall responsibility and authority for the management of litigated cases. This new arrangement is reflected in PS LA 2007/12.

#### **IGT Analysis**

3.25 As discussed in Key Recommendation 1, the Tax Office has recently released a practice statement on its approach to, and conduct of, litigation (PS LA 2007/12). Included in PS LA 2007/12 is an outline of how the Tax Office manages litigation:

- Legal Services Branch (LSB) manages the Tax Office litigation program and is primarily responsible for managing legal risks to the Commissioner.

- Tax Counsel Network (TCN) is involved where there is a strategic litigation matter<sup>12</sup>, or if a matter relates to an existing priority technical issue (PTI).<sup>13</sup> In this type of litigation matter, TCN has the ‘final say’ as to the Tax Office view and the preparation of arguments. However, the level of involvement of TCN is at its discretion.<sup>14</sup>
- Business lines have responsibility for:
  - providing a statement of facts which cross-references to supporting evidence;
  - issuing assessments and amended assessments;
  - assessing risks posed to the Commissioner which arise from the litigation; and
  - developing a strategy to explain and manage the implications of the relevant court decision, and the associated compliance impact.
- Where TCN is not involved in litigation, LSB will be the final decision maker on all issues arising in the course of the litigation, including the technical argument and issues relating to the conduct of the litigation.

3.26 The above approach centres on either LSB or TCN managing litigation. Both of these work areas fall under a single body — the Tax Office’s Law Sub-plan. However, a close reading of PS LA 2007/12 raises some concerns regarding whether there will always be a single point of authority on all occasions; in particular, the ‘continuous role’<sup>15</sup> that the business lines have throughout the course of litigation including their responsibility:

*... for managing the risk associated with the case and dependent cases.*<sup>16</sup>

3.27 The above concerns are also raised with the provision in PS LA 2007/12 of an escalation process when members of the litigation team are unable to resolve an issue.<sup>17</sup> Nevertheless, the creation of the Law Sub-plan as well as the release of PS LA 2007/12 represents a position that is in line with the recommendation.

#### **Implementation Status: Implemented**

Shortly following the Inspector-General’s original report, the Law Sub-plan was made responsible for all aspects of the management of litigation.

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12 ‘Strategic litigation’ refers to litigation that leverages compliance through clarification of the law in key high-risk areas. Strategic litigation also includes cases where law clarification opportunities are not the primary objective, but the other risks to the Commissioner are sufficiently severe as to warrant a strategic corporate response. Strategic litigation is the wider term and will include all priority technical issue litigation (PS LA 2005/22 Litigation and priority technical issues — at para 6).

13 A priority technical issue (PTI) is a technical issue that 1) requires resolution by way of the formation and/or application of the Tax Office view of the law and 2) has been ranked as having a priority 1, 2 or 3 through the Tax Office’s PTI process.

14 PS LA 2007/12 (at para 52).

15 Ibid (at para 61).

16 Ibid (at para 58).

17 Ibid (at para 40 — escalation can be up to the level of the Chief Tax Counsel).

### KEY RECOMMENDATION 3

*The Tax Office should introduce risk management techniques to its management of tax litigation issues. It should start this process by defining the scope of the Commissioner's and the Tax Office's legal risk in collaboration with the Australian Government Solicitor (AGS) and counsel engaged by the Tax Office.*

#### Tax Office Position

3.28 The Tax Office considers that all litigation cases are risk-assessed at the commencement of litigation and that risks are reviewed throughout the course of litigation. Nevertheless, the Tax Office is to review current practices to ensure that the proposed consolidated litigation practice statement clearly articulates the factors that underlie its risk management approach. The Tax Office recently (1 July 2007) released practice statement PS LA 2007/16 *Risk management in litigation* that brings together its risk management approach in litigation.

#### IGT Analysis

3.29 It is expected that the above PS LA 2007/16 will be included as an annexure to the proposed consolidated practice statement on litigation (discussed in Key Recommendation 1). In summary, PS LA 2007/16 defines the legal risk of the Tax Office (at paragraphs 18-24).

3.30 The Tax Office confirmed in discussions held with staff from the Inspector-General's office that in preparing PS LA 2007/16, collaboration was not undertaken with the AGS or counsel engaged by the Tax Office.<sup>18</sup> This represents a failure by the Tax Office to implement one of the major recommendations of the 2003 Behm review.<sup>19</sup>

3.31 The Tax Office finally sought advice from the AGS late in the course of this follow-up review. The Tax Office has now indicated that it has recently (October 2007) received advice from the AGS regarding the scope of the Tax Office's legal risk.<sup>20</sup> The Tax Office recognises however that the advice must still be reviewed by counsel in order to fully satisfy the Behm review requirements. The advice contains a number of recommendations for improvement which the Tax Office is considering. The Tax Office has also committed to review whether any existing documents, including PS LA 2007/16, require updating once counsel has reviewed the advice.<sup>21</sup>

3.32 PS LA 2007/16 does not indicate that the Tax Office has introduced any new risk management techniques to its management of tax litigation issues. Furthermore, there is a distinct absence in PS LA 2007/16 of the need for the Tax Office to consider risk management from the perspective of the commercial and business environments that taxpayers operate

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18 Interview with the Senior Tax Counsel, Strategic Litigation (Tax Office) 16 April 2007

19 In 2003 the Tax Office's Chief Tax Counsel commissioned a major review (the Behm review) of its internal management of legal risk, including the management of the risks associated with its conduct of litigation on Part IVC matters.

20 ATO Minute 19 October 2007 (at p 2).

21 Ibid.

within. As outlined in the 2006 review, the Tax Office must include the risk management techniques used by the ordinary taxpayer.<sup>22</sup>

3.33 Also, as discussed in subsidiary recommendation 5.1, the level of reporting to the ATO Executive fails to include relevant risk management data such as the total quantum of tax in dispute.<sup>23</sup>

#### Implementation Status: Partly Implemented

The Tax Office has prepared a practice statement that brings together its risk management approach in litigation. However, the practice statement does not introduce any new risk management techniques to its management of tax litigation issues.

The Tax Office has also recently sought and received advice from the AGS regarding the scope of the Commissioner and the Tax Office's legal risk. The Tax Office is currently in the process of considering recommendations for improvement by the AGS.

#### KEY RECOMMENDATION 4

*The formal test case program (defined as the program under which a taxpayer makes a formal application for test case funding in accordance with funding criteria that have been publicised by the Tax Office) which is designed to fund cases which will clarify the law by establishing new legal principles should remain but new arrangements for the management of the test case program are needed. Precedents for an appropriate structure which deliver independence without being overly bureaucratic could be the existing Tax Agents' Boards or the Board of Taxation.*

#### Tax Office Position

3.34 The Tax Office responded to the Inspector-General's recommendation by stating that the responsibility for the establishment of a panel independent of the Tax Office to decide applications for test case funding is a matter for government.<sup>24</sup>

3.35 The Tax Office confirmed in discussions held with staff from the Inspector-General's Office that it would not provide any comment on whether the establishment of the new

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22 Review of Tax Office Management of Part IVC Litigation (2006) — Inspector-General of Taxation (key finding 5.2 at p 83).

23 This absence of appropriate risk management was prominently identified in the Inspector-General's 2006 review (Review of Tax Office Management of Part IVC Litigation — Inspector-General of Taxation (at 5.46)).

24 Review of Tax Office Management of Part IVC Litigation (2006) — Inspector-General of Taxation (at 6.190).

Taxation Test Case Funding Review Panel (see below) has provided a new form of management of the test case program.<sup>25</sup>

### IGT Analysis

3.36 In response to the Inspector-General's recommendation for increased independence in the test case funding process, the previous government established the Taxation Test Case Funding Review Panel (Review Panel) in August 2006. Taxpayers that have been unsuccessful in applying for test case funding can request that the decision made by the Tax Office Test Case Litigation Panel be reviewed by the Review Panel.<sup>26</sup>

3.37 The Review Panel is chaired by the Treasury, with three external members who are independent of both the Treasury and the Tax Office. The Review Panel met only for the first time on 15 December 2006 and therefore the Inspector-General's staff have not reviewed the effect of these new arrangements. Of note, there is no published information available for the general public about either the role or the activities of the Review Panel.

#### Implementation Status: Implemented

In August 2006 the previous government introduced the Taxation Test Case Funding Review Panel to review unsuccessful applications for test case funding. While this does not represent a new and independent management process for the whole test case program, it provides an avenue for more independent review and therefore addresses the recommendation. The Inspector-General is concerned that there is no published information available for the general public about either the role or the activities of the Review Panel.

### KEY RECOMMENDATION 5

*The Tax Office should fund taxpayers' expenses in defending the case in all cases where the Tax Office has been unsuccessful at any stage of litigation, a decision is made to appeal the relevant decision and it is fair and in the public interest for the Tax Office to fund the taxpayer's expenses. The Tax Office should develop and publicise appropriate guidelines for the funding of such cases.*

### Tax Office Position

3.38 The Tax Office currently funds the costs of taxpayers in small claims where the Tax Office appeals a decision of the Administrative Appeals Tribunal (AAT) or the Small Taxation Claims Tribunal, to protect small taxpayers from the costs of court litigation. Considerations of capacity to pay are relevant to this practice.

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25 Interview with the Senior Tax Counsel, Strategic Litigation (Tax Office) — 16 March 2007.

26 Unsuccessful applicants to the Tax Office Test Case Litigation Panel are notified in writing. Included in the notification is an outline of how taxpayers can request a review of the decision by the Taxation Test Case Funding Review Panel.

## IGT Analysis

3.39 The previous government asked the Treasury to consult with both the Attorney-General's Department and the Tax Office in the development of guidelines for funding respondents' costs in appeals against court and tribunal decisions adverse to the Commissioner.<sup>27</sup> The work towards reviewing the policy and developing the guidelines is continuing. A timeframe for completing this work appears not yet to have been determined.

3.40 Consideration will be given to whether any changed guidelines emanating from the Treasury review will also need to be included in the proposed consolidated practice statement on litigation.

### Implementation Status: Partly Implemented

The Tax Office continues to work with the Treasury and the Attorney-General's Department in the development of guidelines for funding respondents' costs in appeals against court and tribunal decisions adverse to the Commissioner.

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27 Review of Tax Office Management of Part IVC Litigation — Minister for Revenue and Assistant Treasurer Press Release — 7 August 2006.

## **KEY RECOMMENDATION 6**

*The Tax Office should introduce a standard communication product to communicate the application of finalised court and tribunal decisions. The content of any Tax Office communication should be consistent with its role of administering the tax laws in a fair and objective manner and could include for example:*

- *the issues to be decided by the tribunal or court;*
- *the implications of the decision on each of those issues;*
- *the implications of the decision on the Tax Office view;*
- *how the Tax Office will apply and follow the finalised decision;*
- *the reasons why the Tax Office will apply and follow the finalised decision in that manner; and*
- *whether the Tax Office will be seeking legislative amendments.*

### **Subsidiary Recommendation 7.3**

*The Tax Office should communicate, in a summarised form, its view of the application of all finalised court and tribunal decisions that involve a question of law within eight weeks of the date of the decision. By implication, this will include all finalised decisions considered by the Full Federal Court, the High Court and by the Federal Court on appeal from the Administrative Appeals Tribunal.*

### **Subsidiary Recommendation 7.4**

*The Tax Office should also communicate, in a summarised form, its views of the application of all other decisions within similar timeframes, where it involves a priority technical issue or there is significant community interest in the outcome of the court or tribunal decision.*

### **Subsidiary Recommendation 7.5**

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

## **Tax Office Position**

3.41 In response to Key Recommendation 6 and subsidiary recommendations 7.3, 7.4 and 7.5 the Tax Office introduced onto its external website a new communication product advising taxpayers of the implications of adverse and significant court and tribunal decisions.

## IGT Analysis

3.42 Following the Inspector-General's recommendation, the Tax Office introduced in October 2006 a new page on its external website containing the Commissioner's response to adverse and significant court and tribunal decisions handed down post-1 July 2006. These responses (the decision impact statements) are required to be published no later than eight weeks after the relevant court or tribunal decision has been handed down. Each decision impact statement includes a discussion of the items recommended by the Inspector-General except for the matter regarding the Tax Office seeking legislative amendment following the handing down of a decision. The Tax Office has consulted with both the Treasury and the National Tax Liaison Group (NTLG) in respect of this last point and has concluded that the decision impact statement format would not include details regarding the Tax Office seeking legislative amendment.<sup>28</sup>

3.43 The Tax Office has also consulted with the Treasury and has concluded that it would be inappropriate for the Tax Office to include in the decision impact statement format any indication that a matter has been referred to the Treasury.<sup>29</sup>

3.44 The Inspector-General notes these conclusions and acknowledges that these details regarding the Tax Office seeking legislative amendment or referring matters to the Treasury cannot be included in all cases. However, the Inspector-General considers that for transparency, there is the potential to include in the decision impact statement format a discussion of proposed law changes.

3.45 A summary of the purpose of the decision impact statement is included at paragraph 70 of PS LA 2007/2 which was issued on 15 February 2007 (see Key Recommendation 1).

3.46 The structure of the decision impact statement includes a section outlining how the Tax Office's view (expressed in a public ruling, determination or interpretative decision) is impacted following the handing down of a court or tribunal decision. This includes reference to the items in subsidiary recommendation 7.5 (such as the relevant paragraphs of the particular ruling potentially affected by the court or tribunal decision).

3.47 Also in line with subsidiary recommendation 7.5, PS LA 2007/2 provides that:

***If there is any uncertainty surrounding a Court or Tribunal decision the Decision Impact Statement will explain how the Commissioner will administer the law pending any review of a published Ruling.***<sup>30</sup>

3.48 The functionality of the decision impact statement is enhanced for the purposes of subsidiary recommendation 7.5 with the insertion of hyperlinks providing direct access to appropriate rulings or determinations. In addition, these primary documents are correspondingly earmarked to indicate that they are under review following the release of the relevant court or tribunal decision (a link is included that takes the user back to the relevant decision impact statement).

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28 Interview with the Principal Legal Advisor, Strategic Litigation (Tax Office) — 12 June 2007.

29 This decision was made following the Tax Office's official response to the Inspector-General's 2006 review which stated that it would consult with the Treasury as to whether the decision impact statement format should refer to a situation where a matter has been referred to the Treasury (Review of Tax Office Management of Part IVC Litigation (2006) — Inspector-General of Taxation (at 7.65)).

30 PS LA 2007/2 (at para 71).

3.49 A further positive initiative is that external parties are given the opportunity to provide feedback to the Tax Office within eight weeks of the publishing of the decision impact statement (the contact officer is invariably the Tax Counsel of the particular case). Once this initial eight-week period has expired, the Tax Office sets up a generic Centre of Expertise (CoE) mailbox for the receipt of external submissions. This mailbox is managed by the National Management Team for the Centres of Expertise — any submission indicating the need for change is referred to the appropriate CoE and business line for consideration.

3.50 In relation to the issue of timeliness, PS LA 2007/2 provides that where it is not logistically possible to publish the decision impact statement within eight weeks, an interim statement should be prepared.<sup>31</sup> An example of where this has occurred is the interim statement published on the Tax Office's external website shortly following the handing down of the *Indooroopilly* decision<sup>32</sup>.

#### Implementation Status: Implemented

In October 2006 the Tax Office introduced a new page on its external website containing the Commissioner's responses to adverse and significant court and tribunal decisions handed down post-1 July 2006. These responses (referred to as decision impact statements) include a discussion of most of the suggested matters referred to in Key Recommendation 6 and subsidiary recommendations 7.3, 7.4 and 7.5.

Where possible they are to be published within eight weeks of the date of the decision. Where this is not possible, an interim statement is published.

The introduction of the decision impact statement has been well received by the community, including the NTLG, and is a welcome improvement in updating taxpayers about the application of important court and tribunal decisions.

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31 PS LA 2007/2 (at para 69).

32 Commissioner of Taxation v Indooroopilly Childrens Services Pty Ltd [2007] FCFA 16.

## IMPLEMENTATION OF SUBSIDIARY RECOMMENDATIONS

### Subsidiary Recommendation 3.1

*The Tax Office should publish a more complete picture of the outcomes of litigation to include information on the proportion of applications for review and appeals finalised without a hearing and the outcome.*

### Tax Office Position

3.51 The Tax Office case management system for the LSB<sup>33</sup> was modified in June 2006 to capture the information required as per this subsidiary recommendation. The Tax Office's 2005-06 annual report reflects these figures.

### IGT Analysis

3.52 Following these system improvements, the Tax Office has included in its 2005-06 annual report a table showing the outcome of cases that did not proceed to hearing during that financial year.<sup>34</sup> However, the annual report does not provide a breakdown of the large category of cases settled prior to litigation which were the subject of analysis by the Inspector-General in the 2006 review. Nevertheless, the Inspector-General notes that the Tax Office has recently introduced early resolution reports (see subsidiary recommendation 7.8).

3.53 The Inspector-General considers that there is much potential in the information contained in the early resolution reports to be used to gain a better understanding of why cases are being settled prior to hearing and to improve upstream processes. The Inspector-General believes that this information, together with improvements to be brought about under the Change Program (via the Siebel system<sup>35</sup>), would allow the Tax Office to undertake a more detailed analysis of settled cases.

### Implementation Status: Implemented

Modifications to the Tax Office's case management system have enabled the Tax Office to include in its 2005-06 annual report details regarding applications for review and appeal that have been finalised without a hearing. While this information does not of itself enable the analysis that was undertaken as part of the original 2006 review, the early resolution reports introduced by the Tax Office (as part of its response to subsidiary recommendation 7.8) are a worthwhile alternative.

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33 Known as 'Mind your Matters' (MyM).

34 Tax Office Annual Report 2005-06 (Table 4.6 at p 222).

35 Siebel is the system the Tax Office is rolling out to manage all client dealings in a consistent manner. In summary it comprises three main parts that will work together as one entire system — client relationship management, case management and work management. As a 'front-end client service' system to manage all client related work, Siebel will work with the Tax Office's 'back-end processing system, Integrated Core Processing (ICP)

#### **Subsidiary Recommendation 4.1**

***The Tax Office should develop practical guidelines for staff on the application of the model litigant guidelines.***

#### **Subsidiary Recommendation 4.2**

***The Tax Office, as part of its public statement on its philosophy and approach to tax litigation, should make taxpayers aware of the model litigant guidelines and that the Office of Legal Services Coordination is responsible for administering the model guidelines, including considering any alleged breaches of the model litigant guidelines. This should also include making taxpayers aware of the model litigant guidelines at the outset of litigation.***

#### **Tax Office Position**

3.54 The practice statement on the Tax Office's approach to, and conduct of, litigation (PS LA 2007/12), guides both staff and taxpayers on the application of the model litigant guidelines. In addition, the practice statement outlines the role of the Office of Legal Services Coordination (OLSC) in administering the guidelines.

3.55 The Tax Office also referred to its Legal Services/Legal Practice internal website which since 1999 has contained a Legal Practice Note advising staff about the model litigant guidelines. In addition, all briefs to counsel from the Commissioner in tax litigation matters contain copies of the guidelines.

3.56 The Tax Office has experienced delays in developing a process to include the model litigant guidelines together with an outline of the above-mentioned role of the OLSC in all disallowed and allowed-in-part objection decisions. These delays have been due to resource constraints surrounding the implementation of the Tax Office's Siebel case management system.<sup>36</sup>

#### **IGT Analysis**

3.57 As stated in Key Recommendation 1, the Tax Office has recently released a practice statement on the conduct of litigation (PS LA 2007/12) which includes:

- direction for staff regarding the application of the model litigant guidelines as well as a general outline of the guidelines for taxpayers (paragraphs 12–15); and
- an outline of how the OLSC is responsible for administering the model litigant guidelines including the consideration of any breaches of the guidelines (paragraphs 19–21).

3.58 The Tax Office has also introduced a new procedure whereby Tax Office staff include the model litigant guidelines and details of the role of the OLSC into all disallowed and allowed-in-part objection decisions. This procedure has been introduced to satisfy the

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36 The Tax Office is undergoing a staggered implementation of the new Siebel Case Management system designed to allow its officers to more effectively manage client cases whilst working in conjunction with other Tax Office systems (such as the Client Relationship Management system).

final part of subsidiary recommendation 4.2 with respect to making taxpayers aware of the model litigant guidelines at the outset of litigation. In other words, receipt by the taxpayer of the objection decision (containing these additional outlines) is the point of time when a decision to commence litigation is undertaken.

#### **Implementation Status: Implemented**

The Tax Office has recently released PS LA 2007/12 which includes direction for staff regarding the application of the model litigant guidelines as well as a general outline of the guidelines for taxpayers. The practice statement also includes an outline of the role that the OLSC has in relation to the model litigant guidelines.

The Tax Office has introduced a new procedure to include the model litigant guidelines and details of the role of the OLSC in all disallowed and allowed-in-part objection decisions.

#### **Subsidiary Recommendation 4.3**

*The Tax Office should introduce an escalation process whereby senior tax officers or independent counsel, at the request of taxpayers or their representatives, may administratively review alleged breaches of the model litigant guidelines and departures from the Tax Office's stated philosophy and approach to litigation.*

#### **Tax Office Position**

3.59 The Tax Office has set out in the practice statement on the conduct of litigation (PS LA 2007/12) the escalation process whereby alleged breaches of the model litigant guidelines and departures from the Tax Office's approach to litigation are able to be reviewed independently.

#### **IGT Analysis**

3.60 Paragraphs 19–23 of PS LA 2007/12 provide that persons external to the Tax Office that become aware of alleged breaches of the model litigant guidelines should report the matter to either the Attorney-General or the OLSC. Tax Office staff aware of such breaches can escalate the matter to the Tax Office's General Counsel who will ensure that the matter is investigated, and where appropriate reported to the OLSC.

3.61 Paragraph 29 of PS LA 2007/12 provides that taxpayer complaints regarding the Tax Office's conduct in respect of litigation (other than those types of matters handled by the OLSC) are to be considered by a senior officer, usually the LSB Stream Leader or a member of the LSB Executive.

## Implementation Status: Implemented

The Tax Office has recently released PS LA 2007/12 which includes an outline of how breaches of the model litigant guidelines as well as other alleged breaches of the Tax Office's approach to litigation are to be escalated.

## Subsidiary Recommendation 4.4

*The new area of the Tax Office responsible for the management of all aspects of litigation should establish a formal process under which the terms of existing Tax Office rulings are urgently reviewed either internally by the Tax Office or by outside parties where, during the litigation process, doubts arise as to the correctness of the rulings.*

## Tax Office Position

3.62 The Tax Office considers that its current practice of escalating issues to the TCN where doubts arise about the correctness of a Tax Office ruling<sup>37</sup> '*... have been working well*'.<sup>38</sup> However, following discussions with the Inspector-General, the Tax Office has recently decided:

*... to develop a more robust process to ensure that rulings will be reviewed urgently during the course of litigation where we [the Tax Office] have accepted legal advice that our ruling is wrong.*<sup>39</sup>

## IGT Analysis

3.63 The Tax Office continues to escalate these matters to the TCN in the same manner that occurred during the Inspector-General's original review in 2006. However, as mentioned above, the Tax Office has committed to develop new procedures to ensure that rulings will be reviewed urgently during the course of litigation (where the Tax Office has accepted legal advice that a ruling is wrong). The main part of this change will be to amend existing Tax Office practice statements to reflect that:

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37 This practice is provided for in practice statements PS LA 2005/22 Litigation and priority technical issues and PS LA 2003/10 The Management of Priority Technical Issues. This practice has also been restated by the Tax Office in a draft practice statement titled 'Tax Technical Litigation in the Federal Court' and a further draft practice statement titled 'Briefing Counsel' that are also to form a part of the consolidated practice statement on tax litigation (referred to in Key Recommendation 1).

38 ATO Minute 13 September 2007 (at p 3).

39 Ibid.

- the issue in question will be escalated to the TCN with a fast-tracked PTI proposal<sup>40</sup> (a PTI proposal for these types of cases will always have the highest priority); and
- the Deputy Chief Tax Counsel (DCTC) will determine the timeframe for resolving the issue having regard to the relevant urgency of the litigation.<sup>41</sup>

3.64 The Tax Office has also committed to amend PS LA 2005/22 *Litigation and priority technical issues* in order to document the practice of conceding a matter in litigation at the direction of a DCTC where the Tax Office has received and considered the advice from counsel that a Tax Office ruling is unsupportable.<sup>42</sup>

#### Implementation Status: Implemented

Following discussions with the Inspector-General, the Tax Office has committed to develop new procedures to ensure that where during the course of litigation the Tax Office has accepted legal advice that a ruling is wrong, it will ensure that the ruling is urgently reviewed. The Tax Office has detailed the new procedures and implementation is underway.

#### Subsidiary Recommendation 5.1

*The Tax Office should introduce reporting systems under which its Executive is aware of the total state of all Tax Office Part IVC litigation, including the extent to which cases being litigated have produced negative revenue results.*

#### Tax Office Position

3.65 On a monthly basis the LSB provides the ATO Executive with a report outlining:

- stock of cases on hand;
- resources used;
- standards achieved in terms of timeliness and quality; and
- trends (current month compared to previous month).

3.66 LSB also provides the ATO Executive with a monthly strategic litigation report listing the status of:

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40 A 'PTI' (priority technical issue) is an issue of an interpretative nature that requires a prioritised approach to resolution. Put simply, every possible assistance is provided to ensure that the issue is promptly resolved. The Priority Technical Issues Committee which is chaired by the Second Commissioner (Law), meets on a six-weekly basis and provides guidance and direction in the management of PTIs within the established corporate framework (including monitoring and intervention as required to ensure timely resolution).

41 ATO Minute 13 September 2007 (at p 3).

42 This would be an exception to the general principle that the Tax Office argues its cases consistently with its rulings — ATO Minute 13 September 2007 (at p 3).

- decisions handed down during the month;
- new appeals and finalised matters;
- matters listed for hearing; and
- the status of cases currently before the courts and the AAT.

3.67 The Tax Office considers that the above report meets current needs but will remain under constant review and refinement in light of the subsidiary recommendation.

## IGT Analysis

3.68 The above-mentioned reports fail to include details regarding:

- the value in monetary terms of the cases on hand;
- the revenue at risk<sup>43</sup>; or
- the tax in dispute.

3.69 This type of information would obviously enable the ATO Executive to monitor the level of revenue tied up with litigation and whether the amounts involved are problematical. The Tax Office confirmed in discussions held with the Inspector-General's staff that the ATO Executive are not provided with reports containing this type of information nor the extent to which cases being litigated have produced negative revenue results (contrary to subsidiary recommendation 5.1).<sup>44</sup>

3.70 Following the Inspector-General's 2006 review, changes were made to the Tax Office's litigation case management system (MyM) to record the above information (apart from the negative revenue results). As these system changes only arose mid-financial year, the Tax Office decided not to commit to reporting until the start of the 2007-08 financial year.<sup>45</sup> The Tax Office's intent to introduce this level of reporting to the Law Sub-plan Executive is stated in the recently released PS LA 2007/12:

***LSB also reports to the Law Sub-plan Executive across all litigation work types, including volume trends, resource costs and the amount of revenue at risk.***<sup>46</sup>

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43 ATO Minute 19 June 2007 (at p 2).

44 Interview with the Senior Tax Counsel, Strategic Litigation (Tax Office) — 16 April 2007.

45 ATO Minute 19 June 2007 (at p 2).

46 PS LA 2007/12 (at para 75) — released 21 June 2007.

### Implementation Status: Implemented

The LSB reports on a monthly basis to the ATO Executive on a number of results arising from the litigation program. Reporting of the financial position of the program is currently not provided (nor requested by the ATO Executive<sup>47</sup>). The Tax Office has stated in the recently released PS LA 2007/12 its intent to provide this level of reporting to the Law Sub-plan Executive. This will result in an adequate suite of reports being provided to the ATO Executive and to senior management.

### Subsidiary Recommendation 5.2

*The Tax Office should be more transparent in communicating the overall results of its litigation program (including the number and dollar value of cases heard by a court or tribunal, the number and dollar value of cases settled or resolved by other means and the total costs incurred by the Tax Office in resolving all these disputes) to enable the public to assess whether the Tax Office's overall litigation program is being conducted effectively, fairly and with minimum cost.*

### Tax Office Position

3.71 The Tax Office will examine, in the context of the Tax Office's Change Program, ways to improve the reporting of cases which are litigated, as well as cases that are resolved by other means. Commencing in the 2007-08 annual report, the Tax Office will report the numbers of substantive tax-related court decisions at each level of the judiciary (excluding debt cases).<sup>48</sup>

### IGT Analysis

3.72 The Tax Office is in the initial stage of implementing changes to its litigation case management system (MyM) in order to provide the level of reporting recommended in the Inspector-General's 2006 review. The Tax Office plans to complete this project by the end of 2008.

### Implementation Status: Implemented

As part of the Change Program, the Tax Office is working towards the implementation of a new litigation case management system that will enable appropriate reporting to the public of the effectiveness of the litigation program. The Tax Office has already increased the level of its reporting of litigation and its 2007-08 annual report will further expand this to include more detailed information on litigation.

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47 Interview with the Senior Tax Counsel, Strategic Litigation (Tax Office) — 16 April 2007.

48 ATO Minute 13 September 2007 (at p 3).

### Subsidiary Recommendation 5.3

*The Tax Office should ensure that adequate support tools (such as a database of precedents, adequate facilities to interview taxpayers and/or their representatives, and adequate continuing legal education) are developed for Tax Office staff that are responsible for the actual conduct of cases.*

### Subsidiary Recommendation 5.4

*The Inspector-General recommends that a consolidated and up-to-date set of litigation reference material should be developed and made available to all Tax Office staff.*

## Tax Office Position

3.73 The Tax Office has a number of support tools, including a litigation manual, litigation flow charts and the Significant Issues Litigation Committee (SILC) process<sup>49</sup> to provide guidance to legal services staff. The Tax Office has recently updated its reference materials, including practice statements, instruction bulletins and reference manuals which apply to litigation. These materials have been added to internal websites and shared drives for reference by Tax Office staff.

## IGT Analysis

3.74 The Tax Office has set up a litigation reference database (the Legal Services Branch Portal) which contains:

- new developments in litigation practice within the Tax Office;
- a link to a precedent database;
- access to core legal reference databases such as CCH, ATP (Thomson), LexisNexis, AustLII;
- learning and development materials;
- court lists;
- links to material relating to specific areas of law — for example settlement procedures to be followed by LSB staff;
- links to a number of other databases.

3.75 The portal is maintained and updated by a designated research librarian (deployed to LSB).

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49 SILCs are convened by the LSB officer at every critical stage of all court and tribunal matters. Other attendees at the SILC will vary depending on the business line involved and the strategic importance of the cases, but are likely to include relevant officers from the Tax Office business line, CoE and the TCN.

3.76 A national training coordinator has been engaged to develop, implement and evaluate the learning and development strategy for LSB. LSB staff now have access to an electronic training calendar that contains training opportunities available over the forthcoming three-month period. The calendar focuses on priority topics and assists staff with monitoring their continuing legal education requirements. The functionality of the calendar is supported by additional material provided in the portal regarding forthcoming training opportunities.

3.77 Following the Inspector-General's 2006 review, LSB staff completed a survey that provided feedback on the support tools available to staff. Some key results from the survey include:

1. around 79 per cent of staff that completed the survey considered that the level of learning and development was satisfactory or more than satisfactory;
2. 47 per cent of staff that completed the survey considered that support tools in LSB were either inadequate or barely adequate;
3. 49 per cent of staff that completed the survey considered that interviewing facilities were inadequate or barely adequate.

3.78 In respect of point 2 the Tax Office referred to the implementation of the new portal and in respect of point 3 the Tax Office indicated that the report is currently with the ATO Executive for consideration.<sup>50</sup>

3.79 The Tax Office has recently (October 2007) advised that it has upgraded interviewing facilities for staff in Canberra and Sydney and that it is committed to doing so in other locations when new fit outs are due.

#### **Implementation Status: Implemented**

The Tax Office has developed a sophisticated litigation reference portal that provides LSB staff with access to a wide variety of technical resources. The continued learning and development of staff is now managed on a national level by a designated training coordinator. The Tax Office has recently upgraded facilities for staff in two major locations and is committed to continuing that process.

#### **Subsidiary Recommendation 5.5**

*The Tax Office should develop a reference document which sets out all of its procedures for handling litigated matters which do not involve priority technical issues.*

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50 Interview with the Senior Tax Counsel, Strategic Litigation (Tax Office) — 16 April 2007.

## Tax Office Position

3.80 The Tax Office proposes to develop a single consolidated practice statement which will set out its procedures for handling litigation matters.

## IGT Analysis

3.81 As indicated in Key Recommendation 3, the Tax Office intends to develop a consolidated practice statement on tax litigation which amongst other matters is to set out procedures for the handling of litigated matters which do not involve priority technical issues.<sup>51</sup> PS LA 2007/12 does not specify particular procedures for non-PTI cases, but a substantial amount of the practice statement appears to cover both PTIs and non-PTIs.

### Implementation Status: Implemented

The principles and procedures in PS LA 2007/12 appear to cover both PTI and non-PTI cases in many areas. The Tax Office intends to develop a consolidated practice statement which will include the handling of litigated matters which do not involve priority technical issues.

### Subsidiary Recommendation 5.6

*The Tax Office's LSB area should develop appropriate file and record-keeping procedures for litigated cases. Processes should also be established to monitor the application of these procedures, to review their effectiveness and to implement any necessary improvements.*

## Tax Office Position

3.82 The LSB is in the final stages of updating its File Management Protocol (originally released in May 2001). Following the Inspector-General's 2006 review, the Tax Office also developed an internal corporate management practice statement<sup>52</sup> regarding the legislative and practice requirements for the management of records (Practice Statement PS CM 2006/9 *Records Management* — released November 2006).

3.83 The Tax Office has also recently developed a quality assurance (QA) program to monitor adherence to appropriate file and record-keeping procedures for litigated cases. This program also includes the facility to ensure that implementation of necessary improvements is undertaken.

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51 Tax Office report on the implementation of Inspector-General recommendations — June 2007.

52 Corporate Management Practice Statements (PS CM) are endorsed Tax Office corporate policy and must be followed by Tax Office employees. Each PS CM is supported by corporate management procedures and instructions which detail requirements and processes for implementing the policy.

## IGT Analysis

3.84 Tax Office staff have recently been provided with training in respect of the revised File Management Protocol. However, the protocol remains in draft form due to minor issues relating to requirements under the *Archives Act 1983* (draft advice regarding these requirements has been prepared by AGS and provided to the Tax Office which is now reviewing what needs to be done).

3.85 As stated above, the Tax Office has also developed an internal corporate management practice statement<sup>53</sup> regarding the legislative and practice requirements for the management of records. This practice statement has been developed to ensure that the keeping and management of records in the Tax Office occurs routinely.

3.86 In addition, the Tax Office has recently finalised (in October 2007) the development of a QA program and evaluation report for the LSB. The report will include an analysis of file and record-keeping procedures.<sup>54</sup> Both the QA program and the evaluation report are now approved for full implementation. Further discussion about this new QA program is provided in subsidiary recommendation 5.7.

### Implementation Status: Implemented

The Tax Office is in the process of finalising an update to its file management protocol which is to be adhered to by all staff. An internal corporate management practice statement<sup>55</sup> regarding the legislative and practice requirements for the management of records has also been developed following the Inspector-General's 2006 review.

The Tax Office has recently finalised the development of a QA program which will include the review of file and record-keeping procedures used in the LSB. This program is now approved for full implementation.

### Subsidiary Recommendation 5.7

*The new independent area of the Tax Office that is primarily responsible for the management of all aspects of litigated cases should be subject to formal quality control processes for work conducted by staff of that area.*

## Tax Office Position

3.87 The Tax Office has recently finalised the development of a more structured QA process for litigation work completed by the Tax Office's Law Sub-plan.

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53 PS CM 2006/9 Records Management.

54 Interview with the Senior Tax Counsel, Strategic Litigation (Tax Office) — 23 October 2007 (the approval of the use of this report was given by the LSB Executive on 23 October 2007).

55 PS CM 2006/9 Records Management.

## IGT Analysis

3.88 As mentioned in subsidiary recommendation 5.6, the Tax Office has recently developed a QA process and evaluation report which is in line with existing quality processes including the Tax Office's proposed Integrated Quality Framework (IQF).<sup>56</sup> The Tax Office has commenced the program including using the evaluation report.<sup>57</sup>

3.89 A 'memorandum of understanding' has been signed that establishes an evaluation process for cases where AGS is involved.

### Implementation Status: Implemented

The Tax Office has recently finalised the development of a revised quality control program for litigation work completed by the Law Sub-plan. This program is now operational.

### Subsidiary Recommendation 6.1

*The Tax Office should establish appropriate governance arrangements to allow appropriate oversight by the Tax Office's Executive of all litigated cases which it funds. These governance arrangements should distinguish between cases where the Tax Office has obtained no external advice on its decision to fund the case and those where it has obtained, and followed, that advice.*

## Tax Office Position

3.90 The Tax Office currently reports this information on a monthly basis to the Priority Technical Issues Committee (PTIC) which is chaired by the Second Commissioner (Law).

## IGT Analysis

3.91 The above-mentioned report to the PTIC provides the following details on a year-to-date (YTD) basis:

- total number of litigated cases that have been provided with test case funding;
- total costs relating to test case funding that have been submitted to the Tax Office's LSB for payment (the amount paid so far by LSB is also provided);

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56 The Integrated Quality Framework (IQF) is a set of quality management principles and activities currently being developed which are to be based on the Australian Business Excellence Framework and Australian Standard ISO 9001:2000 (the international standard regarding quality management systems). The purpose of the IQF is to ensure that the Tax Office produces work of a consistently and sustainably high standard. Specifically included in the list of products to be governed by the IQF is litigation.

57 Interview with the Senior Tax Counsel, Strategic Litigation (Tax Office) — 23 October 2007.

- a break-up of the types of cases that have received funding that remain on hand. These cases are further categorised into those cases where the Tax Office obtained external advice on its decision to fund the case and those for which it did not.

3.92 The report also provides a case summary for each matter decided by the Test Case Litigation Panel during its most recent meeting.

#### Implementation Status: Implemented

The Tax Office has implemented a reporting procedure to ensure that its Executive is updated on the litigated cases that have received funding. The report also distinguishes between cases where the Tax Office obtained external advice regarding the decision to fund and those for which it did not obtain external advice.

#### Subsidiary Recommendation 6.2

*The Tax Office should take steps to clearly notify the community of the existence of funding arrangements for cases which fall outside the formal test case program and the other rules for funding Tax Office appeals against AAT decisions and appeals to the High Court. It should notify the community of the types of cases that it will fund in this way and of the circumstances in which this funding has been and will be used by the Tax Office.*

#### Tax Office Position

3.93 Commentary on the different types of cases funded was included in the booklet titled *Test Case Litigation Program*, published in April 2005. However, the Tax Office is in the process of reviewing funding policy with both the Treasury and the Attorney-General's Department. Following completion of the project, the Tax Office undertakes to revise the above-mentioned booklet to incorporate the level of information required in the subsidiary recommendation.<sup>58</sup>

#### IGT Analysis

3.94 As discussed in Key Recommendation 5, the Tax Office is currently working with the Treasury and the Attorney-General's Department to review funding policy and to prepare relevant guidelines. A timeframe for completion of this work appears not yet to have been determined.<sup>59</sup> Completion of the project will enable the Tax Office to revise its above-mentioned booklet to incorporate the level of information recommended by the Inspector-General.

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58 Interview with the Senior Tax Counsel, Strategic Litigation (Tax Office) — 16 April 2007.

59 Interview with the Secretary of the Taxation Test Case Funding Review Panel — 12 June 2007.

### Implementation Status: Partly implemented

The Tax Office continues to work with the Treasury and the Attorney-General's Department to review funding policy and to prepare revised guidelines. The Tax Office has undertaken to revise its *Test Case Litigation Program* booklet to incorporate the level of information required under the subsidiary recommendation.

### Subsidiary Recommendation 6.3

*The Tax Office should ensure that where it funds cases under its general administrative powers, the method of funding (such as the basis and timing of funding) provided is consistent with that which is provided under the formal test case program. This would be to ensure that litigants who achieve funding for law clarification purposes are not disadvantaged when compared with litigants who have achieved Tax Office funding of their case for purposes other than law clarification.*

### Tax Office Position

3.95 The Tax Office's response to the Inspector-General's 2006 review was that it does not draw any distinction in its funding practices based on whether the application was commenced by a taxpayer application or funded by the Commissioner because an important case was involved.<sup>60</sup>

### IGT Analysis

3.96 The Tax Office has also confirmed to the Inspector-General that it funds all cases in the same fashion as those that are accepted by the Test Case Panel.<sup>61</sup>

3.97 As discussed in Key Recommendation 5 and subsidiary recommendation 6.2, the Tax Office is currently working with the Treasury and the Attorney-General's Department to review funding policy and to produce revised guidelines.

### Implementation Status: Implemented

The Tax Office has affirmed to the Inspector-General its commitment to fund all cases in the same fashion as those accepted by the Test Case Panel. The Tax Office has also stated that any changes to funding guidelines will reflect this principle.<sup>62</sup>

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60 Review of Tax Office Management of Part IVC Litigation (2006) – Inspector-General of Taxation (at 6.65).

61 ATO Minute 13 September 2007 (at p 3).

62 Ibid.

#### Subsidiary Recommendation 6.4

***The Inspector-General recommends that any new arrangements for administering the formal test case program should involve making publicly available to taxpayers an annual report on the operations of its processes for funding cases. This report should at a minimum contain the following:***

- an annual assessment of the degree to which test cases funded by the relevant body have achieved the aim of law clarification;***
- details of the extent to which the budget for test cases has been spent; and***
- details of the number of test case applications made, the number granted and the number rejected, with broad details of the reasons for the rejections.***

#### Tax Office Position

3.98 The Tax Office approach is to make publicly available the details of funded cases in either its annual report or another publication.<sup>63</sup>

#### IGT Analysis

3.99 The Tax Office has included in its 2005-06 annual report<sup>64</sup> an outline of the degree to which each case funded under the test case litigation program has contributed to law clarification.

3.100 Also included in the annual report is total expenditure for the program. However, this information does not enable the public to ascertain the extent to which the budget for test cases has been spent. The Tax Office maintains its view that there is no specified budget for or cap on expenditure on test cases and that it has a commitment to fund all cases accepted by the Test Case Panel.

3.101 The remaining information recommended by the Inspector-General has been appropriately included in the annual report.

#### Implementation Status: Implemented

The Tax Office has included in its 2005-06 annual report the minimum level of information recommended by the Inspector-General. A brief description of law clarification is provided against each test and significant case and a brief review of Test Case Panel activity is also provided.

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63 Review of Tax Office Management of Part IVC Litigation (2006) — Inspector-General of Taxation (at 6.199).

64 Tax Office Annual Report 2005-06 (at pp 222-3 and at appendix 5).

## Subsidiary Recommendation 6.5

*The Inspector-General recommends that the current exclusion of tax avoidance cases from the AAT adverse appeal funding arrangements be removed. The Tax Office should develop guidelines which allow funding for the costs of an appeal to be provided to taxpayers in cases involving alleged tax avoidance where the AAT determines that there was no such tax avoidance, the taxpayer wins their case and the Tax Office appeals against that AAT case to the Federal Court.*

## Tax Office Position

3.102 In the agreed response to the subsidiary recommendation, the Tax Office stated that tax avoidance cases will not be automatically excluded where it is fair and in the public interest to fund an appeal.<sup>65</sup>

## IGT Analysis

3.103 As discussed in Key Recommendation 5, subsidiary recommendation 6.2 and subsidiary recommendation 6.3, the Tax Office is currently working with the Treasury and the Attorney-General's Department to review funding policy and to prepare revised guidelines.

## Implementation Status: Not implemented

The Tax Office continues to work with the Treasury and the Attorney-General's Department to review funding policy and to prepare revised guidelines.

The above Tax Office position does not alter its current view that cases involving tax avoidance will generally not be funded. The Inspector-General maintains its view that where a taxpayer has been successful in a matter before the AAT which included testing of the issue of tax avoidance, adverse decision funding should not be denied where the Tax Office decides to appeal. Unless the new guidelines clearly adopt the position recommended by the Inspector-General, the Tax Office approach to this issue will continue to be unfair.

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65 Review of Tax Office Management of Part IVC Litigation (2006) — Inspector-General of Taxation (at 6.216); Interview with the Senior Tax Counsel, Strategic Litigation (Tax Office) — 16 March 2007.

## **Subsidiary Recommendation 6.6**

***The Tax Office, when describing a case as a test case or leading case in any communication whether to taxpayers individually or to the public at large, should clearly indicate:***

- whether it has funded the case and if so, its reasons for funding the case;***
- whether or not the case is expected to determine the tax disputes of taxpayers in similar circumstances;***
- if the case is expected to determine other disputes, the nature of the other disputes that will be determined by the case and the nature of disputes that the case is not expected to determine; and***
- that the above are subject to the actual findings of the relevant tribunal or court.***

## **Tax Office Position**

3.104 The Tax Office is setting out the issues being tested under the test case litigation program in its annual reports so that the community, and in particular the tax profession, are aware of the legal issues that have been or are sought to be tested. The Tax Office has also advised the NTLG of the outcome of test case applications (without reference to the names of taxpayers) as well as the issues being funded.

3.105 The Tax Office has a practice of writing to taxpayers when a lead case will likely deal with an issue that may resolve the particular circumstances of their case.

3.106 After a case is finalised, a decision impact statement is prepared with the intention of advising taxpayers of the Commissioner's reaction to the case and to give guidance on how the Commissioner will apply the decision more broadly.

3.107 Further to these steps already taken, the Tax Office will develop and implement a codified practice that will communicate to the community any pending litigation that it is hoped will provide law clarification for the broader community. In line with the recommendation, the proposed communication strategy will relate to lead and test cases. The Tax Office will identify the name of the lead or test case, as well as the issue, but due to secrecy requirements, will not disclose whether or not the case has been test case-funded. The requirement under the first dot point of the recommendation, that is, that the Tax Office should indicate whether it has funded the case and if so, its reasons for funding the case, will not be dealt with under this strategy, but will continue to be dealt with through the Tax Office's annual report. The annual report will also continue to provide details of the cases that have been funded or agreed to be funded, as well as the issue that has been or is to be tested.

3.108 The Tax Office will implement a codified practice to communicate to the community via its Tax Office website (similar to the decision impact statement process):

- the law clarification that the Tax Office is seeking from a case;***
- that there is no guarantee that the case will produce the law clarification sought;***

- that litigation underway may have consequences for some taxpayers;
- the issue that the Tax Office expects a case to resolve;
- the significance of the issue;
- the types of other disputes that could be resolved depending on the specifics of the court decision.

3.109 The Tax Office considers that the above satisfies the subsidiary recommendation.

### IGT Analysis

3.110 The Tax Office commenced recording in its 2005-06 annual report the details of the cases that had been funded or agreed to fund, as well as the issue to be tested.<sup>66</sup> However the detail provided failed to address the second, third or fourth points in subsidiary recommendation 6.6.

3.111 The introduction of decision impact statements (discussed in Key Recommendation 6) has provided taxpayers with an overview of test case or lead case decisions within generally eight weeks of the judgement date. However, a review by the Inspector-General of all decision impact statements published in the 2006-07 financial year revealed that content relating to the third point of the subsidiary recommendation has not been provided.

3.112 To address these matters, the Tax Office has committed to implement the above-mentioned practices to ensure that the level of information espoused in the subsidiary recommendation is provided to taxpayers and the public at large.

### Implementation Status: Implemented

By committing to implement additional communication practices, and given the work already done to communicate details of funded test cases, the Inspector-General considers that the Tax Office has substantially implemented subsidiary recommendation 6.6. The Tax Office has detailed its plans for completing implementation.

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66 Tax Office Annual Report 2005-06 (at pp 277-279).

### **Subsidiary Recommendation 7.6**

*Where the Tax Office can readily identify how a finalised court or tribunal decision will impact a particular class of taxpayers then taxpayers should not be expected to hold their objections or disputes in abeyance indefinitely pending lengthy Tax Office internal processes for amending or withdrawing public rulings, determinations or interpretative decisions.*

### **Subsidiary Recommendation 7.7**

*The Tax Office should implement processes to ensure that objections and disputes on hand involving a public ruling, determination or interpretative decision under review as a result of a court or tribunal decision are handled and resolved in a timely manner. This could require the resolution process being led by senior tax officers who are able to make a decision based on the current law (the law as interpreted by the courts) rather than the existing Tax Office view.*

### **Tax Office Position**

3.113 The Tax Office agreed with subsidiary recommendations 7.6 and 7.7 in principle and in October 2006 introduced the decision impact statement system to set out how the Commissioner would administratively apply the law as handed down by the courts or tribunal. The workings of the decision impact statement system have been outlined in PS LA 2007/2.

### **IGT Analysis**

3.114 The decision impact statement template contains a section explaining how the Commissioner will administer the law pending any review of a published ruling or determination (following the handing down of the relevant court or tribunal decision). For example, the decision impact statement following the handing down of the *Indooroopilly* decision<sup>67</sup> stated that the Tax Office would:

1. not be appealing the decision; and
2. be reviewing FBT assessments associated with outstanding employee benefit arrangement cases affected by the decision.

3.115 The Inspector-General's staff reviewed documentation evidencing senior tax officers directing staff to administer in accordance with recently released decisions as opposed to existing Tax Office views. This type of conduct, together with the development of the decision impact statement system to drive change following the handing down of significant decisions, represents a practical example of the Tax Office's approach in line with subsidiary recommendations 7.6 and 7.7. However, the Inspector-General considers that the Tax Office should also commit to this type of timely action by including appropriate procedures in PS LA 2007/2. This would reinforce with the community the Tax Office's commitment to the implementation of the subsidiary recommendations.

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<sup>67</sup> Commissioner of Taxation v Indooroopilly Childrens Services Pty Ltd [2007] FCFA 16.

3.116 The ATO contact officer specified in the decision impact statement, invariably the Tax Counsel involved in the relevant case, has corporate responsibility for the progress of any administrative change outlined in the decision impact statement. This can include providing technical leadership to the business line that will arrange for the administrative change to occur. Put simply, the decision impact statement provides the impetus for change so that cases on hand are administered accordingly and are resolved without waiting for the amendment of rulings and other Tax Office views.<sup>68</sup> The timeliness of this process is enhanced because of:

1. the time limits set for the publication of a decision impact statement (as outlined above in subsidiary recommendation 7.3); and
2. the above-mentioned management of change undertaken by the designated contact officer whose name is listed on the decision impact statement for members of the public to contact in the event of delays.

#### **Implementation Status: Implemented**

The introduction of the decision impact statement system has provided the Tax Office with an impetus to promptly administer taxpayer matters in line with recently released court or tribunal decisions. A senior tax officer, invariably the Tax Counsel for the particular case, is assigned responsibility to drive changes in administrative practice.

The Inspector-General considers that the Tax Office should also publicly commit to this type of timely action by including appropriate procedures in PS LA 2007/2.

In summary, the Tax Office has given effect to the spirit of the subsidiary recommendations.

#### **Subsidiary Recommendation 7.8**

*The Tax Office should develop uniform corporate governance processes to deal with the identification, consideration and feeding back to all appropriate areas of the Tax Office of any non-technical issues arising from the conduct of litigation with the aim of improving the quality and efficiency of litigation through better upstream processes.*

#### **Tax Office Position**

3.117 Included as part of PS LA 2007/2 is a procedure requiring a post-decision meeting to be convened within five business days of the handing down of an adverse or partially adverse decision, to consider (amongst other matters) any non-technical issues arising from

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68 Interview with the Senior Tax Counsel, Strategic Litigation (Tax Office) — 16 April 2007.

the conduct of the case.<sup>69</sup> For cases that do not proceed to hearing, the Tax Office has recently developed a reporting system to capture any learnings from the litigation process.

## IGT Analysis

3.118 The above-mentioned post-decision meeting required under PS LA 2007/2 is conducted via the SILC process. Under this process:

- the LSB officer must feed back to the business line (through the relevant business line litigation coordinator or steering committee) any non-technical issues which are relevant to their operations that might improve the Tax Office's litigation process;
- similarly, the business line or other members of the litigation team should feed back to LSB any non-technical issues that might improve the quality of LSB's role in the litigation process.<sup>70</sup>

3.119 For cases that do not proceed to hearing, the Tax Office has recently developed a new reporting system to ensure that feedback about the litigation process is captured and then referred to the cross-business line objections taskforce for consideration. This involves the completion of an early resolution report (ERR) which includes an analysis of (amongst other things):

- whether the litigation phase could have been avoided; and
- implications for the business line's audit or objections processes.

3.120 Put simply, the ERR process is to capture:

- any learnings from the litigation process;
- any problems that arose during the case; and
- any systemic problems identified in the process.

3.121 Training on the use of ERRs was provided to relevant areas in the Tax Office in March and April 2007. ERRs are prepared by the LSB officer in collaboration with the relevant litigation team at the final SILC. As at July 2007, only a dozen ERRs had been prepared.<sup>71</sup>

3.122 In July 2007, the Tax Office advised that it was still finalising the process for the review of ERRs at the cross-business line objections taskforce level. It is proposed that following this review process, any identified systemic problems are to be addressed through the implementation of changes to litigation processes. The ERR is also to be provided to business line litigation coordinators who are to discuss identified problems with business line officers (that is, with a view to improving the performance of these original decision makers). In October 2007, the Tax Office advised that this process was now in place.

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69 PS LA 2007/2 (at para 46).

70 PS LA 2007/2 (at para 46).

71 Interview with the Principal Legal Advisor, Strategic Litigation (Tax Office) — 9 July 2007.

3.123 Also in response to the Inspector-General's subsidiary recommendation, the Tax Office introduced in November 2006 a quarterly workshop whereby executives from TCN (Strategic Litigation) and representatives from the business line work as a team to review and improve the operation of litigation processes.<sup>72</sup> A wide variety of areas relevant to the litigation process are covered as part of this review.

3.124 Also in October 2007, the Tax Office has completed the development of a QA program whereby on a quarterly basis an executive team (one senior executive from LSB and one from each business line) is to review a sample of litigation cases to assess the contribution of business line officers towards the completion of the case.

#### **Implementation Status: Implemented**

The Tax Office has incorporated into PS LA 2007/2 the requirement for a post-decision meeting (a SILC) to be convened within five business days of the handing down of an adverse or partially adverse decision, to consider matters (including non-technical issues) arising from the conduct of the case. Feedback from this process is provided to both LSB and the litigation team for incorporation into work practices.

For cases that do not proceed to hearing, the Tax Office has recently developed the ERR system to ensure that feedback about the litigation process is captured and then referred to the Tax Office's executive-level for action. The Tax Office is still finalising the process by which this executive level review is undertaken.

Also in response to the subsidiary recommendation, the Tax Office has introduced a workshop held on a quarterly basis whereby executives from LSB, TCN and each business line review the operation of litigation processes. Following on from these workshops, recommendations are forwarded to the Provision of Written Advice Steering Committee for consideration.

In summary, the Tax Office has very recently established a series of processes to identify issues arising from the conduct of litigation. Part of this involves the provision of feedback to appropriate areas so as to improve litigation processes.

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72 These quarterly workshops are chaired by the Tax Office's Senior Tax Counsel, Strategic Litigation.

## CHAPTER 4: REVIEW INTO TAX OFFICE AUDIT TIMEFRAMES

### THE JULY 2005 IGT REVIEW

4.1 Prompted by concerns raised with the Inspector-General from industry and tax practitioners, a review was undertaken into the time taken by the Tax Office to complete audits of businesses. The focus of the review was on the Tax Office's practices and approaches that could lead to excessive audit timeframes and result in undue impacts on businesses. In summary, the Inspector-General sought to determine whether the Tax Office was striking an appropriate balance between minimising the adverse impact on business and the risk to the revenue.

4.2 An examination of sample cases during the review revealed that there were certain projects and isolated cases where the Tax Office took far longer to finalise audits than it should have. These projects and cases typically involved matters of complexity and involved delays in decision-making on technical or strategic issues.

4.3 In addition, the sample cases revealed that the general interest charge (GIC) had not been remitted for periods of Tax Office inactivity in many cases. Supporting this finding, the Inspector-General noted that the Tax Office did not have a system in place requiring auditors to identify these periods of inactivity for the purposes of correctly remitting the GIC upon the finalisation of audits.<sup>73</sup>

4.4 However, the Inspector-General found that the Tax Office was actively seeking to improve the way it managed its audit programme to minimise audit timeframes. In particular, there was an increased management focus on reducing audit timeframes through the implementation of revised internal reporting and internal structural changes, exploration of refinements to existing audit approaches and consideration of increased usage of forward compliance agreements.

4.5 In July 2005, the Inspector-General's report was publicly released and included a number of recommendations. The Tax Office agreed with these recommendations and referred to a number of measures that were to address the concerns raised in the 2005 report, including:

- the deployment of two senior Tax Office staff to model expert case management in the most complex cases<sup>74</sup>;

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73 Review into Tax Office Audit Timeframes (2005) — Inspector-General of Taxation (at para 3.103).

74 Four more senior Tax Office staff were also to be appointed to assist in this task (source — Review into Tax Office Audit Timeframes (2005) — Inspector-General of Taxation (at para 2.10)).

- the implementation of a practical approach to auditing substantiation issues in the GST area;
- the establishment of a new Tax Office case management system.<sup>75</sup>

## IMPLEMENTATION OF RECOMMENDATIONS

### KEY RECOMMENDATION 1

*The Inspector-General recommends that the Tax Office:*

- (a) *continues to expeditiously resolve those audits experiencing significant delays; and*
- (b) *fully implements appropriate governance processes to ensure that, in future, the resolution of technical and strategic issues encountered during audits is expeditiously resolved in a manner that provides all parties with adequate opportunity to understand the relative merits of the other's views.*

### Tax Office Position

4.6 The Tax Office has a strong active case management process including routine 'call over' processes. The new Siebel CASE management system has clear review points, case cycle times and detailed management reporting. Aged case analysis is showing a reduction in the age of cases with SES<sup>76</sup> case leaders appointed in many areas.<sup>77</sup>

4.7 Implementation of Siebel CASE included enterprise-wide business processes and procedures for all active compliance products to ensure technical issues are identified and appropriately managed. Resolution of technical issues, including appropriate discussions with clients and technical experts, is addressed through these new enterprise-wide arrangements.

4.8 All active compliance staff are now using the one case system. The effectiveness of the arrangements is monitored through the Active Compliance Steering Committee.<sup>78</sup>

### IGT Analysis

#### Case Management

4.9 Following the release of the Inspector-General's report into audit timeframes in 2005, the Tax Office has introduced a number of initiatives aimed at improving the management of audits so as to reduce audit timeframes. One of the major initiatives is the implementation of Siebel CASE which involves the replacement of the Tax Office's 180 case

<sup>75</sup> Review into Tax Office Audit Timeframes (2005) — Inspector-General of Taxation (at para 2.10).

<sup>76</sup> Senior Executive Service Tax Office staff.

<sup>77</sup> Updated business line response for audit committee (Tax Office report November 2006).

<sup>78</sup> Ibid.

management systems with a single computerised system. Implementation of Siebel CASE is still in the early stages and this is widely acknowledged by the Tax Office:

*Whilst it was originally anticipated that the Change Program and the introduction of Siebel would hopefully also assist in the active management of aged cases, to date this has not been the case. Due to Siebel reporting limitations the introduction of Siebel has actually been a deterrent to the active management of aged cases. This is due to Siebel's inability to provide an accurate aged case report based upon the case allocation date.*<sup>79</sup>

4.10 Notwithstanding the above problems, fieldwork undertaken by the Inspector-General revealed that a number of interim arrangements have been put in place to assist the Tax Office to actively manage cases. Primarily, this centres around the preparation of the annual Compliance Sub-plan Productivity Report which outlines the performance of the Compliance Sub-plan, as well as individual business lines, in achieving compliance cycle times.<sup>80</sup> The report is reviewed by the Tax Office's Active Compliance Steering Committee.

4.11 The 2006-07 productivity report indicates that the Compliance Sub-plan completed 89 per cent of its work within the Tax Office's compliance cycle times. This is compared to 90 per cent for the corresponding 2005-06 report and 76 per cent for the 2004-05 report. The result for 2006-07 is slightly lower than the previous financial year largely, according to the Tax Office, because of the need to devote resources to the implementation of Siebel.<sup>81</sup>

4.12 The Inspector-General notes, however, these headline figures are heavily influenced by large volumes of compliance correspondence action, rather than audits. The following 2006-07 Tax Office cycle time analysis is indicative.

#### Compliance Sub-plan Cycle Time Analysis 2006-07<sup>82</sup>

Work Category	Total Number of Cases Finalised	Number of Cases Finalised Within Cycle Time	Percentage of Cases Finalised Within Cycle Time
Correspondence	777,187	753,772	97%
Field	43,148	26,436	61%
Internal Review	52,717	37,495	71%
Telephony	130,139	71,508	55%
<b>Total</b>	<b>1,003,191</b>	<b>889,211</b>	<b>89%</b>

4.13 Within the context of the original 2005 review, the Inspector-General considers that the 'Field' category of compliance action is the most relevant. As indicated above, the analysis of cycle time performance for Field is only 61 per cent for 2006-07. The Inspector-General notes that the level of performance has not changed over the last three years.<sup>83</sup>

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79 'Micro Enterprises and Individuals — Employer Obligations Stock on Hand & Aged Case Report' — Tax Office Report July 2007 (at p 8).

80 For example, in respect of LB&I audits commenced post-30 June 2005, the relevant timeframe benchmark is 2 years.

81 Source — interview on 17 September 2007 with the Tax Office's Active Compliance Capability Leader.

82 Tax Office report — 'Cycle Time — Productivity Report Compliance Sub-plan' (draft version supplied to the Inspector-General on 4 October 2007). This report provides figures for the 2005, 2006 and 2007 financial years.

83 Ibid.

4.14 The Tax Office has demonstrated significant improvements in audit completion times in respect of large business compliance in both the Large Business & International business line (LB&I) and the GST business line. The Inspector-General notes that improvements were most needed in the large business sector and therefore these gains are important. Nevertheless, overall performance against Tax Office benchmarks appears to be relatively low and static.

4.15 Most Tax Office business lines also have their own case management reporting systems to monitor the progress of cases. However, a review of these systems by the Inspector-General revealed that the level of reporting is patchy and for some business lines quite limited. For example, in providing the Inspector-General with the relevant report for the Tax Office's Micro Enterprises & Individuals (ME&I) business line, the Tax Office stated (in respect of the average cycle times of cases):

*... we are unable to provide this data for Siebel cases as...the functionality to report on this is yet to be available.*<sup>84</sup>

4.16 A further example of the paucity of management information available to Tax Office management is that the current systems (including Siebel) do not have the facility to exclude from their statistics any additional processing time arising from a taxpayer's delay in forwarding requested information.<sup>85</sup> In terms of accurate corporate reporting, this limitation must be addressed.

4.17 Furthermore, there is a distinct lack of meaningful reporting passed on regularly to the Tax Office's senior management.<sup>86</sup> Requests made by the Inspector-General for reports on the trends in the cycle times of audits for Tax Office business lines could not be satisfied. Surprisingly, this form of case management reporting is not undertaken in every compliance business line in the Tax Office. Such gaps in reporting remain a concern to the Inspector-General.

4.18 However, the Tax Office has advised the Inspector-General that it has just released a sophisticated electronic management reporting system (the Executive Information System) that will monitor and report case cycle times. Reporting is provided on a monthly and year-to-date basis in respect of each segment of all business lines as well as for the Compliance Sub-plan itself.

4.19 An additional feature of the Executive Information System (EIS) is its accessibility from the team leader level right through to the Commissioner. EIS provides the user with an ability to drill down to the transactional layer of information, in other words, past management reporting through to source data, allowing the user to perform unstructured analysis. Put simply, this system represents a significant improvement in the regular provision of information regarding cycle times to the Tax Office's senior management, providing it is regularly accessed.

4.20 A review of EIS could not be undertaken by the Inspector-General because of its recent introduction. In addition, the Tax Office advised the Inspector-General that it is still in

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84 Tax Office minute 'Provision of information in relation to audit timeframes review recommendations' — 7 September 2007.

85 Source — interview on 12 September 2007 with the Tax Office's Active Compliance Capability Leader.

86 Currently, there is no monthly reporting to the Tax Office's Compliance Executive [source — interview on 11 September 2007 with the Tax Office's Active Compliance Capability Leader].

the process of resolving data entry issues and therefore the information currently available in the EIS is not necessarily accurate.<sup>87</sup>

#### Case Leadership and the Call Over Process

4.21 In late 2004 the Tax Office introduced the Case Leadership process to focus on aged cases and to mentor and provide support to team leaders and auditors handling cases containing technical and strategic issues that affect case finalisation. In summary, the Case Leadership process now involves three Deputy Commissioners (as Case Leaders) and a number of 'Special Advisers':<sup>88</sup>

- reviewing cases that have exceeded their cycle time;
- identifying the main causes of delays;
- resolving strategic, technical and procedural 'blockers';
- providing high-level technical advice in a timely manner; and
- providing feedback to appropriate areas and staff to improve Active Compliance capability.

4.22 Fieldwork undertaken by the Inspector-General has also seen Special Advisers assist team leaders by:

- making specific interventions from an early stage in some of the more complex, sensitive and potentially difficult cases or issues;
- attending risk review workshops for selected cases to enhance the planning of compliance action;
- providing guidance and counsel in managing technical issues and the progression of cases; and
- providing guidance on areas for overall skill development within the Tax Office.

4.23 The Tax Office has also established a small number of Case Leadership positions that intervene primarily in cases from a pool of work identified by a set range of criteria. Currently this work involves significant interventions in a range of High Wealth Individual (HWI) and Small to Medium Enterprise (SME) matters. These Case Leaders also report to the Second Commissioner (Compliance).

4.24 One of the main tools of Case Leadership is the call over review process. On a six-monthly basis, Special Advisers conduct call overs of current casework (audits and risk reviews).<sup>89</sup> Call overs look at the overall management of current casework, technical issues

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87 Source — interview on 6 September 2007 with the Tax Office's Active Compliance Capability Leader. Information included in the system is currently sourced from Siebel which is also undergoing implementation issues.

88 Special Advisers are at the Senior Executive Service Tax officer level.

89 The call over process is not undertaken in ME&I. Instead, a director monitors the progress of ME&I cases through a 'pivot table' report. Cases are escalated for attention where progress is affected by technical or strategic issues. ME&I does not partake in the Case Leadership program.

and risks and help to identify opportunities to progress the case. The call over process also provides the opportunity for the Special Advisers to commit to providing ongoing assistance to an auditor with a difficult case. Fieldwork undertaken by the Inspector-General's staff revealed that this provision of ongoing assistance was a common practice amongst the larger audits. In fact, the fieldwork revealed that some matters did not require call overs because Special Advisers were attached to the cases.

4.25 On a six-monthly basis, the three Deputy Commissioner Case Leaders provide the Commissioner of Taxation and the Second Commissioners (Compliance) and (Law) with a progress report of Case Leadership together with an analysis of areas in which improvement is required.

4.26 Fieldwork undertaken by Inspector-General's staff revealed that a number of audit team leaders undertake monthly call overs of their team's work. However, this is not a set practice except in LB&I and is varied with some team leaders simply maintaining verbal contact with case officers together with continual monitoring of the progress of cases via the Siebel CASE system.

4.27 A review of sampled statistics and audit cases by the Inspector-General has indicated that the Case Leadership and the call over processes are contributing to a reduction in audit timeframes in the large business sector.<sup>90</sup> The review also demonstrated that these processes address technical and strategic blockers that arise during audits. For example, the monthly call over for one sample case led to the deployment of a specialist to work with the audit team through the strategic issue of Tax Office access to taxpayer records. In addition, the majority of audit cases sampled included the holding of workshops with technical or industry specialists to establish the Tax Office's position.

4.28 Notwithstanding significant improvements in audit timeframes in the large business sector, the Inspector-General's sampling of cases revealed that some aged audits in GST and LB&I remain unresolved despite having been through the call over and Case Leadership processes. However, it would of course be unrealistic to expect 100 per cent achievement of benchmark timeframes.

#### Business Line specific initiatives — Large Business & International

4.29 On 13 October 2005 the then Commissioner of Taxation announced a significant commitment to reduce audit timeframes with the introduction of a revised approach to complete large business<sup>91</sup> audits within two years.<sup>92</sup> The Tax Office's commitment to this initiative was evident with the Commissioner also announcing a new ground for remission of the general interest charge (GIC) and the shortfall interest charge (SIC):

*For audits commencing after 1 July 2005, we will remit interest charges to the base rate for the period the audit extends beyond two years.<sup>93</sup>*

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90 Tax Office report — 'Progress Report for 30 June 2007 for LB&I Case Leadership audits' (at pp 1 and 2). The Inspector-General may make comment on the adequacy of Tax Office benchmarks for completing audits in his Review into the Tax Office's administration of GST audits.

91 For the purposes of market segmentation, the Tax Office classifies large businesses as those groups with a turnover of around \$100 million or more.

92 Within two years of the notification of the commencement of the audit.

93 Large business and tax compliance, 2006 (at p 48).

4.30 Following on from this initiative, the Tax Office released on 30 August 2006 the **Large business and tax compliance** booklet designed to provide large business taxpayers with a point of reference when dealing with the Tax Office. The booklet also incorporates a two-page 'Large business end-to-end audit process plan' mapping out the various steps that its staff follow when undertaking compliance work. This procedural map is linked to Siebel CASE and is designed to ensure that staff cannot proceed through a case until each mandatory step is completed. Of relevance to this recommendation is the step requiring the inclusion of expertise to assist in the resolution of technical or strategic issues (for example, one step involves the holding of a workshop to identify risks and to develop strategies during the initial 'risk review' stage<sup>94</sup> of the audit process). This procedural map is still in its early stages of implementation and therefore its application was not relevant for the audit cases reviewed by the Inspector-General.

#### Early engagement of technical and other specialists

4.31 As discussed further in Key Recommendation 2, the Tax Office is developing additional processes and procedures to facilitate the effective engagement of technical and other specialists early in the audit process. This includes the revision of two existing law administration practice statements — PS LA 2004/4 *Referral of issues to Centres of Expertise for the creation of the precedential ATO view, and early engagement of internal technical specialists in active compliance cases* and PS LA 2003/10 *The Management of 'Priority Technical Issues'*.<sup>95</sup> Fieldwork undertaken by the Inspector-General revealed that the early engagement of technical input is common practice.

4.32 Of relevance to this key recommendation, the Tax Office has a cross sub-plan PTI working group looking at areas where the Tax Office's timeliness of resolution of PTIs can be improved. For example, the working group is reviewing a proposal from the Inspector-General to introduce a six-month benchmark for the TCN and the CoE to provide advice to business lines that are conducting compliance activities including audits. The proposal also includes the situation where at the outset of identifying an 'advice PTI', it is clear that it will take longer than six months to provide the advice and a business case will need to be made and agreed to by the relevant SES Band 2 officer.

4.33 A further proposal being explored by the Tax Office is for the introduction of an appropriate 'top down' intervention mechanism in the management of major/complex issues (including PTIs) when it becomes apparent that a significant milestone will not be met. It is proposed that where appropriate, the intervention will be escalated to involve the Tax Office's Chief Tax Counsel where relevant. The Tax Office is currently working through

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94 Risk reviews for income tax are typically the first step following case selection and are designed to assess whether there may be income tax risks requiring further compliance action such as a full audit.

95 One method by which the Tax Office aims to provide technical input is via the PTI process. A PTI is an issue of interpretative nature that requires a prioritised approach to resolution. Put simply, every possible assistance is provided to ensure that the issue is resolved promptly. The Priority Technical Issues Committee which is chaired by the Second Commissioner (Law), meets on a six-weekly basis and provides guidance and direction in the management of PTIs within the established corporate framework (including monitoring and intervention as required to ensure timely resolution). The Tax Office is still working on updating PS LA 2003/10 and PS LA 2004/4 [this is despite amendments being listed as having occurred in the former practice statement in December 2006 — interview with Assistant Commissioner, GST Active Compliance 15 August 2007 and the Capability Leader — Active Compliance 21 August 2007].

strategies to enhance the progress of PTIs including referral to expert external counsel or consultants for advice.

Providing all parties with the opportunity to understand each other's views

*Interaction with taxpayers throughout the audit process*

4.34 Fieldwork undertaken by the Inspector-General revealed that the Tax Office is proactive in gaining an understanding of the taxpayer's position as well as explaining its own position. Sampled cases demonstrated that this type of activity was undertaken via a number of methods. An example early in the audit process is the holding of an initial meeting with the taxpayer to discuss the audit team's 'audit plan' (that is, the scope of the audit). At this meeting the Tax Office:

- provides the taxpayer with a copy of the audit plan for discussion;
- discusses the audit scope, the periods under audit and the expected completion date;
- discusses the information gathering processes;
- discusses any Tax Office guidelines relevant to the issues and years to be audited, including procedures in relation to voluntary disclosures;
- outlines facilities and assistance which the Tax Office may require; and
- provides the taxpayer with the contact details of a senior officer in case the taxpayer needs to raise any concerns during the audit.<sup>96</sup>

4.35 Relevant interaction with taxpayers in line with the recommendation was also demonstrated in workshops held with taxpayers during the initial stages of a number of audit cases sampled by the Inspector-General. The purpose of these workshops was to gain an understanding of the operation of each taxpayer's business as well as the commercial environment in which each taxpayer operated. In one of the cases sampled, the audit team even provided a presentation to the taxpayer to ensure that the audit team correctly understood the taxpayer's corporate structure (a critical issue in the audit given the size and nature of the taxpayer's dealings).

*Position papers*

4.36 Also relevant to the issue of providing all parties with the opportunity to understand the merits of each other's views, the Tax Office has a procedure for large business, SME and GST taxpayers<sup>97</sup> whereby it provides the taxpayer with a written statement outlining the Tax Office position before an audit is finalised. These written statements, referred to as position papers, set out:

- Tax Office's analysis of the available facts;

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96 Tax Office publication Large business and tax compliance, 2006 (at p 52).

97 ATO Minute 'Follow up review of the Tax Office's implementation of Inspector-General recommendations: Audit Timeframes' (9 August 2007 at p 2). In the GST business line, the position paper process is only applied for large business taxpayers (a similar process is being developed for GST's SME and micro taxpayers with the resulting document to be called an interim decision summary).

- application of the law to the facts; and
- details of any proposed adjustments or recommendations.

4.37 The purpose of the position paper is to provide taxpayers with an opportunity prior to the finalisation of an audit to submit further facts and legal argument that may be relevant to the formulation of the Tax Office's position (generally twenty-eight days is provided depending on the complexity of the issues involved). Taxpayers are given the option of submitting further detail either by written submission or in person via an interview with the case officer.

4.38 The requirement to provide a position paper is specifically included in a number of Tax Office procedural documents.<sup>98</sup> Fieldwork undertaken by the Inspector-General evidenced that the above-mentioned practices relating to position papers are applied. However, the review of sample cases also revealed that in communicating the Tax Office's final decision to the taxpayer (that is post the position paper process), the Tax Office is not always adequately explaining how it has considered the merits of the taxpayer's case in reaching the final decision.

#### Active Compliance Quality Review and Technical Quality Review

4.39 The Tax Office established the Compliance Assurance Practice (CAP) to conduct Active Compliance Quality Reviews (AQR) every six months of a sample of large business sector audits. Cases are reviewed in respect of a number of different areas including the overall management of the case including timeliness. CAP is responsible for passing on to case officers any relevant feedback following the review process.

4.40 Another form of review is the Technical Quality Review (TQR) procedure which is also undertaken generally every six months for all business lines. Under this process a random sample of audit decisions are reviewed by internal and external tax specialists with respect to (amongst other matters):

1. the provision of technical advice; and
2. how this advice assisted in the progression of audits (where relevant).

4.41 The Tax Office's Technical Excellence Practice (TEP)<sup>99</sup> has developed a multi-tiered feedback system for TQR results with individual feedback being provided to case officers, team leaders and segment leaders. A TQR bulletin containing recommendations is also sent to all staff within each relevant business line — for example reminders to audit staff to ensure that they access technical input as required.

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98 For example, the Tax Office's 'Client Audit Management Plan' (used for large market income tax audits) which outlines how Tax Office staff should inform taxpayers about the audit process. This plan is currently operational but is under review. The plan is proposed to be linked to Siebel as an activity step requiring completion.

99 TEP has been set up in LB&I to support audit teams with technical advice and to look into building the technical capability of the Compliance Sub-plan.

## Implementation Status: Implemented

Part (a) of this recommendation is considered to be substantially implemented because improvements in the numbers of aged cases on hand have been achieved against Tax Office benchmarks<sup>100</sup> in the large business sector (being a key area of concern in the Inspector-General's 2005 review).

These improvements are the result of a number of processes put in place by the Tax Office to ensure that issues with the potential to delay audits are resolved. In particular, the introduction of the Case Leadership and call over processes has provided business lines with a definite impetus to regularly address matters with a view to finalisation.

However, the Inspector-General has significant reservations about the adequacy of the Tax Office's current monitoring of cycle times in most business lines as well as the static overall performance levels over the past three years. The above-mentioned interim measures should be recognised, but there remains a significant amount of work to be done. In respect of this, the Tax Office points to the continued implementation of Siebel CASE together with the recent release of the EIS.

In respect of part (b) of the recommendation, the Tax Office has also been proactive in gaining an understanding of taxpayers' positions whilst at the same time explaining its own position. The provision of position papers to taxpayers is a good example of this approach being an important opportunity for taxpayers to understand the Tax Office view and to respond in kind. This progress on part (b) supports an overall implemented status for this recommendation.

## KEY RECOMMENDATION 2

*The Inspector-General of Taxation recommends that, before intensive information-gathering begins in an audit, the Tax Office ensures that appropriate technical input is brought to bear to develop the correct focus of the audit.*

### Tax Office Position

4.42 With the deployment of Siebel CASE, there are now enterprise-wide procedures to ensure that technical issues are identified and reviewed at appropriate points throughout the audit process.

4.43 The system will report on, and alert managers to, periods of inactivity or non-compliance with required audit steps.

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100 The Inspector-General may make comment on the adequacy of Tax Office benchmarks for completing audits in his Review into the Tax Office's Administration of GST Audits.

4.44 Each case now has a specific system-generated 'risks' and 'issues' component which can be monitored by managers and individual case officers to ensure the intended scope of the audit is maintained.<sup>101</sup>

## IGT Analysis

### Early engagement of technical and other specialists

4.45 As outlined in Key Recommendation 1, the Tax Office is currently revising the instructions provided to staff regarding the early engagement of technical specialists in audit planning. This includes the revision of two existing law administration practice statements — PS LA 2004/4 and PS LA 2003/10 (referred to in Key Recommendation 1).

4.46 Also in response to the Inspector-General's 2005 review, the Tax Office has introduced changes to a number of audit procedures to reinforce with its staff the importance of the involvement of specialists in the early stages of the audit process. For example, as discussed in Key Recommendation 1, the Tax Office released in 2006 the *Large business and tax compliance* booklet which includes the two-page Large business end-to-end audit process plan. One of the steps included in this new plan is for audit officers to:

*In selected cases ... conduct an internal workshop which may include technical, topic and industry experts ...*<sup>102</sup>

4.47 The release of the above products also provided an impetus for the Tax Office to incorporate such changes in other business lines. For example, in the SME business line, a mandatory step has been included in its audit procedures requiring case officers to conduct a risk workshop with their team leader and team technical officer to (amongst other matters) identify technical and strategic issues requiring the assistance of both internal and external specialists.

4.48 Sampling of cases from a number of business lines undertaken by the Inspector-General evidenced that the above practices are followed. For example, in one case, technical specialists assisted the audit team to work through a number of complex provisions relating to tax consolidation. This enabled the audit team to prepare an initial questionnaire for the taxpayer which covered all relevant scenarios regarding the taxpayer's entry into tax consolidation.<sup>103</sup>

4.49 The above sampling of cases also indicated that workshops are held early in the audit process to work through strategic issues. For example, one case involved a workshop with an internal expert to review how the issuing of a section 255-20 notice<sup>104</sup> would affect the progression of an audit.

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101 Updated BSL Response for Audit Committee (Tax Office report November 2006).

102 This alerts auditors to the need that appropriate specialists must be 'on board' during the planning of an audit.

103 This case is in contrast to a case sampled in the Inspector-General's original 2005 review where technical resources were not present to tailor the questionnaire resulting in broader information-gathering requests and delays in the completion of the audit [source: para 3.97 Review into Tax Office Audit Timeframes (2005) — Inspector-General of Taxation].

104 Under section 255-20 of the Taxation Administration Act 1953 the Commissioner can bring forward the payment time for a tax related liability in certain cases with the issue of a notice.

4.50 As discussed in Key Recommendation 1, the TQR and call over processes monitor work practices and provide appropriate feedback where shortfalls are identified. In relation to this recommendation, the TQR process reviews the appropriate use of technical and other specialist input early in the audit process.

#### Implementation Status: Implemented

Following the Inspector-General's original 2005 review, the Tax Office has refined its audit procedures to reinforce with its staff the need to consider the use of specialists early in the audit process to ensure that a correct focus is set in place.

Overall, sampling undertaken by the Inspector-General has demonstrated that the Tax Office is proactive in ensuring appropriate technical input is gathered in the early stages of the audit process.

The Tax Office is revising two practice statements (PS LA 2004/4 and PS LA 2003/10) to incorporate instructions to staff regarding the early engagement of technical specialists in audit planning.

### KEY RECOMMENDATION 3

*The Inspector-General recommends that the Tax Office fully implements appropriate governance processes to ensure that the general interest charge attributable to significant periods of Tax Office-caused audit delay is remitted.*

#### Tax Office Position

4.51 The practice statement PS LA 2006/8 *Remission of shortfall interest charge and general interest charge for shortfall periods* has been published. Implementation, including system changes, communication and skilling requirements for the new practice statement, has been completed.<sup>105</sup>

#### IGT Analysis

4.52 In response to the Inspector-General's 2005 *Review into the Tax Office's Administration of Penalties and Interest Arising from Active Compliance*<sup>106</sup>, the ATO Executive commissioned the Penalties and Interest Project to ensure that a range of commitments relating to penalties and interest were implemented in a coordinated way. An early deliverable of the project was to recommend preferred organisational arrangements for improving the administration of the penalties and interest regimes. These arrangements were to provide assurance that policies and practices would be consistent across business lines, revenue products and markets.

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105 Updated BSL response for Audit Committee (Tax Office report November 2006).

106 Publicly released 28 September 2005.

4.53 After reviewing existing arrangements and identifying opportunities for improvement, a model for the administration of penalties and interest was developed which involved shifting responsibility for developing policy and practice in respect of pre-amendment penalty and interest decisions from the Operations area of the Tax Office to the Compliance area.<sup>107</sup> This arose following the Inspector-General's observation<sup>108</sup> that the remission of tax shortfall interest did not appear to occur as often as it should when the Tax Office contributed to delays in case finalisation (partly attributable to the fact that Compliance case officers at the time were not responsible for determining remission of tax shortfall interest).<sup>109</sup>

4.54 In March 2006 the above model was implemented — responsibility for determining the grounds for the remission of tax shortfall interest, as well as any reduction in rate, amount or period, was to be made by the Compliance officer.<sup>110</sup> In addition, Compliance officers handling cases that involved particularly complex calculations (such as cases involving larger entities and/or second or subsequent amendments) could obtain support for account reconciliation through a nominated function within Operations.

#### PS LA 2006/8

4.55 The other key component in terms of this recommendation was the release on 1 August 2006 of PS LA 2006/8 ***Remission of shortfall interest charge and general interest charge for shortfall periods*** which provides direction and assistance to staff in respect of the remission of SIC and GIC for shortfall periods. For example, paragraph 56 of the practice statement directly addresses the above-mentioned problem of Tax Office staff failing to consider the remission of interest despite lengthy delays in the finalising of audits:

*Where an audit case is completed beyond the expected audit completion date, the case authorising officer must undertake a full review of the reasons for the delay to determine whether further remission grounds apply.*

4.56 Of note, in respect of large corporate audits, PS LA 2006/8 specifically provides that interest will be remitted to the base interest rate for the period that an audit extends beyond two years.<sup>111</sup>

4.57 On the day of release of the practice statement, the Tax Office issued a media statement which stated:

*This is an important step forward in showing the community that we are fair and reasonable when it comes to interest charges.*<sup>112</sup>

4.58 In respect of this, the Inspector-General notes that the Tax Office made no mention that the practice statement was a response to issues raised in his 2005 ***Review into the Tax***

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107 It should be noted that this recommendation did not apply to GIC on established debts, which remained with Operations.

108 Review into the Tax Office's Administration of Penalties and Interest Arising from Active Compliance Activities (2005) — Inspector-General of Taxation (at para 4.27).

109 An observation supported by the February 2006 TQR where some business lines considered interest remission in as few as 40 per cent of those cases where it should have been considered.

110 As mentioned above, this recommendation did not apply to GIC on established debts, which remained with Operations.

111 PS LA 2006/8 — at paragraph 19 [discussed further in Key Recommendation 4].

112 Tax Office media release Guidelines for remission of interest charges — 1 August 2006.

**Office's Administration of Penalties and Interest Arising from Active Compliance Activities** or that taxpayers had been unfairly treated by the Tax Office's previous practices.

#### Tax Office assisting its staff to correctly apply PS LA 2006/8

4.59 Just prior to the release of PS LA 2006/8 the Tax Office issued to staff a detailed fact sheet outlining the key points and changes included in the practice statement. This was undertaken in line with the Tax Office's communication strategy of ensuring its staff are advised of relevant changes arising from the *Report on Aspects of Income Tax Self Assessment*<sup>113</sup>.

4.60 Shortly following the release of PS LA 2006/8, the Tax Office issued to staff a set of guidelines on how to impose and remit SIC/GIC. Directly relevant to this recommendation, the Tax Office included in these guidelines the following instruction:

***Operations will remit the interest charge accrued by any ATO processing delay.***<sup>114</sup>

4.61 To assist its staff with navigating through and applying PS LA 2006/8, the Tax Office developed and introduced a decision support tool. Some key points about this support tool include:

- it is a web-based tool designed to guide staff through the hierarchy of questions and relevant grounds to determine the appropriate remission decision outcome;
- the tool directs the officer to the relevant paragraph in the practice statement that applies in a taxpayer's situation;
- the decision tool is linked to the Siebel system so that appropriate monitoring and guidance to staff is available.<sup>115</sup>

4.62 In addition, the Tax Office developed a question and answer tool to provide a number of practical questions and answers reflecting audit situations which involve the practice statement.

4.63 Relevant skilling of Tax Office staff has also been undertaken to further support the implementation of PS LA 2006/8. This has included the continued use of its extensive ROSA i-learn training package.<sup>116</sup> The Tax Office provided the Inspector-General with a copy of a report into the status of staff skilling immediately prior to the release of PS LA 2006/8.<sup>117</sup> This report provided an assurance to the Inspector-General that relevant staff had received

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113 On 24 November 2003 the then Treasurer announced the Review of Aspects of Income Tax Self Assessment. On 16 December 2004 the previous government released the Report on Aspects of Income Tax Self Assessment.

114 'Guidelines for Imposition/Remission of SIC/GIC/s 170AA interest charges' (Tax Office publication released 19 September 2006 — see p 1).

115 The Siebel Case Management system used by the Tax Office (discussed in Key Recommendation 1) contains clear instructions to staff regarding the remission of interest due to Tax Office delays. Quality assurance checks surrounding this issue are also built into Siebel.

116 This package includes a session dealing with the introduction and implementation of PS LA 2006/8. The Tax Office has closely monitored and reported on the completion of the ROSA i-learn training package.

117 'PS LA 2006/8 Skilling: Status Report August 2006' (prepared by the director of the Tax Office's Compliance Penalties and Interest Team).

training on the practice statement and that skilling solutions had been implemented by the various business lines.

4.64 Reviewing the application of PS LA 2006/8 is also a part of call overs and TQRs (discussed in Key Recommendation 1). For example, a copy of the most recent TQR template provided to the Inspector-General included the following question:

*Was the remission of interest charges considered in this case?*

4.65 Only in a small number of cases sampled by the Inspector-General was it appropriate for the remission of SIC/GIC to be considered. A review of these cases demonstrated that the remission processes had been applied appropriately.

#### **Implementation Status: Implemented**

The Tax Office has made appropriate efforts to ensure that an interest charge is remitted where the charge was attributable to Tax Office-caused delay. This has included the shifting of the responsibility for practices relating to the remission of interest charges to the Tax Office's Compliance Sub-plan — back to the officers with first-hand experience of the audit process.

In response to this recommendation, the Tax Office has prepared a revised practice statement to guide Tax Office staff — PS LA 2006/8. Part of the roll-out of the practice statement was an extensive training program to ensure that officers were aware of the implications of the new practice statement and support tools.

A review of cases by the Inspector-General demonstrated that processes to consider the remission of SIC/GIC were applied where relevant. This included the application of PS LA 2006/8.

To monitor adherence to the practice statement, the Tax Office includes a review of the application of PS LA 2006/8 in TQRs and the call over process.

## KEY RECOMMENDATION 4

*The Inspector-General recommends that the Tax Office:*

- (a) clearly articulates to the taxpayer the expected timeframes of the audit at its outset;*
- (b) ensures that Tax Office auditors comply with procedures requiring taxpayer notification of commencement and finalisation of audit activities;*
- (c) notifies taxpayers of the progress of audits where those audits involve periods of Tax Office-caused delay; and*
- (d) in complex matters, allays taxpayer concerns by ensuring that the relevant technical specialist will take account of the taxpayer's full commercial circumstances in determining the Tax Office view.*

### Tax Office Position

#### Part (a)

4.66 For audits which commence after the issue date of PS LA 2006/8 (that is 1 August 2006), the Commissioner has advised that the Tax Office will notify taxpayers at the commencement of an audit of the expected completion date. This expected completion date will be determined by applying a pre-determined cycle time that has been approved by the Active Compliance Steering Committee.<sup>118</sup>

4.67 PS LA 2006/8 has been supported by the development of published cycle times for all audit products. These anticipated cycle times are attached to each case as a part of Siebel CASE.

#### Parts (b) and (c)

4.68 The introduction of Siebel CASE now provides mandatory steps to be completed and recorded which include commencement, progress and completion notification to clients.<sup>119</sup>

#### Part (d)

4.69 A panel of industry experts (particularly in the large business sector) has been established to assist the Tax Office in its understanding of industry economics, commercial practices and related matters. Appropriate panellists will participate in risk review and audit processes.

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118 'Updated BSL response for Audit Committee November 2006' — Tax Office.

119 Ibid.

4.70 The Siebel CASE management system provides mandatory steps to be completed to ensure that technical issues are identified and that industry involvement is considered.<sup>120</sup>

## IGT Analysis

### Part (a)

4.71 On 1 August 2006 the Tax Office's Active Compliance Capability introduced a corporate-wide process to include the expected audit timeframe in all 'intention to audit' letters sent to taxpayers. The application of this process was outlined in PS LA 2006/8 as follows:

***Expected audit completion date — When notifying a taxpayer of the intention to audit, the Tax Office will generally provide an expected audit completion date in that notice. This date will be determined by applying a pre-determined audit cycle timeframe to the commencement of the audit to calculate the expected completion date. The cycle timeframe will be different for different taxes, products and markets. The cycle timeframes will be:***

- ***for Large Corporate audits commencing on or after 1 July 2005 — the time notified at the commencement of the audit or 2 years, whichever is the shorter period, and***
- ***for all other audits commencing on or after 1 July 2006 — as published on the Tax Office intranet.***<sup>121</sup>

4.72 In respect of this last dot point, the Inspector-General considers that it would be beneficial for the Tax Office to publish cycle timeframes on its external website so that taxpayers have the ability to organise their affairs around these pending obligations.

4.73 Sampling of cases commenced post-1 August 2006 undertaken by the Inspector-General demonstrated that expected audit completion dates are included in 'intention to audit' letters. In addition, a number of LB&I cases sampled involved the auditor and team leader conducting an initial meeting with the taxpayer to provide further detail — such as to discuss the types of circumstances that could affect the proposed timeframe for completion of the audit.<sup>122</sup>

4.74 Notification of the expected time to complete an audit is also included as one of the steps in the new Client Audit Management Plan which is used for large market audits. This document is provided to taxpayers (and their advisers) at the commencement of an audit to inform them about the audit process. Included in this plan is a requirement to meet with the taxpayer to discuss (amongst other things) the relevant timeframe of the audit and for both the taxpayer and the Tax Office to commit to that timeframe. Fieldwork undertaken by the

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<sup>120</sup> Ibid.

<sup>121</sup> PS LA 2006/8 — at para 19. The practice statement comments on the use of the word 'generally' by stating that there will be some circumstances when notification will not be appropriate, for example where it is expected that a case involves fraud or evasion or other criminal activity.

<sup>122</sup> The holding of these 'initial meetings' directly address a suggestion by the Inspector-General in the original 2005 review (at para 3.115).

Inspector-General demonstrated adherence to this practice. The Client Audit Management Plan is currently being updated by GST Large Active Compliance as well as by LB&I.<sup>123</sup>

#### Part (b)

4.75 The Tax Office has standard commencement and finalisation of audit letters available on its Active Compliance Work Processes System. Relevant case sampling undertaken by the Inspector-General demonstrated that these letters are being appropriately sent to taxpayers.

4.76 As part of the staggered implementation of Siebel CASE, the Tax Office is in the process of designing revised letters that notify taxpayers of the commencement and finalisation of audit activities. The timeframe for completion of this project has not yet been established.<sup>124</sup> As discussed earlier in this chapter, Siebel CASE is a step-driven system designed to ensure that officers complete this notification step before audits can be progressed to finalisation.

4.77 The requirement to provide commencement and finalisation letters is also included as part of the Tax Office's Client Audit Management Plan.

4.78 It is noted that Case Leadership does not examine the extent to which auditors comply with internal guidelines on notifying taxpayers about the start and end of an audit.

#### Part (c)

4.79 Sampling of cases by the Inspector-General indicated that there are variations in the levels of communication with taxpayers in respect of this part of the recommendation. Some auditors demonstrated a close working relationship with the taxpayer (and their adviser) with constant dialogue throughout the audit. However, in other cases a number of months had passed without appropriate contact being made.

4.80 To address this problem, the Tax Office has just recently introduced into Siebel a step requiring officers to keep taxpayers informed of the progress of an audit and to notify them of any delay. In addition, a new capability has been included into Siebel CASE enabling team leaders to monitor contact made with taxpayers.<sup>125</sup> Because of its recent introduction, it has not been possible for the Inspector-General to review adherence with this new procedure. Furthermore, for large market audits, the Tax Office has recently revised the above-mentioned Client Audit Management Plan to include a direction to staff (and a commitment to the taxpayer) that regular updates on the progress of an audit (as well as a revised plan as appropriate) will be provided. The Client Audit Management Plan is currently being updated by GST Large Active Compliance as well as by LB&I.<sup>126</sup>

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123 Both GST and LB&I use slightly different Client Audit Management Plans. Therefore a review is underway to develop a generic plan that can be used by both business lines (source: Tax Office minute, 20 August 2007).

124 ATO Minute 'Audit Timeframe Review' (20 August 2007 at p 2).

125 Source — interview on 6 September 2007 with the Tax Office's Active Compliance Capability Leader.

126 Both GST and LB&I use slightly different Client Audit Management Plans. Therefore a review is underway to develop a generic plan that can be used by both business lines (source: Tax Office minute, 20 August 2007).

## Part (d)

4.81 As mentioned in Key Recommendation 1, the Tax Office is currently revising the instructions provided to staff regarding the early engagement of technical specialists in audit planning. This involves the revision of two existing law administration practice statements — PS LA 2004/4 and PS LA 2003/10.

4.82 The Tax Office commitment to understanding a taxpayer's business when performing an audit was highlighted in the 2006 *Large business and tax compliance* booklet:

*... the Tax Office needs to understand your business context and environment. Where appropriate we will engage experts on particular industries or specific issues ...*<sup>127</sup>

4.83 In developing that understanding, auditors refer to a table of business characteristics<sup>128</sup> that were drawn from Audit Accounting Standard (402) *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatements*.

4.84 Sampling of cases by the Inspector-General indicated that where relevant, Tax Office staff are enabling the flow of communication between taxpayers and Tax Office technical specialists as per the recommendation. For example, the holding of workshops that include taxpayers, Tax Office auditors and technical specialists to discuss the impact of corporate developments (that is to ensure that the Tax Office understands the commercial circumstances faced by the taxpayer).

4.85 The Inspector-General also reviewed a number of audit cases that had been subject to the Case Leadership and the call over processes. It was evident that these governance processes reviewed whether taxpayers had been given an opportunity to work with Tax Office technical specialists to progress issues arising in the particular audits.

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<sup>127</sup> Large business and tax compliance, 2006 (at p 48).

<sup>128</sup> The table is reproduced at page 49 of the booklet Large business and tax compliance (2006).

### **Implementation Status: Implemented**

The Tax Office has introduced a number of procedural changes to address all parts of this recommendation. Apart from variations in the level of communication to taxpayers regarding the progress of audits, Tax Office staff are following these new procedures.

Sampling of cases by the Inspector-General evidenced that these procedures are being applied by the Tax Office in respect of all facets of the recommendation apart from adequate communication to taxpayers about the progress of audits. The Tax Office is aware of this issue and has recently introduced an additional procedure within Siebel CASE.<sup>129</sup>

Overall, the Tax Office has indicated via a number of public forums its commitment to improve its dealings with taxpayers during an audit. The Inspector-General views this, together with the changes made since the 2005 review, as an important commitment to continued improvements.

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<sup>129</sup> Because of the recent introduction of this change, the Inspector-General was not able to review cases to determine the implementation of this new procedure.

## CHAPTER 5: REVIEW INTO THE TAX OFFICE'S ADMINISTRATION OF PENALTIES AND INTEREST ARISING FROM ACTIVE COMPLIANCE

### OVERVIEW OF THE MAY 2005 IGT REVIEW

5.1 Prompted by concerns raised with the Inspector-General from industry and tax practitioners, a review was undertaken into the Tax Office's administrative approach to the imposition of penalties and interest resulting from audit activity. In doing so, the Inspector-General focused on the consistency in nature and extent of penalties and interest applied, and the consistency of the Tax Office's approach in the application, which were seen as promoted by:

1. having a corporate approach to the administration of the penalty and interest regimes, including a uniform set of work practices and support tools for staff;
2. having in place corporate management information systems;
3. providing guidance to taxpayers and their advisers on the application and remission of penalties and interest; and
4. having in place quality assurance and staff-skilling processes.<sup>130</sup>

#### Australian National Audit Office Review

5.2 Part of the context of the Inspector-General's review was that the Australian National Audit Office (ANAO) had tabled a report in 2000 of its review titled *Administration of Tax Penalties*<sup>131</sup>. This ANAO review examined the Tax Office's administration of penalties with a particular emphasis on its corporate governance framework and issues relating to the consistency, effectiveness and accountability in the administration of the then-current penalty regime.

5.3 The ANAO review found that there was scope for improvement in the Tax Office's administration of the penalty regime and concluded that, although penalties were an important enforcement strategy featured in the ATO Compliance Model, the Tax Office lacked appropriate control structures to oversee the accountability, consistency and effectiveness of its penalty administration. The ANAO made a number of key findings that flowed into five recommendations, all of which were agreed to by the Tax Office.

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130 Review into the Tax Office's Administration of Penalties and Interest Arising from Active Compliance (2005) Inspector-General of Taxation (at 2.4).

131 Australian National Audit Office, Report No. 31 of 1999-2000 (tabled 16 February 2000), *Administration of Tax Penalties*.

## Review of Aspects of Income Tax Self Assessment

5.4 Also relevant to the Inspector-General's review, in November 2003 the then Treasurer announced the Review of Aspects of Income Tax Self Assessment. On 16 December 2004, the outcome of the review was announced by the then Treasurer with the release of the *Report on Aspects of Income Tax Self Assessment* (ROSA). The previous government endorsed all 54 recommendations in the report.

5.5 The recommendations were designed to improve taxpayer certainty through:

- a better framework for Tax Office advice;
- increased protection for taxpayers such as shorter periods of review for those with straightforward tax affairs;
- reduced compliance costs;
- mitigation of the interest and penalty consequences of taxpayer errors; and
- subsequent improvements as a result of better policy processes, law design and administrative approaches.

5.6 Those recommendations requiring legislative solutions were given effect by the *Tax Laws Amendment (Improvements to Self Assessment) Act (No. 1) 2005* and the *Tax Laws Amendment (Improvements to Self Assessment) Act (No. 2) 2005*. The majority of the remaining recommendations require administrative solutions and are being addressed progressively by the Tax Office.

### The Inspector-General's 2005 review

5.7 At the time of release of the Inspector-General's 2005 report only some progress had been made by the Tax Office in implementing the ANAO recommendations. Therefore, the prompt implementation of the remaining ANAO recommendations formed the basis of Key Recommendation 1 of the Inspector-General's report.

## IMPLEMENTATION OF RECOMMENDATIONS

### KEY RECOMMENDATION 1

*The Tax Office promptly acts to ensure that the agreed ANAO recommendations are fully implemented and addresses the findings identified in the ANAO report.*

5.8 To assess the extent to which the Tax Office has implemented the Inspector-General's key recommendations, the Inspector-General has examined progress on all of the ANAO's recommendations and findings made in 2000.

## ANAO Recommendation 1 part (a)

The Tax Office includes penalties administration within its corporate governance framework in order to provide assurance to the Commissioner that it is operating consistently and effectively. This could include:

- establishing organisation-wide quality assurance of the Tax Office penalty administration to assist in promoting better practice and provide assurance that it is operating consistently.

## ANAO Finding 19

The audit found that the Commissioner does not receive assurance through the ATO's corporate governance framework that the penalty regime is operating effectively or consistently.

## ANAO Finding 20

The ANAO considers there would be benefit to the ATO in taking a more systematic approach to the quality assurance of penalties and analysing and reporting penalty information as a part of its governance reporting process.

### Tax Office Position

5.9 The Tax Office has not provided the Inspector-General with its internal view on the status of implementation of the ANAO recommendations and findings.

5.10 The Tax Office reviews the technical quality of its interpretative decisions in February and August of each year through the Technical Quality Review (TQR) process. This process was introduced in 2001 following the release of law administration practice statement PS LA 2001/11 *Technical Decisions — Quality Reviews*. TQRs involve having a statistically sound random sample of interpretative work (including decisions concerning the imposition and remission of penalties) reviewed by specially convened panels of experienced technical Tax Office staff and external tax practitioners. The TQR process also includes a range of conformance checks to measure compliance with the policies and practices that support the technical and interpretative decision making activities of the Tax Office.

5.11 At the completion of each TQR, a report is finalised which includes relevant findings and recommendations that are referred back to business lines to assist in promoting better practice.

5.12 Each business line completes a TQR report template that is referred to the Assistant Commissioner, Technical Practice, Office of the Chief Tax Counsel (OCTC). This report is also referred to the Second Commissioner (Law) and finally to the Commissioner of Taxation for corporate reporting purposes.

5.13 Further quality assurance is undertaken via a number of quality intervention points that are completed within the Tax Office's new case management system (known as Siebel CASE). Data from this system, together with information gathered from a number of sources, is compiled to produce the monthly Heartbeat summary report. This report, prepared by the Compliance Penalties & Interest Team (CPIT) for the Compliance Executive (which includes

the Second Commissioner (Compliance)), tracks performance for each market segment and provides analysis of current issues surrounding penalties administration.

#### IGT Analysis

5.14 A TQR is performed twice per year to provide an analysis of the technical quality of interpretative decisions (including those relating to penalties). Panels of experienced technical Tax Office staff and external tax practitioners review a random sample of cases. These reviews have occurred since the introduction of the process in 2001.<sup>132</sup> Feedback arising from the reviews is provided to case officers (and where relevant, case approvers) to improve work practices and the quality of technical and interpretative decision making. A report is prepared for corporate governance purposes and includes not only performance measurement but also analysis of areas requiring improvement. This report is referred through to the Commissioner of Taxation for corporate reporting purposes (the Tax Office's annual report includes analysis of the TQR process).

5.15 The introduction of the Siebel CASE system in 2006 also provided the Tax Office with a number of quality checks that are undertaken during the case management process. Data from this system is used to prepare the monthly Heartbeat summary report that provides the Compliance Executive with the current performance of each market segment as well as an analysis of the main current issues surrounding penalties administration. The first such report was prepared in February 2007.

#### Implementation Status of ANAO Recommendation: Implemented

The Tax Office undertakes the TQR process twice each year for all business lines. A detailed report is prepared after each review and this is referred to the ATO Executive and finally to the Commissioner of Taxation for corporate reporting purposes. An analysis of the TQR process is included in the Tax Office's annual report. Information gained from the TQR process is used to promote better practice within Active Compliance. Relevant feedback is provided to case officers and case approvers.

The introduction of the Tax Office's Siebel system has also included a number of quality control points in the case management environment. Data from this system is included in the monthly Heartbeat summary report outlining the performance of penalties administration for each market segment.

#### ANAO Recommendation 1 part (b)

The Tax Office includes penalties administration within its corporate governance framework in order to provide assurance to the Commissioner that it is operating consistently and effectively. This could include:

- using statistical and demographic data to monitor the effectiveness of penalties in addressing and improving compliance.

## ANAO Recommendation 5

The Tax Office study the relative effectiveness of penalties on taxpayer behaviour to assist in determining whether penalties have been effective. This would assist the Tax Office in improving taxpayer compliance and in refining the Compliance Model.

### Tax Office Position

5.16 The Tax Office has not provided a report to the Inspector-General of its internal view on the status of implementation of the ANAO recommendations and findings.

5.17 The Tax Office's CPIT coordinated research via two methods:

1. internal research involving the analysis of internal data to identify changed behaviour of taxpayers subsequent to the application of a penalty (completed 3 June 2006);
2. external research which involved the commissioning of Colmar Brunton Social Research<sup>133</sup> (CBSR) to study how the taxation penalties regime influences taxpayer attitudes and behaviour regarding their tax obligations (completed 23 May 2006).

### IGT Analysis

#### *Tax Office Internal Research*

5.18 Two main approaches were used to undertake the internal research:

1. a study of the effectiveness of compliance action and penalties on taxpayer behaviour; and
2. an examination of the characteristics and indicators of compliance across different taxpayer groups in order to assist future compliance monitoring.

5.19 The overall conclusion from the Tax Office's internal analysis was that compliance action and penalties can influence taxpayer's compliance behaviour — however not in all cases. It was found that it was most likely to have a greater impact on taxpayers that are already trying to be compliant. However, it was also concluded that in the absence of controlled pre- and post- audit monitoring and subsequent follow-up action:

***... only inferences can be made about the impact of penalties on their compliance behaviour. There is no actual measure of impact.***<sup>134</sup>

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133 External service providers contracted to provide a quantitative data analysis to measure the effectiveness of penalties on taxpayer behaviour.

134 'Impact of Penalties on Compliance Behaviour — Internal Research' — Tax Office 3 June 2006.

### External Research

5.20 The primary focus for this research was on taxpayer knowledge and awareness of penalties, and the subsequent impact this has on behaviour. The study found that overall awareness of penalties was high, but participants did not have much knowledge of them. More than 90 per cent of respondents believed that the consequence of non-compliance with the Tax Office is a penalty which is in itself a deterrent.

5.21 The CBSR study recommended that the Tax Office develop an education and information package aimed at the general public regarding tax penalties as participants did not possess specific knowledge of the penalty regime. The study also recommended the Tax Office ensure that it has an efficient and fair system that applies penalties to non-compliers and that it continues monitoring community attitudes to tax and tax penalties. This last recommendation was made by CBSR in response to the perception held by participants in the study that:

*... those taxpayers with higher incomes can work the system.*<sup>135</sup>

5.22 In summary, the CBSR study did not conclude that the Tax Office inefficiently and unfairly applies penalties to non-compliers. The recommendation was made to re-affirm the need for the Tax Office to ensure that an efficient and fair system is in place.

5.23 The Tax Office has used both internal and external resources to analyse the effectiveness of penalties on taxpayer compliance by reference to collected data. The internal study provided an overall conclusion that penalties can influence compliance behaviour but noted that there was no direct measure available. The overall conclusion of the CBSR study was that the influence of tax penalties is moderate, with more than half of participants in the study reporting that they comply because there are tax penalties.

5.24 The CPIT has applied knowledge gained from these research projects in preparing the Tax Office's plain English guide to penalties and interest (titled *About penalties and interest charges* — refer to ANAO Recommendation 4).<sup>136</sup>

5.25 It is noted in the ANAO report<sup>137</sup> that the Tax Office does not monitor in subsequent years whether there is any alteration in the behaviour of those taxpayers that had been identified as non-compliant. The Tax Office has confirmed that such systematic follow-up action is not undertaken.<sup>138</sup> The Inspector-General considers that appropriate follow-up action would provide the Tax Office with additional information that could assist in the identification of the need for change in the administration of penalties.

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135 The Influence of Penalties on Taxpayer Behaviour, Colmar Brunton Social Research study — May 2006 (at p 11).

136 External Scrutineers' Recommendations Database — report provided by the Tax Office's Policy & Management Division on 7 March 2007.

137 Australian National Audit Office, Report No. 31 of 1999-2000 (tabled 16 February 2000), Administration of Tax Penalties (at 3.39).

138 Source — conference with the Director in charge of the CPIT — 23 February 2007.

## Implementation Status of ANAO Recommendation: Implemented

The CPIT has corporate responsibility for the roll-out of major improvements relating to penalties and interest, a number of these arising from external reviews. Through this team the Tax Office has coordinated two research studies into the influence that penalties have on taxpayer compliance.

This research has been undertaken in accordance with the ANAO recommendations and the knowledge gained has been used in preparing the Tax Office's plain English guide to penalties and interest (titled *About penalties and interest charges*). The Inspector-General expects that the Tax Office, through the CPIT, will continue to use the two research projects in delivering further improvements.

## ANAO Recommendation 2

The Tax Office technical training material on penalties includes reference to, and discussion of, the impact of the Taxpayers' Charter and the Compliance Model. This would include guidance on the application of penalties to the different scenarios outlined in the Compliance Model.

## ANAO Finding 21

ATO staff training in relation to penalties could be enhanced by including the linkages between the Taxpayers' Charter, the Compliance Model and the imposition and remission of penalties. Also, training materials could be improved by providing analyses of the different gradations of non-compliant behaviour and the appropriate enforcement strategies to be applied.

### Tax Office Position

5.26 The Tax Office has not provided a report to the Inspector-General of its internal view on the status of implementation of the ANAO recommendations and findings.

5.27 The Tax Office has developed the 'Guide to how a taxpayer's compliance history affects a penalty decision' and has a corporate-wide training package in relation to administrative penalties. Both of these products are for internal use only.

### IGT Analysis

5.28 The above-mentioned guide includes discussion on how the Taxpayers' Charter and the Compliance Model are to be applied by Tax Office staff when administering the imposition and remission of penalties. For example, it outlines to staff how the Compliance Model must be applied on a whole-of-taxpayer basis — in other words, where there is some doubt about whether a taxpayer has a good compliance history, that taxpayer's other roles and activities should be examined to assist in forming a view of their overall level of compliance. Guidance on the application of the penalties regime to a number of practical scenarios is also included in the guide in line with the ANAO recommendation.

5.29 The guide has not yet been released as the Tax Office is currently reviewing whether it should be published as a practice statement.

5.30 The Tax Office also provided the Inspector-General with its internal training package relating to penalties. As part of a PowerPoint presentation, some limited comments are made by presenters about both the Compliance Model and the Taxpayers' Charter. However, these comments do not include a discussion of the impact of the Compliance Model or the Taxpayers' Charter.

5.31 The Tax Office has stated that there is no other technical training material relating to penalties which includes instructive guidance on the impact of the Taxpayers' Charter and the Compliance Model.<sup>139</sup>

5.32 The Tax Office has agreed that the recommendation has not been explicitly finalised. However it asserts that it has successfully integrated these principles into its compliance practice. During the 2005-06 financial year more than 3,000 Tax Office staff participated in penalties-related training.

5.33 The Inspector-General has examined practice statements PS LA 2006/2 *Administration of shortfall penalty for false or misleading statement* and PS LA 2006/8 *Remission of shortfall interest charge and general interest charge for shortfall periods* and notes that PS LA 2006/2 instructs staff to consider the Taxpayers' Charter and the Compliance Model and to consider the impact that penalties will have on future compliance by taxpayers. PS LA 2006/2 also refers to the need for Tax Office staff to consider specific principles from the Taxpayers' Charter and the Compliance Model when considering penalty remission.

#### **Implementation Status of ANAO Recommendation: Partly Implemented**

The Tax Office has taken some steps towards implementing this recommendation by developing guidelines for Tax Office staff on how they are to consider a taxpayer's compliance history when making a decision about the imposition or remission of penalties. However, seven years has passed since the release of the ANAO report and these guidelines are yet to be released. Currently the Tax Office is debating what format the guidelines should take, resulting in further delays.

However, the release of the above-mentioned Tax Office practice statements in 2006, together with continued application by Tax Office staff, has addressed the essence of the ANAO recommendation.

#### **ANAO Recommendation 3**

The Tax Office investigates the cost-effectiveness of providing on-line decision support tools to staff to assist with consistent and efficient application of penalties.

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139 Source — conference with the Director in charge of the CPIT — 23 February 2007.

## ANAO Finding 22

The ANAO found the Tax Office could better align its penalty administration with the principles and undertakings of the Taxpayers' Charter and the Compliance Model by developing a cost-effective, on-line rule-based decision support system and access to taxpayer history and profiles.

### Tax Office Position

5.34 The Tax Office has not provided a report to the Inspector-General of its internal view on the status of implementation of the ANAO recommendations and findings.

5.35 In March 2006 the Tax Office issued PS LA 2006/2 *Administration of shortfall penalty for false or misleading statement* in respect of the penalties regime. An online decision support tool is currently in the draft stage with responsibility undertaken by the CPIT.<sup>140</sup>

5.36 The Tax Office has not investigated the cost-effectiveness of this tool.<sup>141</sup>

### IGT Analysis

5.37 The Inspector-General recognises that the development of an online decision support tool relating to the penalties regime is a significant task in light of the complexity and size of the legislation involved. However, over a year has now passed since the release of PS LA 2006/2 and the Tax Office is yet to undertake a cost-effectiveness analysis as recommended by the ANAO.

#### Implementation Status of ANAO Recommendation: Not Implemented

The Tax Office accepts that it has not specifically nor completely implemented this ANAO recommendation. It has been seven years since the ANAO made its recommendation, however, the Tax Office has not yet investigated the cost-effectiveness of an online support tool.

Nevertheless, it appears that the Tax Office is proceeding with an online decision support tool in line with that contemplated by the ANAO, regardless of its cost-effectiveness. The Inspector-General supports this development and the fact that the specific recommendation for a cost-effective study has not been undertaken is not a substantive criticism from a tax administration perspective.

## ANAO Recommendation 4

The Tax Office Guide provides information in a plain English format to taxpayers about the penalties regime.

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140 Tax Office 'Penalties and Interest Issues Paper Work Plan' — 2006.

141 Source — conference with the Director in charge of the CPIT — 23 February 2007.

## ANAO Finding 23

The ANAO considered that informing taxpayers of their tax obligations is central to the issue of fairness. In a self-assessment environment, taxpayers need to know of their obligations and responsibilities under the law. The audit identified the provision of information for taxpayers about penalties as an area that could be readily improved.

### Tax Office Position

5.38 In November 2006, the Tax Office reported that the status of implementation of this recommendation was in progress with a completion rate of 90 per cent.<sup>142</sup>

5.39 The Tax Office has produced a plain English guide to penalties and interest (titled *About penalties and interest charges*) which is available on the Tax Office website. This publication provides taxpayers with an overview of both the penalties and interest regimes including an outline of the factors that are considered by the Tax Office in deciding whether to remit. The Tax Office has also prepared the *ROSA-in-brief* series of reference tools which explain the key changes adopted by the previous government in reforming aspects of income tax self assessment.

### IGT Analysis

5.40 The *About penalties and interest charges* plain English guide has been developed in line with the ANAO recommendation and finding. Also, the Tax Office has already prepared a number of such guides and fact sheets.

#### Implementation Status of ANAO Recommendation: Implemented

The Tax Office has adopted a number of methods to succinctly inform taxpayers about the application and remission of penalties. In addition, a number of new initiatives have been implemented to guide taxpayers through the main changes resulting from ROSA.

5.41 The following ANAO findings were not aligned with any ANAO recommendation. The Inspector-General has reviewed how the Tax Office has addressed these findings.

## ANAO Finding 24

The ANAO found that the ATO does not leverage off its fieldwork where tax shortfalls have been identified, by following-up in future years the effectiveness of penalties on taxpayer behaviour. Such follow-up would enable the ATO to build profiles of non-compliance and to develop indicators of penalty effectiveness.

### Tax Office Position

5.42 In June 2006 the Tax Office completed a research project (as discussed in ANAO Recommendations 1 part (b) and 5) that included an analysis of internal data to identify the

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142 External Scrutineer's Recommendations Database — Tax Office/Policy Management Division, report provided to the Inspector-General on 9 March 2007.

changed behaviour of taxpayers subsequent to the application of a penalty. This also included an examination of the characteristics and indicators of compliance across different taxpayer groups so as to assist the Tax Office with future compliance monitoring.

5.43 The Tax Office is also currently undertaking an internal research project (titled 'Measures of effective compliance') regarding the effect of Tax Office compliance activity on future levels of taxpayer compliance.

#### IGT Analysis

5.44 The above-mentioned projects do not address the ANAO finding that the Tax Office should:

*... monitor those taxpayers identified as non-compliant in subsequent years to review any alteration in behaviour*<sup>143</sup>

5.45 Put simply, the ANAO view was that the Tax Office should undertake a systematic follow-up in future years, where appropriate, of those taxpayers who had previously been detected as liable for a tax shortfall penalty. Such a practice has not been attempted by the Tax Office.<sup>144</sup> However, the Tax Office has thought about the issue raised by the ANAO finding and has done some related research. The Inspector-General notes and accepts the Tax Office's conclusion, based partly on its research, that:

*... it is very difficult to discern the impact of penalties versus the impact of a particular compliance activity such as an audit.*<sup>145</sup>

#### ANAO Finding 25

**Streamlining claims to legal professional privilege and to concessions under ATO Guidelines for Access to Professional Accounting Advisers Papers.**

#### Tax Office Position

5.46 In 2005 the Tax Office commenced a comprehensive review of its 'Access and Information Gathering Manual' which sets out a summary of the law relating to the Tax Office's access powers as well as the way in which it exercises these powers. The review resulted in a number of improvements including the development of a number of pro forma documents for inclusion in the manual. Claimants for legal professional privilege and for the Accountant's Concession must complete one of these pro forma documents which include details on how they substantiate their claim.

#### IGT Analysis

5.47 The requirement to complete these pro forma documents has streamlined the claiming process as claimants quickly become aware of the need to prove their position. The Inspector-General concludes that the Tax Office has addressed ANAO finding 25.

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143 Australian National Audit Office, Report No. 31 of 1999-2000, Administration of Tax Penalties (at 3.39).

144 Source — conference with the Director in charge of the CPIT — 23 February 2007.

145 Tax Office minute — 5 April 2007 (at p 4).

## ANAO Finding 26

The audit found other potential areas for improvement relating to the ATO's administration of particular penalties including:

- i) giving priority to outstanding systems changes to implement accurate calculation of the GIC on a compounding basis as required by legislation.

### Tax Office Position

5.48 Towards the end of 2004-05, the Tax Office was made aware of a possible error in the calculation of GIC with respect to amended assessments for periods prior to 2000. Tax Office business systems had been designed to apply GIC to the total debt outstanding at the date GIC took effect, which included interest amounts incurred under the previous interest regime. In resolving a taxpayer complaint, the Tax Office reviewed the basis of the underlying design of the business system and concluded that GIC should not apply to the previous interest amounts. In September 2005 the Tax Office's systems used to calculate GIC were reprogrammed to fix the error.

### IGT Analysis

5.49 This ANAO finding was made in 2000. Had the Tax Office addressed this issue promptly it may have avoided the significant problems it experienced in 2004-05. As at 31 January 2007, approximately 96.5 per cent of the affected taxpayers had had their matters corrected. Outstanding matters were to be completed by 30 June 2007. The Inspector-General concludes that the Tax Office has now addressed ANAO finding 26 part i), but should have done so earlier.

- ii) eliminating anomalies that exist between administrative penalties and penalties imposed through prosecution. This could reduce the incidence of taxpayers preferring prosecution to administrative penalties.

### Tax Office Position

5.50 In 2000 a new uniform administrative penalty regime was introduced (via Part 4-25 of the *Taxation Administration Act 1953*) that has removed the anomalies raised in this ANAO finding. In particular, Division 286 caps the amount of penalty to \$2,750 for failing to lodge returns or other documents in the approved form by the required time.

### IGT Analysis

5.51 The introduction of new legislation in 2000 has removed the former disparity between the scale of penalties applied by the Tax Office and those imposed as a result of prosecution. Taxpayers no longer have an incentive to delay matters in order to access more favourable treatment through prosecution. The Inspector-General concludes that the Tax Office has addressed ANAO finding 26 part ii).

- iii) implementing system changes to avoid incorrectly applying Late Lodgement Penalty to 'nil trading' companies.

## Tax Office Position

5.52 A number of changes are to be made to the Tax Office's lodgement systems as part of Release 3 of the Change Program (due to commence in late 2007) that directly address this issue for late lodgers. Put simply, the Tax Office proposes that where a return is lodged late the new system is to automatically review the tax position of the taxpayer before deciding on the imposition of penalty. Exclusions are built into the system such that, for example, a non-taxable company will automatically be excluded from the Failure To Lodge (FTL) penalty.

5.53 Note that for non-lodgers the above exclusions do not apply. However, the Tax Office does undertake risk testing to ascertain the profile of the taxpayer. For example, a search of the Australian Securities and Investments Commission database can reveal whether the taxpayer company is actually trading or is simply a shelf company — resulting in the non-imposition of the FTL penalty. Commitment to the Compliance Model also requires the Tax Office to notify taxpayers when a document is late or not lodged at all — further reducing the likelihood of penalty imposition without taxpayer involvement. This is further supported in the Tax Office fact sheet *Failure to lodge on time fact sheet for practitioners* where it is stated that:

***Generally, we will not apply FTL penalties unless we have warned you about a document that is late or not lodged at all.***

## IGT Analysis

5.54 Seven years after this issue was included in the ANAO report, Tax Office systems continue to incorrectly apply FTL penalty to late lodging nil trading companies<sup>146</sup>. The Tax Office response is that this issue has been addressed — where a taxpayer is incorrectly penalised and an error is detected, the penalty will be remitted.<sup>147</sup>

5.55 The Tax Office stated in the ANAO's 2000 report that a system change cannot be developed that would allow the correct differentiation between classes of taxpayers in all cases. Put simply, there is no system change that could identify nil trading companies because classification is dependent upon answering a question of fact (being whether the company in question is or is not 'carrying on business'). The Tax Office also advised that including a new label on income tax returns was not feasible in terms of space on the return and other costs.<sup>148</sup>

5.56 For non-lodgers, the Tax Office undertakes testing to determine whether the taxpayer represents a risk to revenue and therefore should be penalised for failing to lodge as required. The current level of sophistication involved with this testing does not guarantee that nil trading companies will be excluded from FTL penalty. These taxpayers must then request appropriate remission from the Tax Office.

5.57 For late lodgers, Release 3 of the Change Program includes system enhancement to automatically exclude taxpayers such as nil trading companies from FTL penalty. However

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146 Nil trading companies are companies which are defined as having no income, no deductions and/or no carried forward losses.

147 Source — conference with the Director in charge of the CPIT — 23 February 2007.

148 Australian National Audit Office, Report No. 31 of 1999-2000, Administration of Tax Penalties (at 3.71).

these changes are not scheduled to be implemented until late 2007. The Inspector-General concludes that the Tax Office has addressed ANAO finding 26 part iii).

iv) **improving tax agent lodgement programs to reduce the need to apply Late Lodgement Penalty.**

#### **Tax Office Position**

5.58 The Tax Office continues to work with the Lodgement Working Party<sup>149</sup> (a group chaired by the Deputy Commissioner — Tax Practitioner and Lodgement Strategy) to improve the lodgement performance of tax agents. In 2006, the Commissioner of Taxation supported a review of the tax agent lodgement program in order to make preliminary recommendations about how to improve the 2007-08 and future year lodgement programs. A report<sup>150</sup> for the review was released on 18 June 2007 with the vast majority of stakeholders consulted indicating that where they were satisfied with the current lodgement program structure.

#### **IGT Analysis**

5.59 The above-mentioned report found that the lodgement program distributed work loads evenly throughout the year and concluded that the current lodgement structure be retained. However, the report also found that the lodgement program included a number of complexities that could affect the ability of agents to manage their programs; for example, the uncertainty faced by tax agents due to delayed consideration by the Tax Office of complicated lodgement deferral requests. In response the Tax Office has introduced two new options to arrange deferral:

1. Firstly, the self assessed deferral request system provides for lodgement deferrals to be automatically granted under self assessment arrangements. This option saves tax agents the time and resources involved with preparing detailed lodgement deferral requests.
2. The second deferral option is the one-for-one deferral option which allows agents to defer lodging returns for clients who are up to date so as to help ease the burden of preparing and lodging returns for those clients who have been operating outside the system.

5.60 The Inspector-General concludes that the Tax Office has addressed ANAO finding 26 part iv).

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149 The Lodgement Working Party (LWP) is a sub-group of the ATO/Tax Practitioner Forum. The LWP develops and designs the tax agent lodgement program each year to reflect changing workloads, priorities, legislation and revenue requirements. The LWP is chaired by the Deputy Commissioner — Tax Practitioner and Lodgement Strategy.

150 'Lodgment program review final report' — recommendations for the tax agent lodgement program 2007-08, as well as other recommendations to improve the lodgement workloads of agents (Tax Office 18 June 2007).

## Key Recommendation 1 — Overall Implementation status: Implemented

The Tax Office internal report to its Audit Committee on this recommendation is that it is 90 per cent completed. The Inspector-General considers this to be an appropriate assessment.

The Tax Office has implemented three of the five ANAO recommendations and partly implemented the fourth. The Inspector-General notes that the TQR, research studies and the plain English guide to penalties are probably the more significant ANAO recommendations and they have been implemented.

However, seven years since the ANAO review, ANAO Recommendation 2 regarding the development of training material about the impact of the Taxpayers' Charter and the Compliance Model on penalties administration remains only partly implemented.

## KEY RECOMMENDATION 2

*The Tax Office develops a uniform set of processes, procedures, corporate management information systems and guidance to staff for cross-business line application.*

### Tax Office Position

5.61 In November 2006, the Tax Office reported that the implementation of this recommendation was completed with a completion rate of 100 per cent.<sup>151</sup>

5.62 In response to the Inspector-General's original review, the ATO Executive commissioned the Penalties and Interest Project to ensure that a range of commitments relating to penalties and interest were implemented in a coordinated way. An early deliverable of the project was to recommend preferred organisational arrangements for improving the administration of the penalties and interest regime. These arrangements were to provide assurance that policies and practices would be consistent across business lines, revenue products and markets.

5.63 A corporate model was adopted in March 2006. A key member is the CPIT that was established to coordinate and provide a corporate view on policies, practices and decisions relating to penalties and interest. An important contribution to this task was the release by the Tax Office of PS LA 2006/2 and PS LA 2006/8 (together with various support tools).

5.64 The Tax Office is also undertaking a staggered implementation of the Siebel system designed to manage how the Tax Office actions, monitors and stores its case work — a 'one-stop' corporate management information system. Work continues with the roll-out of

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151 External Scrutineer's Recommendations Database — Tax Office/Policy Management Division, report provided to the Inspector-General on 9 March 2007.

Siebel's Case Management and Work Management systems.<sup>152</sup> The next stage of implementation is the delivery of a facility that will develop purpose-specific reporting for penalties and interest — the Integrated Core Processing system.<sup>153</sup>

5.65 The monthly Heartbeat report is also a useful management information system that tracks the imposition of penalties and interest. This report is prepared by the CPIT and contains comments from the director of the CPIT regarding the performance of Active Compliance with regards to penalties and interest administration.

5.66 The TQR process is the corporate tool uniformly applied throughout the Tax Office to measure the technical quality of interpretative decisions. Information gained from this process is included in a report that is referred to the ATO Executive including the Commissioner of Taxation for corporate reporting purposes. These reports are also referred back to the business lines to provide staff with further guidance and instruction on the completion of interpretative decisions.

#### IGT Analysis

5.67 The establishment of the CPIT has resulted in a single area with corporate responsibility for ensuring policies, practices and information relating to penalties and interest administration is provided to staff for cross-business line application. Prior to this, such work was undertaken individually by each business line, often resulting in disjointed practices throughout the Tax Office.

5.68 The project work undertaken by the CPIT has resulted in a number of changes including the release of PS LA 2006/2 and PS LA 2006/8. The release of these two practice statements has seen the completion of a significant piece of work for the CPIT and provides Tax Office staff with guidance, direction and assistance in line with Key Recommendation 2. Importantly, the progress of implementation of these changes continues to be monitored in terms of technical quality via the TQR process (see ANAO Recommendation 1 (part a)).

5.69 However, the Tax Office has acknowledged that until further implementation of the Siebel system is completed, it will not have the ability to readily access data on a macro-level and therefore be able to undertake the level of analysis required to provide information from a corporate-wide perspective.<sup>154</sup> In addition, the Tax Office acknowledges that the value of comments included in the draft February 2007 Heartbeat report provided to the Inspector-General is limited.<sup>155</sup>

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152 'Simplifying Tax Administration in a Complex World: The Challenge of Infinite Variety' — speech by the Commissioner of Taxation at the Australasian Tax Teachers Association Conference (24 January 2007).

153 'Penalties and interest project finalisation report 30 June 2006' — Tax Office (at page 17). The Integrated Core Processing System (ICP) is to replace around 75 systems and is designed to capture information in one location so as to reduce the likelihood of repeated requests by Tax Office staff for a taxpayer to provide the same set of information. It is anticipated that ICP will be ready to handle income tax matters from March 2008.

154 Source — conference with the Director in charge of the CPIT — 23 February 2007.

155 Ibid.

## Implementation Status: Implemented

In response to the Inspector-General's 2005 review, the Tax Office put in place a corporate model designed to support the consistent and accurate administration of penalties and interest. A key part of this was the establishment of the Corporate Penalties and Interest Team which continues to coordinate the implementation of a number of the Inspector-General's recommendations. An important initiative of this team has been the release of PS LA 2006/2 and PS LA 2006/8 which has provided significant direction and impetus for change corporately.

The Tax Office has yet to implement a corporate management information system that can examine whether there is consistency in the nature and extent of penalties and interest applied at a Tax Office-wide level. However, the continued implementation of the Siebel system as part of Release 3 of the Change Program is set to establish this level of reporting.

## KEY RECOMMENDATION 3

*The Tax Office includes an examination of the administration of the tax shortfall interest regime from the same perspective as its internal review into the penalty regime.*

### Tax Office Position

5.70 In November 2006, the Tax Office reported that the status of implementation of this recommendation had been fully implemented.<sup>156</sup>

5.71 In October 2005 the ATO Executive commissioned a project (known as the Penalties and Interest Project) to ensure that a range of outstanding commitments relating to the tax shortfall interest regime were implemented. These commitments related to reviews undertaken by the Inspector-General and the ANAO as well as Treasury's Review of Aspects of Income Tax Self Assessment. The initial scope of responsibilities for the project team was limited to these outstanding commitments and optimising organisational arrangements for the administration of the interest (and penalties) regimes. However, it was soon decided by the ATO Executive that an additional need was for a compliance view on interest (and penalties) resulting in the formation of the CPIT.

5.72 In 2006 the CPIT reviewed existing arrangements relating to the tax shortfall interest regime and identified a number of opportunities for improvement. For example in line with the Inspector-General's 2005 review<sup>157</sup>, a major organisational change shifting responsibility for developing policy and practice of pre-amendment interest decisions from Operations to Compliance was adopted.

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156 External Scrutineer's Recommendations Database — Tax Office/Policy Management Division, report provided to the Inspector-General on 9 March 2007.

157 Review into the Tax Office's Administration of Penalties and Interest Arising from Active Compliance (2005) — Inspector-General of Taxation (at 4.26).

5.73 The CPIT's review also involved consideration of the outcomes and recommendations arising from the Review of Aspects of Income Tax Self Assessment. Most important in terms of this recommendation was the release of PS LA 2006/8.

#### IGT Analysis

5.74 Although a formalised internal examination of the administration of the tax shortfall interest regime as recommended by the Inspector-General has not occurred, the CPIT has reviewed, and continues to review, this regime with a view to ensuring that a range of commitments arising from previous external reviews are implemented. As part of this process, the CPIT has examined existing arrangements and identified a number of opportunities for change and improvement. An example is the continued work by the CPIT in respect of the inclusion of remission of interest decisions in the TQR process in April 2007.

#### Implementation Status: Implemented

Following the Inspector-General's 2005 review, the ATO Executive commissioned a project to ensure that a range of commitments relating to the tax shortfall interest regime were implemented. This included establishing a corporate model for the administration of interest and the subsequent release of PS LA 2006/8.

Although a formal review of the administration of the tax shortfall interest regime as recommended by the Inspector-General has not been undertaken, the significant work involved with the above key initiatives has effectively achieved the implementation of this recommendation.

#### KEY RECOMMENDATION 4

*The Tax Office considers, as part of its internal review, suggested improvements to the administration of the penalties and interest regime as set out in Chapter 4.*

#### Tax Office Position

5.75 In November 2006, the Tax Office reported that the status of implementation of this recommendation had been fully implemented.<sup>158</sup>

5.76 Submissions from professional associations together with enquiries and investigations by the Inspector-General identified a number of improvements for the Tax Office to consider in its administration of the penalties and interest regimes. These suggested improvements were included in the Inspector-General's original report.<sup>159</sup>

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158 External Scrutineer's Recommendations Database — Tax Office/Policy Management Division, report provided to the Inspector-General on 9 March 2007.

159 Review into the Tax Office's Administration of Penalties and Interest Arising from Active Compliance (2005) — Inspector-General of Taxation (at 4.111).

5.77 The Inspector-General has examined the extent of implementation of this recommendation and concludes that the Tax Office has considered all suggested improvements from Chapter 4 of the Inspector-General's 2005 review. The suggested improvements are as follows:

1. Providing staff with general guidance on determining a taxpayer's overall level of compliance.
2. Providing clearer guidance on when an audit has commenced and providing taxpayers with an opportunity to make voluntary disclosures prior to an audit formally commencing.
3. Providing greater guidance to taxpayers and their advisers on the operation of the penalty concessions for voluntary disclosures.
4. Consolidating the Tax Office view on voluntary disclosures into one corporate document.
5. Introducing service standards for the finalisation of an audit where the taxpayer makes a voluntary disclosure.
6. Introducing service standards for issuing amended assessments once the final audit report is approved and sent to the taxpayer.
7. Clarifying the responsibility of case officers to consider tax shortfall interest remission as part of the audit process under the Tax Office's Receivables Policy.
8. Providing greater guidance to taxpayers and their advisers on the factors that staff would consider in determining the statutory increase, decrease and remission of penalties.
9. Reviewing the currency of a number of taxation rulings released by the Tax Office prior to the introduction of the new administrative penalties regime.
10. Providing greater guidance to taxpayers and their advisers on the application of penalties relating to schemes pursuant to Subdivision 284-C of the *Taxation Administration Act 1953*, including how the provisions operate and the circumstances that lead to an increase in the base penalty amount.
11. Providing more targeted information to taxpayers in different markets and tailoring its education strategy to deal with differences in understanding and focus in different markets.
12. Providing further training and guidance to staff to improve file management and the quality of written penalty decisions.
13. Establishing organisation-wide quality assurance processes for tax shortfall interest remission decisions.
14. Developing a skilling package in relation to the tax shortfall interest regime.

15. Developing a template for penalty and interest decisions to provide greater guidance to staff on the key issues that should be addressed when considering the application of penalties and interest.
16. Including, as part of its audit quality assurance process, consideration of the extent that case officers follow the audit procedures regarding the imposition and remission of administrative penalties and interest.

**Implementation Status: Implemented**

The Tax Office has considered all of the suggested improvements that were included in Chapter 4 of the Inspector-General's 2005 review. More importantly, the Inspector-General's analysis has shown that the Tax Office has also taken action in respect of a number of the ANAO suggested improvements.

## CHAPTER 6: REVIEW INTO THE TAX OFFICE'S SMALL BUSINESS DEBT COLLECTION PRACTICES

### OVERVIEW OF THE APRIL 2005 IGT REVIEW

6.1 The key theme raised by small businesses and their advisers during the Inspector-General's original review in 2005 related to the Tax Office's inability, on a broad systemic basis, to distinguish between the different general categories of tax payment compliance attitudes: those businesses wanting to meet tax payment obligations but unable to do so without short-term assistance; and those businesses either incapable of meeting tax payment obligations or in serial default.

6.2 The business community highlighted that flowing on from this a competitive disadvantage of the same payment leniency shown to normally compliant businesses, facing manageable cash flow problems, was also being shown to serial defaulters and those incapable of meeting their tax payment obligations. Non-compliant businesses could simply reduce operating costs where tax debts continued to remain unpaid and therefore undercut compliant businesses' prices. Creditors were also potentially disadvantaged through having to deal with small businesses capable of continuing to trade only because of Tax Office-supplied credit.

6.3 The Tax Office agreed with the Inspector-General's recommendation that an improved analytical tool was needed to better distinguish debt collection processes.

6.4 The 2005 review also established that notwithstanding a number of obstacles facing the Tax Office, including resource allocations and the large numbers of outstanding debt cases, the Tax Office must work with the small business sector to develop and implement new administrative measures to actively assist small businesses with managing cash flows and meeting tax liabilities as and when they fall due.

### IMPLEMENTATION OF RECOMMENDATIONS

#### KEY RECOMMENDATION 1

*The Inspector-General recommends that the Tax Office addresses issues of competitive disadvantage by distinguishing collection approaches between:*

- *those small business tax debtors that want to comply with their payment obligations but need short term assistance to do so; and*
- *those small business tax debtors that are either incapable of meeting tax payment obligations within a relatively short timeframe or are in serial default.*

## **Tax Office Position**

6.5 The Tax Office agreed with this recommendation and is in the process of delivering a fully automated risk model based on analytics which is expected to significantly improve risk profiling capability. The Tax Office expects that the risk model, together with expert business rules and relational formulas, will help to differentiate taxpayers according to their revenue and compliance risks. The primary objective is for higher risk cases to be identified for treatment proportionate to their risk.

6.6 The Tax Office view is that implementation of this model, together with a new enterprise-wide risk-based selection capability, should contribute to maximising earlier and fairer debt collection. It is expected that the model should be able to predict a taxpayer's payment compliance behaviour more accurately than current methods and previous models.

6.7 There will be an ongoing requirement to make the model more intuitive to adapt to changes in circumstances both internal and external to the Tax Office.

6.8 The Tax Office has in place an ongoing integrated strategy of awareness through communication and education to ensure that its officers understand how the new system will operate and impact on their work.

6.9 In July 2006 the Tax Office's Internal Assurance Branch prepared a report on the progress of implementation of the IGT recommendations. The status of implementation of Recommendation 1 contained in this report was stated as 'in progress'.

## **IGT Analysis**

6.10 The Tax Office's current approaches do provide some capability to differentiate along the lines recommended in the Inspector-General's review. The extensive use of payment arrangements is a form of assistance to small business tax debtors who want to comply, but arrangements are also afforded to those who are in fact incapable of meeting payment obligations and may also be abused by serial defaulters. The approach to persistent debtors does identify and enable differentiated management of a limited number (estimated at about 6,000) of known serial defaulters; but it is labour-intensive and therefore limited by resources. These current approaches are therefore limited in their sophistication and range.

6.11 In this context, the Tax Office's approach to implementing this recommendation is to develop a sophisticated and fully automated system based on an analytics model being developed as part of its Change Program. Implementation is entirely dependent on the success of this model which is still under development and therefore cannot be tested by the Inspector-General. A very broad overview of the model has been provided to the Inspector-General, including a list of the types of client attributes that will be analysed to determine the compliance risk profile of each case. No finalisation date for this initiative has been provided.

6.12 The Inspector-General notes that model design includes two predictive scoring approaches that relate directly to the recommendation: (1) a propensity to pay score, and (2) a capacity to pay score. These scores would be combined with business rules and formulas to determine the appropriate treatment of each case. The expectation that the model will be a fully automated predictive model that will enable the Tax Office to select treatment strategies based on the risk profile of a debtor, appears to be in line with the Inspector-General's recommendation.

6.13 The Tax Office approach and expectations are sophisticated and ambitious. The Inspector-General also notes that the December 2006 progress report to the Tax Office by Accenture said that a number of key improvements to the model were required and that a conclusion as to the model's effectiveness was not currently possible.

6.14 In its February 2007 response to the Inspector-General<sup>160</sup>, the Tax Office acknowledged that this recommendation had been with them for nearly two years. However in respect of this point, the Tax Office referred to the progressive implementation of the Change Program which they stated is due for completion in 2009.

6.15 Notwithstanding this, the Tax Office has identified a number of opportunities to change existing practices, including:

- remission of small residual general interest charge (GIC) on completed promises to pay;
- accepting GIC remission requests to the value of \$1,500 over the phone;
- simpler and more flexible guidelines for payment arrangement proposals including those under \$25,000;
- removing the need for taxpayers to lodge outstanding returns before the Tax Office agrees to enter into a payment arrangement;
- the development of key guiding principles, which reflect the Tax Office's organisational values.

6.16 The Tax Office has not advised when these opportunities will be realised.

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160 Tax Office minute 'IGT08-RECS-2007' — at p 3 (28 February 2007).

## Implementation Status: Not implemented

The Tax Office is in a prolonged process of developing an automated risk profiling capability that will enable treatment strategies to be based on the risk profile of a debt case.

The key design features of the proposed analytics model appear to be broadly in line with the Inspector-General's recommendation. It is apparent that the proposed model will need to perform more detailed analysis to effectively distinguish collection processes between compliant and non-compliant small business taxpayers.

The likely effectiveness of the proposed capability cannot currently be assessed. The model is not yet operational. No finalisation date for this initiative has been provided.

Pending successful implementation of the new capability, the Tax Office remains reliant upon existing capability that does not differentiate to the level required by the recommendation.

After two years, this recommendation is not implemented. However, the challenge of building a system with the level of sophistication needed to deliver the required capability is significant. The Inspector-General is satisfied that the Tax Office is attempting to meet this challenge.

## KEY RECOMMENDATION 2

***The Inspector-General recommends that the Tax Office works with the small business sector, and their representatives, to develop new administrative approaches to actively assist small businesses to better manage cash flows, if necessary, to meet tax liabilities as and when they fall due.***

### Tax Office Position

6.17 The Tax Office agreed with this recommendation by responding:

***It too reflects current directions as evidenced by the taxi industry initiative referred to in your report and the education program we now run to support taxpayers identified as new to business.***<sup>161</sup>

6.18 A number of speeches by the Commissioner in early 2006 highlighted the key message that the Tax Office would be supportive and work with taxpayers in difficulty by arranging payment of debt by instalments to fit their circumstances. Following this, the Debt

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161 Review into the Tax Office's Small Business Debt Collection Practices (2005) — Inspector-General of Taxation (at p 20).

Business Line commenced a review of its practices and behaviours with the aim of developing a framework that assists taxpayers to meet their obligations and encourages parties to work together to resolve problems. A series of business design changes were proposed as part of this review including:

- periodic GIC remission on debt balances of \$100 or less with net GIC postings totalling \$100 or more;
- actioning of debts under \$25,000 in line with the interactive voice recognition system; and
- granting of standard payment arrangements where there are outstanding lodgements.

6.19 In addition to the above, the Tax Office trialled in 2006 a number of new strategies, such as dialler technology, aimed at re-engaging taxpayers who had not responded to previous demands and increasing the number of taxpayers that are contacted.

6.20 The Tax Office's July 2006 Internal Assurance Branch report recorded the status of implementation of Recommendation 2 as completed.

### **IGT Analysis**

6.21 The above-mentioned changes specifically focus on established debt whereas the Inspector-General's recommendation was for the Tax Office itself to adopt new administrative approaches that would enable taxpayers to better plan for and avoid debt arising in the first place — in other words, to adequately manage cash flow in order to provide for tax obligations as and when they fall due.

6.22 The Tax Office continues to communicate to taxpayers through a series of guides and fact sheets about the importance of managing cash flows as well as budgeting for tax liabilities. Included in these guides are useful tools designed to assist taxpayers with monitoring their position with a view to meeting their tax obligations — an example of such a tool is e-Record. The Tax Office also continues to conduct a series of seminars around the country dedicated to educating small business on record keeping and managing cash flows.

6.23 The Tax Office has worked with the small business sector to continue to improve these important educative strategies. However, the strategies do not represent any change in administrative approaches by the Tax Office that would assist businesses in line with this recommendation.

6.24 The Inspector-General considers that a range of possibilities exist for new Tax Office administrative approaches that should by now have been considered and developed by the Tax Office, working with the small business sector. Examples of these possibilities include:

- Extending the kind of thinking and approaches used in the taxi industry to other industries or sectors;
- Working with the banking sector to develop a withholding facility for selected industry groups which requires businesses to deposit regular amounts into the facility. Once deposited, these amounts would in turn be directed towards tax liabilities. Related possibilities include facilitating and encouraging the use of BPAY facilities towards the same end;

- Working with the small business sector to conduct research into the cash flow cycles and terms of trade of particular industries as a basis for both considering administrative changes (for example by re-aligning payment due dates with periods when funds are available) and for improved understanding when managing debt cases.

#### **Implementation Status: Not implemented**

The continued improvement, in cooperation with the small business sector, of the range of cash flow management tools and education strategies aimed at helping small business to improve their approaches is very positive.

The Tax Office has not provided evidence that it has considered or developed any changes to its own administrative approaches that would assist business to manage cash flows and to meet tax obligations as and when they fall due. There has been no indication of any new approach such as occurred with the taxi industry initiative. The Tax Office has not followed on from its response to the original Inspector-General report.

The Tax Office should have done more over the two years since the recommendation was accepted to consider if it could change its own approaches. The recommendation has therefore not been implemented.

## **CHAPTER 7: REVIEW OF TAX OFFICE ADMINISTRATION OF GST REFUNDS RESULTING FROM THE LODGEMENT OF CREDIT BASs**

### **THE JANUARY 2005 IGT REVIEW**

7.1 Underlying the decision to conduct this review in 2005, was the Tax Office's approach of subjecting the vast majority of the dollar value of GST refunds to manual pre-issue checking using the risk rating engine (RRE). At the time this was considered to be a somewhat unsophisticated risk management approach. Both taxpayers and tax practitioners raised their concerns to the Inspector-General that the RRE processes failed to allow the nature of the taxpayer's industry, the life cycle stage of the taxpayer's business or their past history in terms of previous compliance checks to halt the manual RRE process. This was of particular relevance for government organisations and large ongoing businesses that are not representative of the type of taxpayer that would fail to comply with their tax obligations by simply disappearing. A number of these taxpayers advised the Inspector-General that they were having successive refunds delayed despite being in an industry where GST refunds were the norm or where the taxpayer's previous compliance history indicated that such a procedure was not in accordance with the Tax Office's Compliance Model.

7.2 During 2003-04, the pre-issue review of \$20 billion of GST refunds resulted in the recovery of approximately \$275 million — a 1.3 per cent yield. This practice obviously created tension with one of the principal design features of Australian GST law — that refunds should be paid promptly. Receiving refunds within a reasonable timeframe is often critical for businesses and other entities in funding their enterprises. Any delay has the potential to place affected taxpayers at a competitive disadvantage through affecting their cash flow.

7.3 The Inspector-General's 2005 review also established that Tax Office management systems could not generate information showing the time required to process all GST refunds from the date of lodgement to the time of payment. Nor could the systems provide the time taken to process particular kinds of refunds (such as those which have been stopped for manual checking).

7.4 In response to the Inspector-General's 2005 review, the Tax Office advised that it was well advanced in the process of improving the RRE.

## IMPLEMENTATION OF RECOMMENDATIONS

### KEY RECOMMENDATION 1

*The Inspector-General recommends that the Tax Office improve its systems to better match the risk issues associated with paying GST refunds. These systems need to achieve a better balance between paying GST refunds in a timely manner and preventing fraudulent or incorrect refunds from issuing.*

#### Tax Office Position

7.5 The RRE is a risk methodology applied prior to the issue of a GST refund. The RRE comprises of a number of separate tests that focus on assessing the likelihood and consequences of GST refunds being fraudulent or incorrect. Implementation of a series of improvements in the RRE began in July 2004.

7.6 An override facility has been implemented which provides more automated streamlining of refunds from taxpayers with a proven historical record of good compliance and regular refund claims. Put simply, the override suppresses one or all RRE GST tests where despite being identified as a high-risk refund by the RRE tests, other information available to the Tax Office indicates that the taxpayer in question represents a sufficiently low risk to not require pre-issue checking.

#### IGT Analysis

7.7 The following table provides an analysis of RRE operation over the last three financial years.

#### RRE GST Pre Issue Tests Work Item Analysis<sup>162</sup>

Issue	2003-04	2004-05	2005-06	2006-07
Total activity statement refunds claimed by taxpayers	\$31.57b	\$36.47b	\$41.24b	\$41.25b
Total value of refunds stopped pre issue	<b>\$20.48b</b>	<b>\$16.40b</b>	<b>\$12.76b</b>	<b>\$12.94b</b>
Per cent refunds stopped/total refunds	<b>64.87%</b>	<b>44.97%</b>	<b>30.94%</b>	<b>31.37%</b>
Total RRE GST pre issue work items created	84,054	81,825	76,799	78,949
Per cent change per year	0%	-2.65%	-6.14%	2.79%
Per cent change overall	0%	-2.65%	-8.63%	-6.07%
RRE GST liabilities raised	<b>\$252.3m</b>	<b>\$294.8m</b>	<b>\$385.5m</b>	<b>Not Available</b>
RRE other heads of revenue liabilities raised	\$4.4m	\$7.8m	\$21.4m	Not Available
Total liabilities raised	\$256.7m	\$302.6m	\$406.9m	Not Available
Per cent change per year	0%	+17.88%	+34.47%	Not Available
Per cent change overall	0%	+17.88 %	+58.51%	Not Available
Per cent of total value of refunds stopped pre issue	1.25%	1.84%	3.18%	Not Available
RRE GST strike rate(a)	14.19%	14.27%	16.23%	Not Available
Per cent change per year	0%	+0.56%	+13.74%	Not Available
Per cent change per overall	0%	+0.56%	+14.38%	Not Available

(a) Cases where the refund adjusted as a percentage of the total taxpayer contact cases.

7.8 The value of refunds stopped for RRE testing as a percentage of total activity statement refunds lodged has decreased from 64.87 per cent in 2003-04 to 31.37 per cent in 2006-07. This represents an actual reduction of \$7.54 billion in refunds stopped pre-issue in the 2006-07 financial year compared to the 2003-04 financial year despite total activity statement refunds increasing over the same period by \$9.68 billion (that is, 30.7 per cent). These results are a significant achievement by the Tax Office in response to the Inspector-General's recommendation. The introduction of the override facility and its continued enhancement have meant that in 2005-06 some 11,989 work items totalling \$14.952 billion were not stopped by RRE testing (that is, 36.25 per cent of activity statement refunds). Overall the introduction of the override facility has seen a higher percentage of activity statement refunds passing through without being stopped: 69.06 per cent in 2005-06 compared to 55.03 per cent in 2004-05 and 35.13 per cent in 2003-04.

7.9 However, the proportionate amount of additional tax recovered (when compared to the value of refunds tested through the RRE — the yield) remains relatively low. The overall yield for RRE testing was 3.18 per cent in 2005-06 (despite being an improvement on the 1.84 per cent achieved in 2004-05 and the 1.25 per cent in 2003-04). The dollar amount of liabilities raised from refunds stopped and found to be incorrectly claimed is however significant at over \$400 million. The yield and dollar amounts are nevertheless particularly low in the large business and government sectors. This issue was highlighted in the Inspector-General's 2005 report at paragraphs 4.42 and 4.43 (in summary):

*During the 2003-04 financial year, \$7.35 billion of GST refunds claimed by large enterprises were flagged for RRE checking. \$14.5 million in tax liabilities were raised (that is, a 0.2 per cent result). For the large government and community sector \$7.6 billion was checked resulting in the raising of just \$0.1 million (that is, a 0.0014 per cent result).*

7.10 In comparison during the 2005-06 financial year, \$3.8 billion of GST refunds claimed by large enterprises were flagged for RRE checking, but only \$27.84 million in tax liabilities were raised<sup>163</sup> (that is, a 0.73 per cent result). For the large government and community sector \$685 million was checked with \$1.55 million in liabilities raised<sup>164</sup> (that is, a 0.2 per cent result).

7.11 Comparing the 2005-06 figures with the 2003-04 figures demonstrates that the yield from RRE activity for these two groups has increased. However, in line with the overall figure of 3.18 per cent (referred to above in 7.9), the yield from RRE activity remains low for the large enterprise sector (0.73 per cent) and for the large government and community sector (0.2 per cent).

7.12 These figures indicate that whilst significant improvements have been made, the Tax Office can still achieve more in line with its response to the Inspector-General's 2005 review:

*... that close to all of these entities [large and government sectors] will become subject to the override policy.<sup>165</sup>*

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163 Tax Office minute to the Inspector-General of Taxation, 24 January 2007 (at p 3).

164 Ibid.

165 Review of Tax Office Administration of GST Refunds Resulting from the Lodgement of Credit BASs (2005) — Inspector-General of Taxation (at 4.46).

7.13 In considering the true impact of this on taxpayers, it is important to consider the proportion of stopped refunds that are still issued within the 14-day corporate standard. Snapshot figures supplied by the Tax Office suggest that the proportion is up to 70 per cent. In the large business and government sectors this proportion is higher with 96 per cent and 97 per cent respectively released within 14 days. The Inspector-General notes that these are positive figures, but the question that remains is how effective the RRE is given that in dollar terms most of its results are overridden. From 2005-06 Tax Office data the Inspector-General has formed the following broad picture of the three major GST refund sectors:

	Large Business	Government	Micro and SME
Total refunds claimed by taxpayers	\$10b	\$10b	\$21b
Refunds stopped pre issue	\$3.8b	\$0.7b	\$8.3b
Liabilities raised	\$26m	\$1.6m	\$378m
Yield per cent	0.68 per cent	0.23 per cent	4.55 per cent

7.14 The above statistics indicate that in the large business and government sectors the RRE is still identifying for manual checking, cases that contain a low level of risk. Put simply, while the improvements made by the override facility are very significant, the Tax Office RRE still stops around 30 per cent of the value of large business GST refunds (over \$3.7 billion) yet only raises a small amount in liabilities.

#### Implementation Status: Implemented

The Tax Office has implemented a series of changes to the RRE that have resulted in the introduction of additional case selection rules. The introduction of the override facility has avoided a significant number of activity statement refunds being stopped unnecessarily by the RRE process. This has in turn achieved a major reduction in the value of delayed GST refunds.

The Tax Office continues to drive these improvements. The Inspector-General notes that there are still significant opportunities for further improvement in the large business and government sectors in particular.

The Tax Office is aware of this situation and is continuing to increase its override program and is planning to implement more sophisticated processes than the RRE as part of the Change Program.

#### Key Recommendation 1 Subsidiary Recommendation 1

*The Inspector-General recommends that the Tax Office establish systems which identify all cases where delayed refund interest should be paid.*

## Tax Office Position

### Automatically Processed Cases

7.15 Historically, 95 per cent of work involving delayed refund interest (DRI) is completed using automated systems and the remaining 5 per cent is through manual work.<sup>166</sup> Automatic calculation of DRI involves not only the calculating of DRI, but also posting and then refunding the DRI to the taxpayer. An auto-calculation of DRI is triggered by the:

- processing of an original credit activity statement;
- processing of a revised credit activity statement; or
- release of a stored refund.

### Manually Processed Cases

7.16 For manually processed cases, procedures have been adopted which instruct Tax Office staff how to identify whether an entity is entitled to DRI. On finalising a case, officers are required to complete and retain a 'Refund Integrity Checklist'<sup>167</sup> which includes the direct question of whether the issue of DRI has been appropriately addressed.

### Quality Assurance and Control

7.17 The Tax Office has implemented a sustainable and practical ongoing process that periodically assures that DRI is being appropriately paid. Specifically, this is undertaken at the team level by a weekly quality assurance (QA) process and at the national level by a tri-annual quality control (QC) process. Results from these processes are recorded and monitored.

7.18 Coaching of staff is undertaken on an ongoing basis with operative staff receiving coaching every two months. Coaching of new staff is undertaken monthly until they attain a level of proficiency and experience whereupon coaching is undertaken on a two-monthly basis. A monthly report is prepared for the Assistant Commissioner (Client Account Services) outlining areas requiring improvement.

### IGT Analysis

7.19 As outlined above, the identification of manually processed cases requiring the calculation of DRI is dependant upon case officers completing a checklist which includes the question of whether DRI has been correctly addressed. For cases processed automatically, the calculation of DRI is triggered by relevant activities such as the processing of a credit activity statement. For Taxpayer Accounting Teams, the exercising of authorisations and the appropriate completion of checklists relating to DRI are supported at the team level by a weekly QA process and at the national level by a tri-annual QC process (see below). Results

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166 'Review of delayed refund interest' — Tax Office publication July 2005 (p 10).

167 Section 1.12.1 of the Tax Office's 'Taxation Authorisation Guidelines' also refers to highlighted segments of the 'Refund Integrity Checklist'. This checklist also provides a number of other specific questions relating to DRI.

from the QA process are entered into a database and team leaders are provided with their team's ratings. A report is also prepared for the Assistant Commissioner (Client Account Services).

7.20 Relevant Tax Office sampling of cases undertaken shortly after the Inspector-General's original review revealed that an overpayment of DRI occurred in 5.4 per cent of cases and an underpayment in 1.4 per cent of cases. This arose in three different scenarios where Tax Office systems failed to capture the correct sequence of events that occurred between the date that the original activity statement was lodged and the date the refund was issued. However, system changes have been recently implemented to address two of the three scenarios. The system fix addressing the third scenario is not proceeding as only a very small number of cases involving limited amounts of overpayment were involved. Testing of the effectiveness of the two system improvements already in place has not been undertaken by the Inspector-General because of their recent implementation.

#### **Implementation Status: Implemented**

Case officers are required to complete a checklist for each case which includes a direct question as to whether DRI is payable. Quality assurance is undertaken weekly for each team and tri-annually on a national basis with relevant reporting of results to the Assistant Commissioner (Client Account Services). This process includes a review of the application of DRI.

Case sampling revealed underpayment or overpayment of DRI in only a small number of cases. System changes have recently been implemented to address the vast majority of these cases.

#### **Key Recommendation 1 Subsidiary Recommendation 2**

*The Inspector-General recommends that the Tax Office publish statistics to advise taxpayers, on a regular basis, of the number of days it will take the Tax Office to pay a GST refund after lodgement of either a paper or electronic BAS.*

#### **Tax Office Position**

7.21 Since 1 August 2005, the Tax Office website has provided on a weekly basis the expected processing times for activity statement refunds that do not require off-line checking by the Tax Office before issuing. Expected processing times are based on the average processing times achieved in the preceding week.

#### **IGT Analysis**

7.22 The Inspector-General considers that the level of reporting provided by this weekly report addresses the subsidiary recommendation. It is simply not practical for the Tax Office to report on the processing times of cases that require prolonged intervention.

### **Implementation Status: Implemented**

The Tax Office reports on its external website the average number of days it will take to pay a GST refund after lodgement of a routine activity statement (that is, one that does not require detailed investigation). This statistic is based on average processing times achieved in the preceding week.

### **Key Recommendation 1 Subsidiary Recommendation 3**

*The Inspector-General recommends that the Tax Office take steps to ensure that credit amendments to income tax assessments do not inappropriately halt the payment of GST refunds.*

### **Tax Office Position**

7.23 The introduction in January 2008 of the Tax Office's new Integrated Core Processing System is proposed to ensure that the processing of credit amendment requests will not delay the payment of GST refunds. In the interim period, the Tax Office has put in place a manual process to reduce delays in processing. This involves a team identifying on a weekly basis those activity statement refunds that are held pending the processing of an income tax return. Where such a case is identified, contact is made with the relevant processing area to arrange for the finalisation of the return as a matter of priority. Monitoring is undertaken to ensure timely resolution.

### **IGT Analysis**

7.24 Statistics on the effectiveness of this interim process reveal that on average only one activity statement refund per week has been delayed due to an income tax return being processed.

### **Implementation Status: Implemented**

Current procedures are adequately addressing this issue. The Tax Office is working towards implementation of a final systems solution in 2008.

### **Key Recommendation 1 Subsidiary Recommendation 4**

*The Inspector General recommends that the Tax Office address the problem of ensuring that amounts shown on paper-lodged GST returns have been shown in whole dollars only in a way which does not involve large numbers of refunds being taken off line from automatic processes.*

## Tax Office Position

7.25 The Tax Office has implemented a number of changes to the format of the activity statement to address the problem identified in the Inspector-General's original report regarding the incidence of taxpayers incorrectly including 'cents' on activity statements. For example, the initial instruction for completing the form now reads 'show whole dollars only (do not show cents)'. In addition, the Tax Office has improved procedures at the pre-processing stage to identify and action activity statements where 'cents' have been included at the image capture stage.

7.26 The Tax Office has also taken a proactive approach to client education through publishing the details of common errors made in completing activity statements (such as the inclusion of 'cents').

## IGT Analysis

7.27 Statistics maintained by the Tax Office indicate that the above-mentioned improvements have worked because only a very small number of cases are now taken off-line for review. In addition, improvements to Tax Office systems and procedures have made this review process significantly more efficient with most cases being completed in minutes.

### Implementation Status: Implemented

The Tax Office has implemented a number of physical changes to the activity statement as well as procedures at the pre-processing stage that have resulted in only a very small number of cases being taken off automatic processing.

### Key Recommendation 1 Subsidiary Recommendation 5

*The Inspector-General recommends that the Tax Office publish on a regular basis, comprehensive lists of clerical errors commonly made on a BAS which could delay a GST refund.*

## Tax Office Position

7.28 The Tax Office has implemented this recommendation through publishing a number of lists and documents on its external website to ensure that taxpayers are aware of the common BAS errors that can potentially delay a refund. The Tax Office has also included information on BAS errors in some of its quarterly *Activity Statement Update* publications which are posted out to taxpayers with their quarterly BAS.

## IGT Analysis

7.29 The Tax Office has implemented this recommendation through publishing the above-mentioned material on its external website. The Inspector-General expects that the Tax

Office will continue this practice on a regular basis to ensure that taxpayers are updated on the errors that are commonly made.

#### **Implementation Status: Implemented**

The Tax Office has implemented this recommendation through regularly publishing on its website the common BAS errors that can potentially delay a GST refund.

#### **Key Recommendation 1 Subsidiary Recommendation 6**

*The Inspector-General recommends that the Tax Office supplement its existing performance standard for activity statement refunds processing, which is based on the number of refunds processed, by regularly publishing supplementary management information which indicates the average dollar value of refunds held for more than 14 days after lodgement for either verification purposes or for other reasons.*

#### **Tax Office Position**

7.30 Since the 2004-05 financial year, the Tax Office has included in its annual report the dollar value of an average refund held for more than 14 days after lodgement for either verification purposes or for other reasons. In the 2005-06 financial year, the relevant amount was \$4,989 (a 13 per cent reduction from the 2004-05 figure of \$5,706). The Tax Office was of the view that the inclusion of this information in its annual report is regularly publishing in line with the subsidiary recommendation. However in discussions with the Inspector-General during the follow-up review, the Tax Office accepted that what it implemented was based on a misreading of the recommendation.

#### **IGT Analysis**

7.31 The above-mentioned figure is obtained from the Tax Office's 'Weekly Potential Stored Refunds Report' which contains the number and total value of activity statement refunds that have taken more than 14 days to finalise.<sup>168</sup> The Tax Office has simply taken the total value of these types of refunds for the year and divided the figure by the number of refund cases — a simple averaging calculation.

7.32 However, the Tax Office has misread the Inspector-General's recommendation by tailoring this calculation to obtain the average dollar value of a refund instead of the average dollar value of all refunds held for more than 14 days after lodgement.

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168 The 'Weekly Potential Stored Refund Report' excludes activity statement refunds which do not require checking by the Tax Office during processing (referred to as 'routine' cases). As confirmed by relevant sampling, almost all of these cases are finalised within the 14-day standard (over 99 per cent in the week tested). The Tax Office reports on these cases elsewhere (as outlined in Key Recommendation 2) but can include them in the relevant figure for the purpose of this subsidiary recommendation if required.

7.33 Following discussions between the Inspector-General of Taxation and senior Tax Office staff, it has been decided to replace the above-mentioned figure with a table containing two, monthly indicators that together should show the effect of continuing improvements in this area. The Inspector-General's aim is for the Tax Office to report:

- the dollar amount at any point in time of all GST refunds that it has held up for more than 14 days for compliance checks; and
- the total amount of adjustments made as a result of compliance checks.

7.34 The first indicator is the total value of all GST refunds held by the Tax Office for more than 14 days because of compliance action. As the Tax Office continues to implement a range of improvement actions this indicator should go down over time.

7.35 The second indicator is the total value of adjustments made during each month as a result of compliance checks. As the Tax Office refines its risk management approaches this indicator should go up over time.

#### **Implementation Status: Partly Implemented**

The Tax Office implemented a report in good faith but it was based on a misunderstanding of the Inspector-General's recommendation and as a result does not report the recommended indicator.

In discussions with the Inspector-General, as outlined above, the Tax Office has agreed to implement two new monthly reports which it agrees will provide a meaningful indication of the impact of its continuing improvement strategies.

## **KEY RECOMMENDATION 2**

*The Inspector General recommends that the Tax Office establish 'whole of office' systems which measure the total elapsed time for the payment of GST refunds.*

### **Tax Office Position**

7.36 In July 2005 the Tax Office completed a review of the activity statement refund reporting framework which identified a number of deficiencies. Following this review a new reporting framework was designed and implemented by 1 August 2005 which comprises four major reports.

7.37 The Tax Office prepares an additional report that provides management information on refunds stored at the end of each week. Cases are categorised according to the period of time that they have been held and the reason why they are being held.

## IGT Analysis

7.38 The new reporting framework provides a greater level of assurance in relation to the accuracy of reporting of activity statement refunds. The new reports (along with increased scrutiny of refund data) also enhance the Tax Office's ability to monitor and track refund flows with a view to identifying blockers, delays and potential improvements.

### Implementation Status: Implemented

Following the Inspector-General's 2005 report, the Tax Office undertook a complete review of the activity statement refund reporting framework. The Tax Office now has five reports that enable end-to-end monitoring of not only processing times but also reasons for delay.

### Key Recommendation 2 Subsidiary Recommendation 7

*The Inspector-General recommends that the Tax Office introduce an eight-day service standard for the processing of 'routine' electronically lodged GST refunds.*

## Tax Office Position

7.39 On 18 May 2006 the Tax Office announced that it would implement an informal standard of 99 per cent within eight days for these types of cases.

7.40 On 1 June 2006 the Tax Office's external website was enhanced to report the year-to-date performance against the eight-day standard. This data is updated on a weekly basis. The performance for the preceding week is also included.

## IGT Analysis

7.41 During 2005-06 the Tax Office processed 99.74 per cent of 'routine'<sup>169</sup> electronic activity statement refund cases within eight days. Analysis has determined that the small number of cases processed outside the eight-day standard is due to extended system downtime (for example the Christmas shutdown period).

### Implementation Status: Implemented

The Tax Office introduced an eight-day standard for the processing of 'routine' electronically lodged activity statement refunds. The year-to-date performance and the preceding week's performance are reported on the Tax Office's external website each week.

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169 'Routine' activity statement refunds are those that do not require checking by the Tax Office during processing.

## Key Recommendation 2 Subsidiary Recommendation 8

*The Inspector-General recommends that the Tax Office provide clearer guidance to taxpayers generally of the circumstances in which an offset involving a GST refund will occur and when a taxpayer will need to request the Tax Office to pay any credit balances that arise after an offset is made.*

### Tax Office Position

7.42 The issue raised in this subsidiary recommendation primarily affected chapter 72 of the ATO Receivables Policy. Since the Inspector-General's 2005 review, the Tax Office has published this policy as a Tax Office practice statement (Law Administration Practice Statement 2006/11 *ATO Receivables Policy*). A rewrite of chapter 72 was undertaken, together with the development of an additional four chapters.

### IGT Analysis

7.43 The concerns raised during the Inspector-General's 2005 review regarding the readability of the ATO Receivables Policy resulted in the above-mentioned rewrite of the policy and its publication as a Tax Office practice statement. In addition, the Tax Office saw the need to publish a simple plain English guide in the form of a Tax Office fact sheet titled *Where is my refund?* This fact sheet contains a complete list of the circumstances in which an activity statement refund and other refunds will be offset and when a taxpayer will need to request the Tax Office to pay credit balances after an offset has been made.

### Implementation Status: Implemented

The Tax Office has published a plain English guide for taxpayers explaining the issues raised in this subsidiary recommendation. In addition, the Tax Office has revised a number of chapters in its Receivables Policy (now published as a Tax Office practice statement) to provide taxpayers with further guidance.

## Key Recommendation 2 Subsidiary Recommendation 9

*The Inspector-General recommends that, where a large enterprise taxpayer has a GST refund which is being delayed for verification, the electronic message which is sent to the taxpayer to notify them that their GST refund has been delayed contain the name and contact details of the taxpayer's key client manager. For all other taxpayers whose refunds are to be subject to verification, the Inspector-General recommends that the Tax Office provide the relevant taxpayer with the name of the Tax Office staff member who will be dealing with their case at the earliest possible opportunity.*

## **Tax Office Position**

7.44 For large enterprise taxpayers, Tax Office staff are required to open and consider for action any work item received within 48 hours of arrival within the GST Active Compliance Large Group. If the work item is not actioned within 48 hours, the client must be contacted and advised of the name and contact number of the officer handling the case as well as that officer's proposed course of action. In addition, an email must be sent to the client notifying them of the delay. Included in this email are the key client manager's name and contact details.

7.45 For all types of taxpayers, staff from the Tax Office's GST Client Verification Cell (CVC) must advise the taxpayer within 48 hours by phone that an activity statement refund is being held for verification. Employee Identification Practice Statement PS 2005/02 requires that during the phone call, staff must provide the name and phone number of the staff member who will be dealing with the case.

## **IGT Analysis**

7.46 As outlined above, the Tax Office has in place procedures whereby taxpayers are advised when their activity statement refund is being held for verification. For large enterprise taxpayers an internal assurance process has been implemented to ensure that client contact is made in line with the above-mentioned procedures. Delayed refund cases are monitored on a weekly basis and finalised aged RRE work items are randomly sampled to ensure work items have been actioned appropriately.

7.47 For all other taxpayers, quality assurance of the above-mentioned procedures includes the review of one live case per operative each quarter. For 2005-06, 88.9 per cent of cases complied with the above-mentioned procedures.<sup>170</sup> CVC reports on a weekly basis to Tax Office management about the extent to which the 48-hour standard has been met in the previous week and on a year-to-date basis.

### **Implementation Status: Implemented**

The Tax Office has implemented procedures whereby its staff must notify taxpayers that their activity statement refund has been delayed pending verification. For large enterprise taxpayers contact must be made within 48 hours from when the case arrived in the Compliance group. A separate notification is also sent electronically to the taxpayer advising them of the delay and including the name and contact details of the taxpayer's key client manager. For all other taxpayers, telephone contact must be made within 48 hours advising the taxpayer of the delay due to verification procedures.

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170 Tax Office 'Briefing Paper: Implementation of IGOT Recommendations (GST Refunds)' 3 August 2006 (at p 7). The relevant Tax Office standard is currently 80 per cent of taxpayers to be contacted within 48 hours of the creation of the work item.

## Key Recommendation 2 Subsidiary Recommendation 10

*The Inspector-General recommends that the Tax Office introduce better systems for recording information obtained from taxpayers, for example, on the nature of the taxpayer's industry, and ensure that this information can be accessed by tax officers when required.*

### Tax Office Position

7.48 In June 2006 the Tax Office completed the implementation of the latest contemporary standard of industry classification, ensuring that the most accurate information relating to the nature of a taxpayer's industry is made available to Tax Office staff. This involved the conversion and update of more than 9.3 million taxpayer records.

### IGT Analysis

7.49 The improved accuracy of this information provided through the above-mentioned system enables the Tax Office to better manage the allocation of its compliance resources.

7.50 The Tax Office also continues to work towards Release 3 of the Change Program and in particular implementation of the Integrated Core Processing System (ICP) which is to replace around 75 systems. ICP is designed to capture information in one location so as to reduce the likelihood of repeated requests by Tax Office staff for a taxpayer to provide the same set of information. It is anticipated that ICP will be ready to handle income tax matters from March 2008.

7.51 The Tax Office's new file management system (Siebel) is also a better way for recording information obtained from taxpayers. This system is currently being rolled out throughout the Tax Office. Siebel is a significant improvement to the systems that were in place during the Inspector-General's 2005 review. An advantage of Siebel is that it brings together information from a range of systems — put simply, it is a single repository of customer relationship management, case management and work management.

### Implementation Status: Implemented

The Tax Office has implemented the latest contemporary standard of industry classification, ensuring that the most accurate information relating to the nature of a taxpayer's industry is made available to Tax Office staff.

The Tax Office is also working towards the implementation of major file management, case management and customer relationship management systems.

## **CHAPTER 8: REVIEW OF THE REMISSION OF THE GENERAL INTEREST CHARGE FOR GROUPS OF TAXPAYERS IN DISPUTE WITH THE TAX OFFICE**

### **THE AUGUST 2004 IGT REVIEW**

8.1 The 2004 review was conducted by the Inspector-General following a request made by the then Minister for Revenue and Assistant Treasurer for an evaluation of the administration of general interest charge (GIC or interest) remission in cases of tax dispute where settlement offers involving groups of taxpayers have been made. The Minister asked that particular consideration be given to the situation of participants in Employee Benefit Arrangements (EBAs).

8.2 Consultations between the Inspector-General and the tax community expressed substantial concern about the Tax Office's approach to remitting GIC. They were particularly concerned that the Tax Office's approach, especially in the area of Mass Marketed Tax Effective Investments (MMTEI), was inconsistent with its practice elsewhere, such as in relation to EBAs. These consultations also indicated that there was a view among accounting and tax practitioner bodies that the Tax Office was reluctant to use its power to remit the GIC.

8.3 In undertaking the review, the Inspector-General did not review the actual efficacy of the disputed arrangements or the Tax Office processes for achieving finalisation<sup>171</sup>. The key issue for the review was the consistency of approach by the Tax Office in the application of its GIC remission powers.

8.4 Care was taken to avoid standing in the shoes of the Commissioner in respect of making individual judgements on specific cases. It was acknowledged that the responsibility to consider remission of GIC in whole or in part rests with the Commissioner, and various review rights are available to aggrieved taxpayers.

8.5 The focus of the review was on the broader systemic approach and conduct of the Tax Office, resulting in the following key findings and, in certain cases, recommendations by the Inspector-General. The essence of these findings was as follows:

1. Despite the tax laws providing the Commissioner with a broad power to remit GIC, the Commissioner had adopted a narrow approach regarding the circumstances in which the GIC remission power would be exercised. The interest remission guidelines (inferred as being required) must be flexible and responsive to remove inappropriate punitive-like consequences where out-of-the-ordinary circumstances exist.

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171 Many participants (particularly those involved in employee benefit trusts) had also received alternative fringe benefits tax assessments. These alternative assessments were only withdrawn upon settlement. As well, shortfall penalties of 50 per cent or so were remitted to 5 or 10 per cent.

2. The Tax Office does not provide adequate guidance for remission of GIC and, therefore, the Commissioner should publish a separate policy document on the GIC remission power which not only provides clear guidance but also includes the different considerations relevant to determining whether remission of GIC is warranted for either or both the pre-amended and post-amended assessment periods.
3. Although disputes involving different groups of taxpayers may have distinguishing features, at the taxpayer level there are more common features between the individuals forming part of each group of taxpayers than points of differentiation. Against this background, an examination of all the circumstances of the taxpayers involved in these arrangements may indicate that it is more appropriate for a similar interest remission outcome to arise for taxpayers who share similar individual circumstances regardless of the particular arrangement involved.
4. The approach of the Commissioner suggested that more focus has been on considerations of administrative efficiency as opposed to an examination of a taxpayer's individual conduct and circumstances. In particular, considerations of the type and nature of the arrangement and the extent to which members of a group shared certain further characteristics have overshadowed consideration of the conduct and circumstances for each individual.
5. The factors that the Tax Office has considered relevant in the statutory reduction and remission of penalties may also be relevant in considering the remission of the interest charge for groups of taxpayers in dispute with the Tax Office.
6. Tax administration would improve if an internal review process of a structure similar to that adopted for MMTEI investors was adopted for EBA taxpayers. However, any such review process would need to operate according to the overriding principle that all individual circumstances relating to particular taxpayers are taken into account during the operation of this process.
7. A focus on the nature of the arrangement in EBA disputes appears to have led to taxpayers involved in EBA disputes receiving interest remission outcomes which are inconsistent with those received by other groups of taxpayers. It has also led to taxpayers involved in certain types of EBAs receiving interest remission outcomes which are not consistent with those applied to taxpayers involved in other forms of EBAs.

8.6 In communications before the public release of the report, the then Commissioner of Taxation advised the Inspector-General that in response to the review he would issue guidelines to the effect that where the EBA participant had a good history of payment and lodgement, was not previously involved in a MMTEI or other tax avoidance scheme and one or both of the following applied, the Tax Office would remit interest to 4.72 per cent for the pre-amended assessment period:

- (a) the participant was subject to the type of aggressive and sophisticated marketing techniques commonly employed in MMTEIs; and
- (b) the participant entered into an arrangement relying on advice from the Tax Office held by the advisor in relation to that particular type of arrangement.

8.7 The Commissioner further advised that, where one or more of the following was able to be demonstrated, remission of interest for both pre- and post-amended assessment periods to 4.72 per cent would apply:

- (a) the participant suffered financial difficulties because of the existence of both income tax and fringe benefits tax assessments. This could include, for example, evidence of an inability to secure borrowings that, but for there being multiple liabilities, could reasonably be expected to have been available;
- (b) the participant's financial circumstances are such that they could not reasonably meet repayment of the liability with full interest component;
- (c) the participant relied on advice given by the Tax Office to them or their agent or advisor about the particular arrangement.

8.8 Following public release of the Inspector-General's 2004 report, the Tax Office announced<sup>172</sup> in November 2004 four major steps it was committed to take to bring about improvements to GIC administration:

1. Undertake a review of the guidelines on the remission of interest charges in consultation with the Inspector-General, the Ombudsman and other key community representatives.
2. Set up a panel of senior tax officers to consider the situations where widely based settlement offers are appropriate. The panel would be supported by guidelines specifically tailored to these situations. The guidelines will be open for public consultation and will be kept under review.
3. Enable participants in EBAs to apply for remission of interest and penalties based on their individual circumstances. Where the conditions for remission were satisfied, interest was generally to be reduced to 4.72 per cent for part, or in some cases all, of the period the debt was outstanding.
4. Interest accruing prior to 19 January 2005 would be capped at 70 per cent of the primary tax owed for EBAs.

### ***Report on Aspects of Income Tax Self Assessment***

8.9 Shortly after the then Commissioner's November 2004 announcement, in December 2004 the previous government released its *Report on Aspects of Income Tax Self Assessment* (ROSA)<sup>173</sup>. ROSA included a number of important developments relevant to this review, notably the legislative changes relating to the treatment of tax shortfalls brought about by the *Tax Laws Amendment (Improvements to Self Assessment) Act (No. 1) 2005* including:

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172 Tax Office improves GIC administration — Tax Office media release 04/78 (18 November 2004).

173 The review focused on identifying whether the income tax laws achieved a fair balance between protecting the rights of individual taxpayers and protecting the revenue for the benefit of the whole Australian community. The review examined a range of issues, including the statutory timeframes for amending assessments, the duration of the audit process, the reliance that taxpayers should be able to place on Tax Office advice and aspects of the general interest charge.

- the introduction of the shortfall interest charge (SIC) with its three percentage point uplift over the base rate, from the due date of the original assessment to the day before the shortfall is corrected<sup>174</sup>;
- broader power for the Commissioner to remit the SIC where it is ‘fair and reasonable’ to do so.

8.10 Together with the specific findings of the Inspector-General’s 2004 review and the then Commissioner’s four-step commitment, the ROSA changes completed the new administrative context for GIC administration. The extent to which the Tax Office has fulfilled its commitment to implement the four major steps, and in so doing has also addressed the Inspector-General’s specific findings, is the subject of this follow-up review.

## IMPLEMENTATION OF FINDINGS

8.11 This first review conducted by the Inspector-General made findings rather than specific recommendations. The Tax Office responded to these findings, but also agreed to take four major steps to address the core concerns raised by the review (see paragraph 8.8 above). Since then, the Inspector-General has maintained a watching brief on the Tax Office’s handling of EBA cases and has sought and received periodic briefings from the Tax Office on progress.

8.12 From this ongoing monitoring and from fieldwork done as part of this follow-up review, the Inspector-General has concluded that the Tax Office has fulfilled its commitment to implement the four important steps mentioned above. The Inspector-General considers this to be an important achievement that provides positive context for his assessment of the status of the Tax Office’s responses to the findings of the review.

8.13 The following analysis of status against findings is therefore somewhat different to that of previous chapters covering the specific recommendations of more recent reviews.

### KEY FINDING 1

*The legislative provisions authorising interest remission for the pre-amended assessment period provide the Commissioner with a broad power to remit the interest charge.*

*However, the Commissioner has adopted a narrow approach regarding the circumstances in which the interest remission power will be exercised.*

*This has meant that, particularly where this interest has accrued over a period of up to 4 or 6 years, the pre-amended assessment interest charge without remission may have a far broader and punitive-like effect. The interest remission guidelines must be flexible and responsive to remove inappropriate punitive-like consequences where out-of-the-ordinary circumstances exist.*

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174 This being a welcomed change from income tax shortfalls attracting GIC with its seven percentage point uplift over the base rate from the due date of the original assessment until paid.

## Tax Office Position

8.14 Implemented.

## IGT Analysis

8.15 On 1 August 2006, the Tax Office released a practice statement providing guidelines for the remission of SIC and GIC — PS LA 2006/8 *Remission of shortfall interest charge and general interest charge for shortfall periods*. In summary, the practice statement provides that:

*The Commissioner may remit all or part of SIC or shortfall GIC where the Commissioner considers it fair and reasonable to do so.*<sup>175</sup>

8.16 PS LA 2006/8 provides guidance to Tax Office staff about making fair and reasonable decisions on the remission of interest charges whilst having regard to the facts of the matter and the individual circumstances of the taxpayer involved.

8.17 Throughout the practice statement a number of practical examples are provided which give further guidance to staff about the use of remission powers as well as the extent of remission (that is to what level remission is appropriate).

8.18 In terms of Key Finding 1, the practice statement discusses ‘out of the ordinary’ situations where a flexible and responsive approach by Tax Office staff is considered appropriate to alleviate punitive-like consequences. In addition, Tax Office staff are directed to consider (where relevant) when making decisions about remission:

*... the extent to which factors beyond the taxpayer’s control were responsible for the size and duration of the shortfall.*<sup>176</sup>

8.19 An example is the resolution of an audit beyond a reasonable completion time because of the complexity of issues involved.<sup>177</sup> Another example is where there are delays outside of the taxpayer’s control such as the occurrence of a natural disaster or where the taxpayer has suffered serious illness.<sup>178</sup>

### Implementation Status: Implemented

The Tax Office has released guidelines regarding the remission of interest — PS LA 2006/8. In line with this key finding, the practice statement provides guidance to Tax Office staff about the need for a flexible approach to remission where circumstances beyond a taxpayer’s control have been responsible for the size and duration of the shortfall.

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175 PS LA 2006/8 (at para 34).

176 Ibid (at para 35).

177 Ibid (at paras 62-64).

178 PS LA 2006/8 (at paras 72-73).

## KEY FINDING 2

*Prior to 1992, the Commissioner had an established policy that the remission power for interest, or its equivalent, for the pre-amended assessment period would only be exercised in exceptional circumstances.*

*With the 1992 legislative amendments to the penalty and interest provisions, including the introduction of the interest 'uplift' factor, the Commissioner did not revise his previous policy regarding the circumstances in which the interest remission power would be exercised.*

*As such, there was no detailed policy framework for the remission of the pre-amended assessment interest charge for the years of income from 1992-93 up to and including 1999-2000.*

*For the years of income 2000-01 and onwards, the ATO's Receivables Policy does not provide sufficient guidance to the public on how the interest remission power is to be exercised for the pre-amended assessment period.*

*For this reason, tax administration would benefit if the Commissioner published a separate policy document which provides clear guidelines on his policy, covering the current and prior years, for the remission of the interest charge.*

*The policy should include the different considerations relevant to determining whether remission of the interest charge is warranted for either or both the pre-amended and post-amended assessment periods.*

## Tax Office Position

8.20 Implemented.

## IGT Analysis

8.21 As outlined in Key Finding 1, the Tax Office has published a policy document in the form of PS LA 2006/8 that provides guidance about the issues to be considered when determining whether remission of interest charge is warranted. The practice statement provides this guidance in respect of both pre- and post-amendment assessment periods. Some examples of the different considerations raised in the practice statement include:

- Tax Office delay in commencing an audit.
- Tax Office delay in obtaining information from a third party.
- Tax Office exceeds expected audit completion date.
- Delay is outside of a taxpayer's control.
- The taxpayer has made an unprompted voluntary disclosure.

- The taxpayer could not have been aware of the shortfall when lodging the relevant return.

8.22 PS LA 2006/8 states that the above list of different considerations:

*... are not exhaustive and are not intended to limit the Commissioner in his discretion to remit interest charges when it is fair and reasonable to do so.*<sup>179</sup>

8.23 PS LA 2006/8 deals with both GIC that accrues in the period prior to the amendment or revision of a tax liability, and the SIC that applies whenever an income tax assessment is amended increasing tax payable. The SIC applies to amendments of income tax assessments relating to the 2004-05 year of income and later years.

#### Implementation Status: Implemented

On 1 August 2006 the Tax Office released PS LA 2006/8 that provides guidance on the remission of the interest charge for either or both the pre-amended and post-amended assessment periods. The practice statement includes a number of considerations that are relevant to determining whether remission of the interest charge is warranted.

### KEY FINDING 3

*Although disputes involving different groups of taxpayers may have distinguishing features including the nature, complexity and sophistication of the arrangements, at the taxpayer level there are more common features between the individuals forming part of each group than points of differentiation. These include a broad array of investors, targeted marketing techniques, prior ATO advice/advance opinions/rulings and time delays.*

*Against this background, an examination of all the circumstances of the taxpayers involved in these arrangements may indicate that it is more appropriate for a similar interest remission outcome to arise for taxpayers who share similar individual circumstances regardless of the particular arrangement involved.*

#### Tax Office Position

8.24 Implemented.

#### IGT Analysis

8.25 In response to the Inspector-General's 2004 review, the Tax Office set up a panel of senior Tax Office staff to consider the situations where widely based settlement offers were appropriate for EBA participants. Following the process, a table was released to the public outlining the various settlement positions. In line with this key finding, these remission

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179 PS LA 2006/8 (at para 46).

outcomes were aligned so that taxpayers sharing similar individual circumstances would be treated similarly. Put simply, remission outcomes were not classed solely with reference to the particular arrangement involved.

8.26 In support of this, taxpayers were invited to put forward their individual financial and other circumstances not directly related to the nature of the particular arrangement and the circumstances of the person's position in it. Fieldwork undertaken by the Inspector-General indicated that remission outcomes were applied in accordance with the above mentioned grouping so that individual circumstances of taxpayers were given appropriate weighting as per the key finding.

**Implementation Status: Implemented**

#### **KEY FINDING 4**

*Administrative procedures regarding the remission of the interest charge for groups of taxpayers require that an appropriate balance is achieved between considerations of administrative efficiency in dealing with groups of taxpayers and examining the conduct and circumstances of a taxpayer in accordance with the Taxpayers' Charter.*

*To date, the approach of the Commissioner suggests more focus has been on considerations of administrative efficiency as opposed to an examination of a taxpayer's individual conduct and circumstances. In particular, considerations of the type and nature of the arrangement and the extent to which members of a group share certain further characteristics have overshadowed consideration of the conduct and circumstances for each individual.*

#### **Tax Office Position**

8.27 Implemented.

#### **IGT Analysis**

8.28 As outlined in Key Finding 3, fieldwork undertaken by the Inspector-General demonstrated that the individual conduct of a taxpayer and the circumstances involved have been the focus of Tax Office staff following on from the development of widely based settlement offers for EBA participants. This practice has been promoted with taxpayers being invited (when requesting the remission of interest) to put forward their individual financial and other circumstances not directly related to the nature of the particular arrangement, and the circumstances of the person's position in it.

**Implementation Status: Implemented**

## KEY FINDING 6

*For certain investors in Mass Marketed Tax Effective Investments (MMTEIs) the ATO set up a formal process, which also involved separate ATO internal review procedures, for the remission of interest and other elements contained in the standardised settlement arrangements. A similar process has not been established for participants in employee benefit arrangements.*

*The actual formal structure of this process for certain MMTEI investors and its accompanying review procedures were well documented within the ATO and transparent to taxpayers.*

*Currently, taxpayers who are seeking a review of the level of interest charged by the ATO can only do so by making an application for judicial review in accordance with the terms of the Administrative Decisions (Judicial Review) Act 1977 (ADJR). This is a costly and lengthy process.*

*Tax administration would therefore be improved if an internal review process of a structure similar to that adopted for MMTEI investors was adopted for EBA taxpayers. Such a process would be a quicker, less expensive and more transparent review mechanism for the remission of interest than that which currently exists for such taxpayers.*

*However, any such review process would need to operate according to the overriding principle that all individual circumstances relating to particular taxpayers are taken into account during the operation of this process.*

*In particular, considerations of the extent to which taxpayers who are subject to this review process are members of a particular group, or share other certain characteristics of other taxpayers in the same process, should not override considerations of the conduct and circumstances of each individual.*

### Tax Office Position

8.29 Implemented.

### IGT Analysis

8.30 In response to the Inspector-General's 2004 review, the Tax Office established a process whereby EBA taxpayers could apply to an internal panel to review an original request for the remission of interest.

8.31 Case sampling undertaken by the Inspector-General in respect of this review process revealed that an appropriate examination of taxpayer's individual conduct and circumstances had been undertaken in line with the key finding<sup>180</sup> In addition, appropriate

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<sup>180</sup> Case sampling demonstrated that the extent to which a particular taxpayer was a member of a particular group or shared other certain characteristics of other taxpayers in the process did not override considerations of the conduct and circumstances of the individual taxpayer.

procedural information is in place to ensure that Tax Office staff are aware of their obligation to carry out this type of examination.

8.32 The availability of this internal review process has been made transparent to taxpayers by notification in:

- Tax Office media release *Tax Office improves GIC administration* (18 November 2004);
- Tax Office fact sheet *Employee Benefit Arrangements*<sup>181</sup>;
- letters forwarded to EBA participants shortly following the release of the Inspector-General's 2004 review;
- letters forwarded to EBA participants who have unsuccessfully applied for a remission of interest.

**Implementation Status: Implemented**

## **KEY FINDING 7**

*Taxpayers who are members of groups of taxpayers in dispute with the ATO over arrangements frequently share a range of common features. Some of these features were identified by the ATO and used to determine the final settlement offer that was made to the majority of MMTEI investors. In the ATO's view, these common features suggested the existence of exceptional circumstances which justified applying an interest remission policy which led to the interest charge being reduced to nil.*

*The present ATO treatment of pre- and post-amended assessment interest charges for taxpayers involved in EBAs has focussed principally on the nature of the arrangement giving rise to the particular dispute. For taxpayers involved in three kinds of EBAs full interest has been charged while for taxpayers involved in one form of EBA a reduced interest rate has been applied.*

*This focus on the nature of the arrangement in EBA disputes appears to have led to taxpayers involved in EBA disputes receiving interest remission outcomes which are inconsistent with those received by other groups of taxpayers. It has also led to taxpayers involved in certain types of EBAs receiving interest remission outcomes which are not consistent with those applied to taxpayers involved in other forms of EBAs.*

## **Tax Office Position**

8.33 Implemented.

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181 Tax Office fact sheet Nat 11998-11.2004.

## IGT Analysis

8.34 In implementing major steps 3 and 4 (see above) and by improving its website and direct communication with taxpayers, the Tax Office achieved greater consistency in interest remission outcomes in line with the recommendation.

**Implementation Status: Implemented**

## IMPLEMENTATION OF SUBSIDIARY FINDINGS

### Subsidiary Finding 1

*The current ATO Receivables Policy only deals with the remission of the interest charge due to ATO delay in the issuing of an amended assessment once all information and evidence has been gathered and the ATO has formed a view.*

*Tax administration could be improved if the interest remission policy also specifically set out how the remission power would be exercised where the ATO has contributed to the delay during the pre-amended assessment period due to operational reasons or some uncertainty as to the operation of the law.*

*This could be similar to the approach adopted in previous ATO guidelines, such as Taxation Ruling IT 2517.*

## Tax Office Position

8.35 Implemented.

## IGT Analysis

8.36 Subsidiary finding 1 has been specifically addressed at paragraphs 47–69 of PS LA 2006/8.

**Implementation Status: Implemented**

### Subsidiary Finding 2

*Taxpayers would benefit if the Commissioner produced a simple guide to the remission of the interest charge, similar to an ATO Fact Sheet, outlining the process for requesting remission of the interest charge and the supporting information that the ATO requires.*

## Tax Office Position

8.37 Implemented.

## IGT Analysis

8.38 The Tax Office has published a number of fact sheets that outline the process for requesting the remission of interest charge as well as the supporting information that is required by the Tax Office.<sup>182</sup>

**Implementation Status: Implemented**

## Subsidiary Finding 3

*Taxpayers would benefit from the Commissioner publishing more supplementary information dealing with the remission of the interest charge. For example, greater guidance could be provided in the form of more ATO Interpretative Decisions being released and referred to in the ATO interest charge remission guidelines.*

## Tax Office Position

8.39 Implemented.

## IGT Analysis

8.40 As outlined previously, the Tax Office has provided supplementary information in line with this subsidiary finding in the form of PS LA 2006/8 as well as through a number of supporting guides, fact sheets and media releases.

**Implementation Status: Implemented**

## Subsidiary Finding 4

*Taxpayers would benefit if, in relation to pre-amended assessment interest, the Commissioner provided upon request the factors considered relevant to the decision to maintain, remit or reduce the statutory interest charge.*

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<sup>182</sup> For example, Tax Office fact sheet Employee Benefit Arrangements.

## Tax Office Position

8.41 Implemented.

## IGT Analysis

8.42 As outlined in Key Finding 2, the Tax Office has provided taxpayers with the information suggested in this subsidiary finding via the publication of PS LA 2006/8 as well as associated guidelines and fact sheets regarding EBAs.

8.43 A further point in respect of this subsidiary finding is that audit finalisation letters include a summary of the rationale for penalty and interest.

**Implementation Status: Implemented**

## Subsidiary Finding 5

*Tax administration could be improved if the interest remission policy specifically set out how the remission power would be exercised for pre-amended assessment interest in instances where:*

- *no penalty is imposed due to the taxpayer's previous good compliance record in accordance with the ATO Compliance Model;*
- *the taxpayer has made a voluntary disclosure to the Commissioner regarding their taxation position and there is no evidence of any prior intention to avoid the payment of tax;*
- *there is reasonable and positive cooperation by the taxpayer; and*
- *there is evidence of a general administrative practice by the Commissioner supporting the approach taken by the taxpayer.*

*Such an approach would be similar to that adopted in previous ATO rulings and would serve to promote and encourage voluntary compliance by taxpayers.*

## Tax Office Position

8.44 Implemented.

## IGT Analysis

8.45 The Tax Office has specifically addressed all points included in this subsidiary finding as follows:

- no penalty is imposed due to the taxpayer's previous good compliance record in accordance with the ATO Compliance Model — via paragraph 84 of PS LA 2006/8;
- the taxpayer has made a voluntary disclosure to the Commissioner regarding their taxation position and there is no evidence of any prior intention to avoid the payment of tax — via paragraphs 81 to 85 of PS LA 2006/8;
- there is reasonable and positive cooperation by the taxpayer — via paragraphs 72 to 73 of PS LA 2006/8;
- there is evidence of a general administrative practice by the Commissioner supporting the approach taken by the taxpayer — via paragraphs 99 to 107 of PS LA 2006/8.

#### Implementation Status: Implemented

#### Subsidiary Finding 6

*Taxpayers would benefit if the ATO adopted a case management arrangement for finalising the total amount, including interest, which taxpayers must pay to finalise their dispute.*

#### Tax Office Position

8.46 Implemented.

#### IGT Analysis

8.47 An end-to-end process has been implemented by the Tax Office in finalising remaining scheme cases. Settlements for taxpayers involve agreement on primary tax, penalty, and interest (including agreed rates applicable to payment arrangements). Tax agents also have access to the various Tax Office portals which provide current debts with updated interest charged.

#### Implementation Status: Implemented

#### Subsidiary Finding 7

*The ATO policy document dealing with the remission of interest should clearly articulate the type of key factors the Commissioner considers relevant to the remission of pre-amended assessment interest. Taxation Ruling IT 2517 is a useful model in that it contains an explanation of relevant factors and worked examples.*

## Tax Office Position

8.48 Implemented.

## IGT Analysis

8.49 As discussed in Key Finding 2, on 1 August 2006 the Tax Office released PS LA 2006/8 which (amongst other matters) deals with the remission of GIC that accrues in the period prior to the amendment or revision of a tax liability. This practice statement includes the use of worked examples to provide further guidance.

**Implementation Status: Implemented**

## Subsidiary Finding 8

*Tax administration would be improved if the ATO, as a matter of fairness, communicated to all EBA participants that the existence of prior non-binding ATO advice, including advice provided to an adviser in respect of unnamed clients, may entitle them to receive a partial reduction in the rate of interest.*

## Tax Office Position

8.50 Implemented.

## IGT Analysis

8.51 The Tax Office explicitly included this information in its settlement framework for EBA cases on its website and in its fact sheet titled *Options for employee benefit arrangement participants*. All EBA participants were invited to seek further remissions based upon, inter alia, their having relied upon Tax Office advice. Where this advice was provided to the Tax Office by any participant, it was accepted as applying to all participants in a particular arrangement, who had claimed to have relied upon that advice.

**Implementation Status: Implemented**

## Subsidiary Finding 9

*Tax administration would be improved if the ATO ensured that in all cases where interest remission decisions are made the reasons for these decisions are appropriately recorded on the file at the relevant time. This procedure would more readily allow these decisions to be the subject of internal ATO review (as recommended above) and also any external ATO review.*

## Tax Office Position

8.52 Implemented.

## IGT Analysis

8.53 Case sampling undertaken by the Inspector-General demonstrated that the practices referred to in this subsidiary finding are appropriately applied.

**Implementation Status: Implemented**

## Subsidiary Finding 12

*Tax administration would be improved if ATO communications to EBA taxpayers specifically made reference to the fact that ATO delay is a ground for interest remission.*

## Tax Office Position

8.54 Implemented.

## IGT Analysis

8.55 All EBA taxpayers were advised through a mail-out of the fact sheet titled ***Employee benefit arrangements*** that ATO delay is a ground for interest remission. Where there is a period of unreasonable delay, taxpayers are advised separately of that period of delay.

**Implementation Status: Implemented**

## CHAPTER 9: OTHER MATTERS

### MONITORING AND REPORTING OF IMPLEMENTATION OF RECOMMENDATIONS TO SENIOR TAX OFFICE MANAGEMENT

9.1 Shortly following the announcement of this review, representatives from both the Inspector-General's Office and the Tax Office held a meeting on 7 July 2006 to consider the policies, systems and procedures used to monitor and report on the implementation of the recommendations. Monitoring of the progress of recommendations from all external scrutineers (for example the ANAO, Ombudsman) including those of the Inspector-General is undertaken by the Tax Office's Audit Committee. Reports to this Committee are coordinated by the Tax Office's Internal Audit Branch (IAB) via the following steps:

1. On a quarterly basis, all business lines with active recommendations are required to provide the IAB with a written report detailing:
  - responsibility for a recommendation;
  - status of implementation expressed as a percentage;
  - anticipated target completion date; and
  - description of the progress during the current quarter.
2. The responses are then entered into a database<sup>183</sup> and scrutinised. The IAB undertakes a quality review of the information provided by the business lines.<sup>184</sup>
3. Based on the above information, the IAB determines the issues or reasons for the incomplete implementation and prepares a final report for the quarterly Audit Committee meeting.<sup>185</sup>

9.2 The Audit Committee meeting is held and recommendations requiring attention are then referred to either the Tax Office's Chief Internal Auditor (attached to the IAB) or other senior Tax Office staff for action.

9.3 Representatives from the IAB (including the Director of Governance) meet bi-monthly with senior Tax Office staff from the business lines to discuss the above-mentioned reporting process. The Tax Office has advised the Inspector-General that a project<sup>186</sup> is being designed to streamline the reporting process. In particular, this project will

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183 The IAB's Recommendations Database.

184 Business lines are reminded each quarter that the IAB requires full disclosure of relevant material.

185 Note that the February and August reports only contain detail of any change in the status of implementation that has occurred since the last report (that is, they are on an 'exception reporting' basis).

186 This project is an IAB initiative — conference with the Director of Governance, IAB, 17 October 2007.

be looking at the level of information provided to the IAB and ultimately to the Audit Committee.

9.4 Copies of the above-mentioned quarterly Audit Committee reports provided to the Inspector-General were patchy and contained very limited analysis. The Inspector-General considers that monitoring at the level of the Audit Committee is appropriate, but hopes that the above-mentioned IAB project will increase the level of information included in the reports beyond the current numerical exception data.

## COMMUNICATION TO TAXPAYERS OF THE CHANGES BROUGHT ABOUT BY THE IMPLEMENTATION OF RECOMMENDATIONS

9.5 The level of change undertaken to implement the recommendations and findings contained in this follow-up review has necessitated a proactive approach by the Tax Office in terms of communicating with taxpayers. This was particularly the case with the changes announced in 2004 to improve the administration of the GIC.<sup>187</sup> This required a significant commitment on behalf of the Tax Office to guide EBA participants in dispute with the Tax Office, which included:

- writing to all EBA participant taxpayers and their representatives about the Inspector-General's 2004 review and the available option to apply for remission of interest previously charged on the additional tax relating to the EBA;
- providing a set of detailed guidelines explaining the circumstances in which EBA participants may be entitled to a remission of interest.

9.6 In the area of Tax Office management of litigation, a number of methods have been used to advise taxpayers of changes. In particular has been the release of a number of law administration practice statements such as PS LA 2007/12 *Conduct of Tax Office Litigation in Courts and Tribunals*. Although these documents are designed for use by Tax Office staff, they provide a considerable level of information about the Tax Office approach. Another important communication product has been the development of the new decision impact statement which provides a brief outline of the Commissioner's position in relation to recently released court decisions as well as how the law will be administered as a consequence of a decision. This form of communication product has been particularly well received by the tax community at large.

9.7 The Tax Office has also been proactive in making the public aware of changes in the area of audits. For example on 13 October 2005 the then Commissioner of Taxation released the *Large business and tax compliance* booklet which included an announcement of a significant commitment to reduce audit timeframes with the introduction of a revised approach to complete large business audits within two years. In line with this commitment, the Commissioner also announced that large business audits exceeding that timeframe would be considered a new ground for the remission of the GIC and the SIC.<sup>188</sup>

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187 Tax Office press release — Tax Office improves GIC administration arising in response to the Inspector-General's 2004 Review of the Remission of the General Interest Charge for Groups of Taxpayers in Dispute with the Tax Office.

188 This in turn lead to the release of further guidance to the public via PS LA 2006/8 Remission of shortfall interest charge and general interest charge for shortfall periods.

9.8 The communication of changes has also been directed at the individual taxpayer. For example, concerns raised by the Inspector-General regarding the timeliness of GST refunds<sup>189</sup> saw the rewrite of the ATO Receivables Policy as a practice statement (PS LA 2006/11). In addition, the Tax Office saw the need to publish a plain English guide in the form of a Tax Office fact sheet titled *Where is my refund?* which contained a complete list of the circumstances in which an activity statement refund and other refunds will be offset and when a taxpayer will need to request the Tax Office to pay credit balances after an offset has been made. This type of informative communication has also occurred in the area of debt management through a series of guides and fact sheets about the importance of managing cash flows as well as budgeting for tax liabilities.

9.9 The Inspector-General recognises the efforts undertaken by the Tax Office in advising taxpayers of changes following on from IGT reviews. The level of information communicated has on the whole been done in a practical and accessible manner via a number of mediums.

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189 Review of Tax Office Administration of GST Refunds Resulting from the Lodgement of Credit BASs (2005) — Inspector-General of Taxation.

## **APPENDIX 1: TERMS OF REFERENCE**

**A.1.1 On 29 June 2006 the Inspector-General announced the terms of reference for this review. These were:**

**The Inspector-General will investigate to what extent the Tax Office has implemented the recommendations included in the above-mentioned reports. Particular attention will be given to:**

- evidence of a commitment to timely implementation of agreed recommendations;**
- Tax Office policies and procedures in respect of implementing these recommendations, including systems used to monitor implementation and to report progress to senior management;**
- processes adopted by the Tax Office where relevant to communicate to taxpayers changes brought about by the implementation of the recommendations;**
- determine whether the Tax Office has addressed systemic issues identified in the reports.**

## APPENDIX 2: CONDUCT OF REVIEW

A.2.1 The focus of this review has been to systematically verify the level of implementation of recommendations from the previous six reviews released by the Inspector-General.<sup>190</sup> The period of time required to complete this review has arisen because of the size of the task which has involved the analysis and testing of 73 recommendations and findings. Fieldwork was undertaken at Tax Office sites throughout the country on 37 occasions which included the accessing of Tax Office systems and procedures as well as numerous taxpayer files.

A.2.2 As part of this follow-up review process, the Tax Office provided the Inspector-General with a considerable amount of supplementary information explaining the operation of its systems and procedures. A thorough review of this information was undertaken by the Inspector-General in order to appreciate the environment within which the Tax Office operates. This work in turn enabled more informed identification of areas requiring further attention in terms of the recommendations and findings.

A.2.3 Although there was no issue regarding access to information throughout the duration of the review, there still remained a number of occasions upon which the Tax Office simply did not have the appropriate levels of reporting required to directly address points raised by the Inspector-General. On occasion these shortfalls in reporting made it difficult for timely analysis to be undertaken by the Inspector-General. Throughout the course of the review, the Tax Office has referred to the Change Program as a means by which such shortfalls are being addressed. The Inspector-General recognises the size of the Change Program but also observes that not all of the above-mentioned shortfalls are attributable to the program.

A.2.4 A welcome aspect of this review has been the general willingness of the Tax Office to work with the Inspector-General's office to make changes to some of its implementation work in order to demonstrate an implemented or partly implemented status. This was a very satisfactory and cooperative process and has been facilitated with the deployment of senior executive Tax Office staff to ensure that assistance has been appropriately provided.

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190 Up until the announcement of this review on 29 June 2006.

## **APPENDIX 3: RESPONSE FROM THE SECOND COMMISSIONER OF TAXATION**

A.3.1 The Second Commissioner's letter in response to the review is reproduced on pages 127 and 128. The detailed responses are set out after the Second Commissioner's letter, with the Inspector-General's comments on these responses also included.



Mr David Vos  
Inspector-General of Taxation  
Level 19, 50 Bridge Street  
Sydney NSW 2001

Dear David

**FOLLOW UP REVIEW INTO IMPLEMENTATION OF AGREED RECOMMENDATIONS**

Thank you for your letter of 26 October 2007 providing your final draft report on the above review.

The Tax Office commitment to improving the administration of the tax system has been demonstrated in the outcome of this review which, as you note, finds that the vast majority (62 of 65) of agreed recommendations from the six Inspector-General of Taxation reports prepared between August 2003 and May 2006 have been either fully implemented or significant progress has been made towards implementation. Your report also notes at paragraph 2.1 that even the few agreed recommendations that you have assessed as not implemented have all been progressed to some extent.

It is pleasing that your report acknowledges the cooperation and willingness of tax officials to work collaboratively with your officers to clarify expectations and make improvements throughout the review process. Our commitment to working with external scrutineers to achieve our shared goal of improving the tax administration system is demonstrated by the 'very positive' outcome of this report. We appreciate your acknowledgement in this regard.

There is, of course, always room for improvement and we would like to draw to your attention the focus the Tax Office Executive and Audit Committee has placed this year on the timely implementation of external scrutineer recommendations. For example:

- National Program Managers have been asked to review governance arrangements, including nominating realistic implementation timeframes;
- Sub-Plan Chairs have been requested to monitor the level and nature of progress against outstanding recommendations; and
- an integrity indicator has been developed that will measure and report corporately the progress of all agreed recommendations.

Whilst I would like to draw your attention to both the general and specific comments I have made on chapters three, six, seven and nine in the attachment to this letter, I would also like to take this opportunity to make the following two observations:

### ***Chapter 3: Review of Management of Part IVC Litigation***

I welcome your conclusion that all but one (subsidiary recommendation 6.5 where progress is contingent upon another agency) agreed recommendations resulting from this review have been fully or substantively implemented.

### ***Chapter 6: Review into Small Business Debt Collection Practices***

You have assessed the two recommendations from this review as not implemented. We appreciate your acknowledgement of the significant challenge associated with implementing key recommendation 1 and the collaborative nature of Tax Office initiatives adopted in response to key recommendation 2, but I would like to refer you to the attachment to this letter which shows the considerable progress made in this area in the last few months.

Thank you for opportunity to comment on your final draft report.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Bruce Quigley', with a long horizontal flourish extending to the right.

Bruce Quigley  
Second Commissioner Law  
26 November 2007

## THE INSPECTOR-GENERAL OF TAXATION'S REVIEW INTO IMPLEMENTATION OF AGREED RECOMMENDATIONS

### THE TAX OFFICE'S DETAILED RESPONSE COMBINED WITH THE INSPECTOR-GENERAL'S COMMENTS

## Chapter 3 — Review of Tax Office Management of Part IVC Litigation

### General comments

A.3.2 The Commissioner welcomed the opportunity to work with the Inspector-General during the review process to establish a better common understanding of the expectations underlying the recommendations and perceived status of the implementation of the recommendations. This enabled the Commissioner to agree, in some instances, to undertake further work to meet these expectations prior to the review being completed. This resulted, as the Inspector-General's analysis in Chapter 3 shows, all but one of the agreed recommendations having been either fully or partly implemented as agreed.

A.3.3 Of the remaining four recommendations that are not yet fully implemented, one (key recommendation 3) has been implemented to the extent it was agreed, although we have since agreed to do further work on this recommendation. The final implementation of three of them (key recommendation 5, subsidiary recommendations 6.2 and 6.5) is contingent upon the actions of another agency.

### Key Recommendation 3

#### INSPECTOR-GENERAL'S KEY RECOMMENDATION 3

*The Tax Office should introduce risk management techniques to its management of tax litigation issues. It should start this process by defining the scope of the Commissioner's and the Tax Office's legal risk in collaboration with the Australian Government Solicitor (AGS) and counsel engaged by the Tax Office.*

#### Inspector-General's Implementation Status: Partly implemented

*The Tax Office has prepared a practice statement that brings together their risk management approach in litigation. However, the practice statement does not introduce any new risk management techniques to its management of tax litigation issues.*

*The Tax Office has also recently sought and now received advice from the AGS regarding the scope of the Commissioner and the Tax Office's legal risk. The Tax Office is currently in the process of considering recommendations for improvement by the AGS.*

## Tax Office Response to Key Recommendation 3

A.3.4 The Tax Office responded to this review recommendation as follows:<sup>191</sup>

- We will review our current practices with this recommendation in mind.
- All litigation cases are risk assessed at the commencement of litigation and risks are reviewed throughout the course of litigation. The Tax Office has a practice statement that outlines the process for risk assessment in litigation — see PSLA 2005/22.
- Although that practice statement focuses on priority technical issues (PTI) it makes it clear that, whether or not a case is linked to a priority technical issue, business lines must adhere to their own governance practices to ensure decision making is made at the appropriate level. Moreover, the Tax Office's Code of Settlement Practice provides guidance for Tax Office staff considering settlement of disputes, which also encapsulates risk management concepts. Where counsel and the AGS are involved in litigation, they assist in identifying legal risks to the Commissioner throughout the course of litigation.
- Nevertheless we will review our current practices to ensure that the proposed litigation practice statement clearly articulates how we approach litigation in cases which do not involve PTIs, including a better articulation of the factors that underlie our risk management approach.

A.3.5 We have reviewed our risk management techniques, modified many current practices, as evidenced in this review, and incorporated many of those practices in practice statements that have issued following the review. We ensured that proposed practice statements would clearly articulate the approach in litigation for matters that were not a PTI, including a better articulation of factors that underlie our risk management approach.

A.3.6 Importantly, as a result of the review, we issued practice statement PS LA 2007/16 'Risk Management in Litigation' which captured the risk management practices already in place and set them out in a more structured way.

A.3.7 Paragraph 3.32 of the Inspector-General's report states that PS LA 2007/16 lacks consideration of the commercial and business environments that *taxpayers* operate within. This suggests that in responding to litigation brought by a taxpayer, the Commissioner should identify the risks to the taxpayer, as opposed to the risks to the Commissioner. The Inspector General also takes the position that risk management should include the techniques used by the ordinary taxpayer. It would seem that this is a reference to the Inspector General's view that the Commissioner should only continue with a disputed tax case where the expected monetary benefit from the case exceeds the costs incurred in litigating the case<sup>192</sup>. As explained in our response to the 2006 Report, we cannot agree with that view, as a general proposition<sup>193</sup>.

A.3.8 Although the Commissioner's approach to risk is generally different to that of taxpayers, given the Commissioner's interest in the administration of the tax system generally, we believe that two important aspects of the Commissioner's administration

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191 Review of Tax Office Management of Part IVC Litigation (2006) — Inspector-General of Taxation (at 2.56).

192 Ibid (at 5.57).

193 Ibid (at A3.c.10).

provide some balance. Firstly the code of settlement practice provides scope for mutual resolution of disputes, in the interests of good administration, where important points of principle will not be compromised. Secondly, the Tax Office's Test Case program, which broadly meets the taxpayer's costs of litigation in important cases, provides some balance between the Commissioner's desire to test areas of contention in the law and the taxpayer's interest in a commercial outcome.

A.3.9 We acknowledge the comments made by the Inspector General in relation to Behm<sup>194</sup> Recommendation 3.2.1, which lies behind the Key Recommendation.

A.3.10 We agree that we did not at that time obtain a formal advice on the scope of the Commissioner's legal risk, and given the Inspector General's views, we agreed during this review as noted by the Inspector General (paragraph 3.31), to formally obtain from AGS a more complete and focussed advice on the scope of the Commissioner's legal risk. We have received that advice and will now have that advice reviewed, and if necessary updated and finalised by counsel, in line with the recommendations. This will deal decisively with Behm recommendation 3.2.1 and the related residual issue in Key Recommendation 3. We will consider whether any existing documents require updating once the advice is finalised.

### **Inspector-General's comments on Tax Office response**

A.3.11 The Tax Office response incorrectly assumes that at paragraph 3.32 the Inspector-General is suggesting that in responding to litigation brought by a taxpayer, the Commissioner should identify the risks to the taxpayer, as opposed to the risks to the Commissioner. Paragraph 3.32 is simply saying that the Tax Office needs to consider risk management from the perspective of the commercial and business environments that taxpayers operate within.

A.3.12 The Tax Office response also incorrectly assumes that the Inspector-General is suggesting that the Commissioner should continue with a disputed tax case only where the expected monetary benefit from the case exceeds the costs incurred in litigating the case. Reference should be made to paragraph 5.57 of the Inspector-General's 2006 review<sup>195</sup> which clearly states that in assessing litigation risk the Tax Office should do so in the same manner as a normal litigant.

A.3.13 The Inspector-General notes that the Tax Office has now obtained formal advice from the AGS regarding the scope of the Commissioner's legal risk and has undertaken to have the advice reviewed, and if necessary, updated and finalised by counsel. Furthermore, the Tax Office has undertaken to update any existing documents once the advice is finalised.

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194 In 2003 a review of the management of the risks associated with the Tax Office's conduct of litigation on Part IVC matters was conducted by Mr Allan Behm, Director of Knowledge Pond Pty Ltd, with technical assistance provided by The Value Creation Group Pty Ltd. The report from this review was finalised in September 2003.

195 Review of Tax Office Management of Part IVC Litigation (2006) — Inspector-General of Taxation.

## Key Recommendation 4

### INSPECTOR-GENERAL'S KEY RECOMMENDATION 4

*The formal test case program (defined as the program under which a taxpayer makes a formal application for test case funding in accordance with funding criteria that have been publicised by the Tax Office) which is designed to fund cases which will clarify the law by establishing new legal principles should remain but new arrangements for the management of the test case program are needed. Precedents for an appropriate structure which deliver independence without being overly bureaucratic could be the existing Tax Agents' Boards or the Board of Taxation.*

### Inspector-General's Implementation Status: Partly implemented

*In August 2006 the previous government introduced the Taxation Test Case Funding Review Panel to review unsuccessful applications for test case funding. While this does not represent a new and independent management process for the whole test case program, it provides an avenue for more independent review and therefore addresses the recommendation. The Inspector-General is concerned that there is no published information available for the general public about either the role or the activities of the Review Panel.*

## Tax Office Response to Key Recommendation 4

A.3.14 Whilst the Inspector-General has noted that this recommendation has been implemented through the previous government's decision to establish the Taxation Test Case Funding Review Panel in August 2006, he is still concerned that there is no published information available for the general public about either the role or the activities of this Review Panel. That is primarily a responsibility for Treasury. Nonetheless, a revised Test Case Booklet will be published that will incorporate the arrangements put into place by Treasury. This booklet is also awaiting advice from Treasury in relation to the issues set out in Key Recommendation 5.

## Inspector-General's comments on Tax Office response

A.3.15 The Tax Office has undertaken to prepare a revised Test Case Booklet that will include information about the role and activities of the Taxation Test Case Funding Review Panel. This will substantially address the Inspector-General's residual concerns regarding implementation of this recommendation.

## Key Recommendation 5 and Subsidiary Recommendation 6.2

### INSPECTOR-GENERAL'S KEY RECOMMENDATION 5

*The Tax Office should fund taxpayers' expenses in defending the case in all cases where the Tax Office has been unsuccessful at any stage of litigation, a decision is made to appeal the relevant decision and it is fair and in the public interest for the Tax Office to fund the taxpayer's expenses. The Tax Office should develop and publicise appropriate guidelines for the funding of such cases.*

#### Inspector-General's implementation status: Partly implemented

*The Tax Office continues to work with the Treasury and the Attorney-General's Department in the development of guidelines for funding respondents' costs in appeals against court and tribunal decisions adverse to the Commissioner.*

### Inspector General's Subsidiary Recommendation 6.2

*The Tax Office should take steps to clearly notify the community of the existence of funding arrangements for cases which fall outside the formal test case program and the other rules for funding Tax Office appeals against AAT decisions and appeals to the High Court. It should notify the community of the types of cases that it will fund in this way and of the circumstances in which this funding has been and will be used by the Tax Office*

#### Inspector-General's implementation status: Partly implemented

*The Tax Office continues to work with the Treasury and the Attorney-General's Department to review funding policy and to prepare revised guidelines. The Tax Office has undertaken to revise its 'Test Case Litigation Program' booklet to incorporate the level of information required under the subsidiary recommendation.*

## Tax Office Response to Key Recommendation 5 and Subsidiary Recommendation 6.2

A.3.16 We will continue to work with the Treasury and the Attorney-General's Department to implement these recommendations.

## Subsidiary Recommendation 6.5

### Inspector-General's Subsidiary Recommendation 6.5

*The Inspector-General recommends that the current exclusion of tax avoidance cases from the AAT adverse appeal funding arrangements be removed. The Tax Office should develop guidelines which allow funding for the costs of an appeal to be provided to taxpayers in cases involving alleged tax avoidance where the AAT determines that there was no such tax avoidance, the taxpayer wins their case and the Tax Office appeals against that AAT case to the Federal Court.*

### Inspector-General's implementation status: Not implemented

*The Tax Office continues to work with the Treasury and the Attorney-General's Department to review funding policy and to prepare revised guidelines.*

*The above Tax Office position does not alter its current view that cases involving tax avoidance will generally not be funded. The Inspector-General maintains its view that where a taxpayer has been successful in a matter before the AAT which included testing of the issue of tax avoidance, adverse decision funding should not be denied where the Tax Office decides to appeal. Unless the new guidelines clearly adopt the position recommended by the Inspector-General, the Tax Office approach to this issue will continue to be unfair.*

## Tax Office Response to Subsidiary Recommendation 6.5

A.3.17 The Tax Office response to subsidiary recommendation 6.5 was 'tax avoidance cases will not be automatically excluded where it is fair and in the public interest to fund an appeal.'

A.3.18 The revised Test Case Booklet will reflect that cases involving tax avoidance schemes or attempts to gain a benefit clearly not intended by the law will not be automatically declined where it is fair and in the public interest for them to be funded. The Inspector-General is aware that we have previously funded cases involving an application of tax avoidance principles. In those circumstances it was regarded as being in the public interest to do so.

### Inspector-General's comments on Tax Office response

A.3.19 The above Tax Office position does not alter its current view that cases involving tax avoidance will generally not be funded. The Inspector-General maintains its view that where a taxpayer has been successful in a matter before the AAT which included testing of the issue of tax avoidance, adverse decision funding should not be denied where the Tax Office decides to appeal. Unless the new guidelines clearly adopt the position recommended by the Inspector-General, the Tax Office approach to this issue will continue to be unfair.

## Chapter 6 — Review into the Tax Office's Small Business Debt Collection Practices

### Key Recommendation 1

#### INSPECTOR-GENERAL'S KEY RECOMMENDATION 1

*The Inspector-General recommends that the Tax Office addresses issues of competitive disadvantage by distinguishing collection approaches between:*

- those small business tax debtors that want to comply with their payment obligations but need short term assistance to do so; and*
- those small business tax debtors that are either incapable of meeting tax payment obligations within a relatively short time frame or are in serial default.*

#### Inspector-General's implementation status: Not implemented

*The Tax Office is in a prolonged process of developing an automated risk profiling capability that will enable treatment strategies to be based on the risk profile of a debt case.*

*The key design features of the proposed analytics model appear to be broadly in line with the Inspector-General's recommendation. It is apparent that the proposed model will need to perform more detailed analysis to effectively distinguish collection processes between compliant and non-compliant small business taxpayers.*

*The likely effectiveness of the proposed capability cannot currently be assessed. The model is not yet operational. No finalisation date for this initiative has been provided.*

*Pending successful implementation of the new capability, the Tax Office remains reliant upon existing capability that does not differentiate to the level required by the recommendation.*

*After two years, this recommendation is not implemented. However, the challenge of building a system with the level of sophistication needed to deliver the required capability is significant. The Inspector-General is satisfied that the Tax Office is attempting to meet this challenge.*

### Tax Office Response to Key Recommendation 1

A.3.20 The Tax Office agrees with the Inspector-General's comments that building the systems with the level of sophistication needed to deliver the required capability (Operational Analytics) will be challenging. Notwithstanding, the Tax Office is meeting this challenge. Since the Tax Office's Minute to the Inspector-General dated 28 February 2007 we have made considerable progress in this area.

#### Debt Analytics Models (paragraphs 6.11 — 6.13)

- The Tax Office has made further progress to both the development and implementation of debt analytics models.
- Analytics allows the Tax Office to transform qualitative and qualitative data and information into knowledge to help differentiate taxpayers and to support business decision making.
- Pilots on the use of analytics in building risk rating models have been ongoing since November 2005.
- An Expert risk model has been operational in the Debt legals environment since July 2006.
- Propensity to Pay and Capacity to Pay models have been undergoing further testing and a gradual rollout across the outbound contact debt collection environment commenced in August 2007.

#### Opportunities to change existing practices (paragraphs 6.15 — 6.16)

- The Tax Office has now fully implemented and integrated into its debt collection processes the following changes:
  - remission of small residual general interest charge ('GIC') on completed promises to pay;
  - accepting GIC remission requests to the value of \$1,500 over the phone;
  - simpler and more flexible guidelines for payment arrangement proposals including those under \$25,000;
  - removing the need for taxpayers to lodge outstanding returns before the Tax Office agrees to enter into a payment arrangement;
  - the development of key guiding principles, which reflect the Tax Office's; and
  - organisational values as outlined in the Strategic Statement.

**A.3.21** These initiatives support the Tax Office's intent to deliver an improved and differentiated client experience.

**A.3.22** The Business Perceptions Survey conducted in May 2007 indicated that 64 per cent of businesses surveyed agreed that the Tax Office takes into account their circumstances when making decisions. This is up from 50 per cent for the previous survey, which was conducted in November 2006.

**A.3.23** Surveys are conducted on behalf of the Tax Office by Eureka Strategic Research on a regular basis, involving samples of around 1,500 micro businesses and small to medium enterprises.

## Inspector-General's comments on Tax Office response

A.3.24 The Inspector-General acknowledges the further progress that the Tax Office has made in relation to the debt analytics models as well as with the changes identified in paragraph 6.15. The Inspector-General has not reviewed the implementation of these changes because of their recent introduction. As noted in the Tax Office response, there is still more work ahead including the continuing development of the analytics models.<sup>196</sup>

## Key Recommendation 2

### INSPECTOR-GENERAL'S KEY RECOMMENDATION 2

*The Inspector-General recommends that the Tax Office works with the small business sector, and their representatives, to develop new administrative approaches to actively assist small businesses to better manage cash flows, if necessary, to meet tax liabilities as and when they fall due.*

### Inspector-General's implementation status: Not implemented

*The continued improvement, in co-operation with the small business sector, of the range of cash flow management tools and education strategies aimed at helping small business to improve their approaches is very positive.*

*The Tax Office has not provided evidence that it has considered or developed any changes to its own administrative approaches that would assist business to manage cash flows and to meet tax obligations as and when they fall due. There has been no indication of any new approach such as occurred with the taxi industry initiative. The Tax Office has not followed-on from their response to the original Inspector-General report.*

*The Tax Office should have done more over the two years since the recommendation was accepted to consider if it could change its own approaches. The recommendation has therefore not been implemented.*

## Tax Office Response to Key Recommendation 2

A.3.25 Paragraphs 6.18 to 6.19 do not seem to note the Tax Office's response on the progress of this recommendation, contained in our Minute to the Inspector-General dated 28 February 2007 and in any event, the Tax Office's ongoing commitment to small business is demonstrated by recent additional initiatives.

### Small Business Assistance Program (SBAP)

- In delivering a range of assistance programs to small business, the Tax Office has launched the Small Business Assistance Program (SBAP). The program provides a co-ordinated assistance approach tailored to meet the needs of small business at

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196 Including the two predictive scoring approaches — the propensity to pay score and the capacity to pay score.

particular stages of their business lifecycles and designed to make it as easy as possible for businesses to comply with their tax obligations.

- This program identifies how we currently assist small business and the key gaps in our service delivery from which pilots will be conducted to improve our service levels.
- Following the recognition by the Inspector-General of the taxi industry activity payment card as one approach in assisting small business with cash flow, the SBAP is now considering implementation of a pilot to commence from late November 2007 to determine the feasibility and benefits of further expansion of the card to other industries.
- The target population for this pilot is within the micro business segment and will draw on taxpayers in the four industries that have the highest representation in the available population.

#### Debtor Research

- In recognising that small businesses account for the majority of the Tax Office's collectable debt, we are currently undertaking Debtor research at both the tactical and strategic level. We have adopted a multi-faceted research approach, with the aim of identifying characteristics of tax debtors and gaining a better understanding of the factors shaping the incidence of tax debt among small businesses.
- In particular, the research will broadly investigate:
  - how macro-economic factors influence small business tax debt;
  - how changes in economic conditions impact on the level of small business tax debt;
  - how small businesses manage their cash flows and what systems and strategies they use to monitor their cash flows;
  - how small businesses manage their overall debts;
  - where the Tax Office sits in terms of priority of payment;
  - perceptions of the Tax Office prior to, and after, incurring the debt; and
  - the effectiveness of the Tax Office's current strategies in assisting taxpayers to clear their debt.
- Activities underway as part of the project include:
  - engaged external consultant, Eureka Strategic Research, who have completed initial qualitative research. We expect to commence the quantitative component in February 2008. This will involve a large number of interviews with small business taxpayers, some with a tax debt and others who do not have a tax debt.
  - engaged academics based at the University of Queensland to undertake a scoping study to develop a research framework, and

- commenced analysis of information provided from tax administrations (that is UK/USA) that attended an International Debt Collections Workshop held in Brisbane, Queensland, April 2007.
- The Tax Office expects to gain a better understanding of the factors influencing the decision-making behaviour of small businesses with regards to tax obligations. The findings of the project may also be used to enhance the Tax Office's taxpayer education, communication and collection strategies.

### **Inspector-General's comments on Tax Office response**

A.3.26 The Inspector-General acknowledges the continuing efforts of the Tax Office to develop initiatives aimed at assisting the small business sector to better manage cash flows and so meet their tax liabilities as and when they fall due. However, the Tax Office response suggests that it is still primarily focussed on small business approaches and has still not considered or developed any changes to its *own* administrative approaches that would in turn assist small business to manage cash flows and to meet tax obligations as and when they fall due. Hopefully proposals will emerge from the research project that the Tax Office now has underway. The Tax Office consideration of a pilot expansion of the taxi industry activity payment card is welcomed.

### **Inspector-General's Paragraph 6.24**

6.24 The Inspector-General considers that a range of possibilities exists for new Tax Office administrative approaches that should by now have been considered and developed by the Tax Office, working with the small business sector. Examples of these possibilities include:

- Extending the kind of thinking and approaches used in the taxi industry to other industries or sectors.
- Working with the banking sector to develop a 'withholding facility' for selected industry groups which requires businesses to deposit regular amounts into the facility. Once deposited, these amounts would in turn be directed towards tax liabilities. Related possibilities include facilitating and encouraging the use of BPAY facilities towards the same end.
- Working with the small business sector to conduct research into the cash flow cycles and terms of trade of particular industries as a basis for both considering administrative changes (for example by re-aligning payment due dates with periods when funds are available) and for improved understanding when managing debt cases.

### **Tax Office Response to Paragraph 6.24**

A.3.27 In relation to the Inspector-General's suggestion of working with the banking sector to develop a withholding facility, the Tax Office confirms that many of the major financial institutions offer their customers a GST offset account. These accounts enable customers to keep their GST outlays separate from their daily business banking and allow money to be remitted directly to the Tax Office via a number of payment methods, such as phone banking or BPAY.

## Chapter 7 — Review into the Tax Office Administration of GST Refunds Resulting from the Lodgement of Credit BASs

### General comments

A.3.28 The Tax Office welcomes the Inspector-General of Taxation's confirmation of the substantive implementation of recommendations arising from the *Review into Tax Office Administration of GST Refunds resulting from lodgement of credit BASs*. As noted in the report, agreement has been reached on what is needed to finalise the one remaining partially implemented sub-recommendation.

## Chapter 9 — Other matters

### Inspector-General's Paragraphs 9.3 and 9.4

9.3 Representatives from the IAB (including the Director of Governance) meet bi-monthly with the senior Tax Office staff from the business lines to discuss the above mentioned reporting process. The Tax Office has advised the Inspector-General that a project<sup>197</sup> is being designed to improve and streamline the reporting process. In particular, this project will be looking at the level of information provided to the IAB and ultimately to the Audit Committee.

9.4 Copies of the above mentioned quarterly Audit Committee reports provided to the Inspector-General were patchy and contained very limited analysis. The Inspector-General considers that monitoring at the level of the Audit Committee is appropriate; but hopes that the above mentioned IAB project will increase the level of information included in the reports beyond the current numerical exception data.

### Tax Office Response to Paragraphs 9.3 and 9.4

A.3.29 As noted by the Inspector-General, the Tax Office is committed to implementing agreed outcomes from external scrutineer reviews. In line with this commitment Internal Audit Branch (IAB) has initiated the following improvements to our governance processes:

- incorporating into one report to the Audit Committee, Tax Office progress against the implementation of both external and internal recommendations. Reports to the Audit Committee are provided on a quarterly basis.
- development of improved functionality of the recommendations database to enable more detailed and informed analysis of data and subsequent reporting
- introduction, from July 1 2007, of an external scrutineer integrity indicator that measures the timeliness of implementing agreed outcomes, both at the corporate and business/service line level.

A.3.30 These initiatives will provide a more effective and efficient process and accountability mechanism for monitoring the implementation of external scrutineer recommendations.

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197 This project is an IAB initiative — conference with the Director of Governance, IAB, 17 October 2007.

## APPENDIX 4: ABBREVIATIONS

AAT	Administrative Appeals Tribunal
AGS	Australian Government Solicitor
ALRC	Australian Law Reform Commission
ANAO	Australian National Audit Office
AQR	Active Compliance Quality Review
ATO	Australian Taxation Office
CAP	Compliance Assurance Practice
CoE	Centre of Excellence
Commissioner	Commissioner of Taxation
CPIT	Compliance Penalties & Interest Team
CTU	Complex Technical Unit
DRI	Delayed Refund Interest
EBA	Employee Benefit Arrangement
EIS	Executive Information System
FBT	Fringe Benefits Tax
FBTAA	<i>Fringe Benefits Tax Assessment Act 1986</i>
GIC	General Interest Charge
GST	Goods and Services Tax
GSTR	Goods and Services Tax Ruling
HWI	High Wealth Individual
IAB	Internal Audit Branch
IGT	Inspector-General of Taxation
IGT Act	<i>Inspector-General of Taxation Act 2003</i>
Inspector-General	Inspector-General of Taxation
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
JCPA	Joint Committee of Public Accounts
LB&I	Large Business and International
LSB	Legal Services Branch

ME&I	Micro Enterprises & Individuals
MMTEI	Mass Marketed Tax Effective Investment
NTLG	National Tax Liaison Group
OCTC	Office of the Chief Tax Counsel
OLSC	Office of Legal Services Co-ordination
PS	Practice Statement
PS CM	Practice Statement Corporate Management
PS LA	Practice Statement Law Administration
PTI	Priority Technical Issue
ROSA	Report on Aspects of Income Tax Self Assessment
SB	Small Business
SIC	Shortfall Interest Charge
SILC	Significant Issues Litigation Committee
SME	Small to Medium Enterprise
SNC	Serious Non Compliance
STCT	Small Taxation Claims Tribunal
TAA 1953	<b><i>Taxation Administration Act 1953</i></b>
Tax Office	Australian Taxation Office
TC	Test Case
TCN	Tax Counsel Network
TEP	Technical Excellence Practice
TQR	Technical Quality Review