



**Australian Government**  
**Inspector-General of Taxation**

# **Follow up review into the Australian Taxation Office's implementation of agreed recommendations included in the six reports prepared by the Inspector-General of Taxation between June 2006 and October 2008**

**A report to the Assistant Treasurer**

**Inspector-General of Taxation**

**June 2010**



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Taxation Office's implementation of  
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**Reviewer:** Peter Glass

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30 June 2010

Senator the Hon Nick Sherry  
Assistant Treasurer  
Parliament House  
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Dear Minister

I am pleased to present to you my report in respect of the review into the ATO's implementation of agreed recommendations included in the six reports prepared by my office between June 2006 and October 2008.

The review was announced on 24 June 2009. This report has been prepared under section 10 of the *Inspector-General of Taxation Act 2003*.

The ATO agreed wholly or in part to implement 41 of the 45 recommendations made in the six reports. The main focus of the review was to investigate to what extent the ATO has implemented the agreed recommendations. I am pleased to report that the ATO has implemented or made significant progress with the vast majority (38 of 41) of the agreed recommendations. Importantly, agreed recommendations are those aspects of my original recommendations that the ATO agreed to implement. Concerns remain in relation to those recommendations or aspects thereof upon which agreement was not reached and/or were not implemented. In particular, the ATO's comments regarding my recommendation to ensure that ATO guidance which is of a significant nature, and which affects a large segment of the taxpayer population, be in a binding form. I also have raised concern on this issue in the IGT's 2009 review into the ATO's administration of public binding advice.

Overall, the outcome reflects the valuable contribution of information, time and support by taxpayers and their advisers, the work of my office, and the ATO's commitment to improving tax administration.

I have provided the Commissioner of Taxation with the opportunity to respond to the report's findings. The ATO's response, which I have fully considered, is in Appendix 2 to the report.

This review has been akin to undertaking six separate reviews – albeit of a smaller scale than the original review process.

In the report I have acknowledged the assistance of ATO staff who provided assistance and cooperation in support of the review process. There were aspects of this review process that require improvement particularly with respect to timely provision of information and resolution as to whether a recommendation was implemented or otherwise. However, my office and the ATO are working cooperatively to finalise a new implementation framework designed to enhance the follow up review process and outcomes for IGT recommendations.

Yours faithfully

Ali Noroozi  
Inspector-General of Taxation





# 1. EXECUTIVE SUMMARY

1.1 The IGT considered it important and necessary to assess, after a reasonable period, the implementation of improvements to tax administration recommended and agreed to by the ATO in the six reviews he had completed between June 2006 and October 2008. In undertaking this review, the IGT has also assessed the timeliness of the publication of Decision Impact Statements following on from recommendations in his 2006 report on the Tax Office's management of Part IVC litigation.

1.2 This review has been akin to undertaking six separate reviews — albeit of a smaller scale than the original review process.

1.3 Based on a thorough analysis of the ATO's actions in response to each agreed recommendation, the IGT has determined that the ATO has implemented or partly implemented 38 of 41 agreed IGT recommendations. Importantly, agreed recommendations are those aspects of the original IGT recommendations that the ATO agreed to implement.

1.4 Concerns remain in relation to those recommendations or aspects thereof upon which agreement was not reached and/or were not implemented. In particular, the ATO's comments regarding the IGT's recommendation<sup>1</sup> to ensure that ATO guidance which is of a significant nature, and which affects a large segment of the taxpayer population be in a binding form. This concern regarding the level of binding advice is also raised in the IGT 2009 review<sup>2</sup> into the ATO's administration of public binding advice.

1.5 This follow up review's implementation outcomes are a reflection of the work of the IGT and the ATO's openness to scrutiny and commitment to making improvements. 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 IGT. These organisations provided a range of support to the IGT in the conduct of this review.

1.6 The level of change associated with the implementation of a number of recommendations has been accompanied by appropriate communication with taxpayers through a number of mediums. The monitoring and reporting of the status of implementation of recommendations to senior ATO management remains an area requiring improvement. However, the ATO is currently in the process of introducing a number of initiatives that are aimed at addressing this issue.

1.7 A welcome aspect of this review has been the general willingness of the ATO to work with the IGT to make changes to some of its implementation work in order to demonstrate an implemented or partly implemented status. There were aspects of this review that require improvement with respect to timely provision of information and resolution of issues. However my office and the ATO are working cooperatively to finalise a new implementation framework designed to enhance the follow up review process and outcomes for IGT recommendations.

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1 Recommendation 8 of IGT's 2007 *Review of Tax Office's management of complex issues – Case study on service entity arrangements*(publicly released January 2007).

2 *Review of the Tax Office's administration of public binding advice* (publicly released April 2009).

1.8 The ATO's formal response notes that this follow up review has been of benefit by providing useful indicators on where it needs to focus for those areas requiring further improvement.

1.9 The IGT will also maintain a specific watching brief over certain matters or undertakings the ATO has provided in the context of the report.

## 2. CONDUCT OF THE REVIEW

### INITIATING THE REVIEW

2.1 This is the report on the follow up review into the ATO's implementation of recommendations included in all six publicly released reports prepared by the IGT between June 2006 to October 2008. The review was conducted pursuant to section 8(1) of the *Inspector-General of Taxation Act 2003* (IGT Act).

2.2 The IGT 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 ATO.

2.3 This review was announced on 24 June 2009. Its terms of reference are reproduced at Appendix 1 to this report. The ATO's detailed response is reproduced in Appendix 2.

### SCOPE AND FOCUS

2.4 As of 30 June 2009, the IGT had completed the following reports on systemic tax administration issues identified through consultation as relevant to stakeholders:

- *Review of Tax Office's management of complex issues - Case study on service entity arrangements* (publicly released 24 April 2007)
- *Review of Tax Office's management of complex issues - Case study on living-away-from-home allowances* (publicly released 10 May 2007)
- *Review of Tax Office's management of complex issues - Case study on research and development syndicates* (publicly released 16 August 2007)
- *Review of the potential revenue bias in private binding rulings involving large complex matters* (publicly released 25 February 2008)
- *Review of the Tax Office's administration of GST audits for large taxpayers* (publicly released 11 June 2008)
- *Improvement to tax administration arising from the Inspector-General's case study reviews of the Tax Office's management of major, complex issues* (publicly released 29 October 2008).

2.5 In these reviews the IGT made a total of 45 recommendations for improvement of which the ATO agreed to implement 41 in whole or in part. The following table shows the numbers of recommendations for each review:

IGT Review	Number accepted (in whole or in part) / total recommendations
Review of Tax Office's management of complex issues - Case study on service entity arrangements	10/12
Review of Tax Office's management of complex issues - Case study on living-away-from-home allowances	2/2
Review of Tax Office's management of complex issues - Case study on research and development syndicates	1/1
Review of the potential revenue bias in private binding rulings involving large complex matters	10/10
Review of the Tax Office's administration of GST audits for large taxpayers	12/14
Improvement to tax administration arising from the Inspector-General's case study reviews of the Tax Office's management of major, complex issues	6/6
<b>Total</b>	<b>41/45</b>

2.6 The main focus of this review was to investigate to what extent the ATO has implemented the agreed recommendations. Throughout the review, particular attention was given to:

- evidence of a commitment to timely implementation of agreed recommendations;
- ATO 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 ATO where relevant to communicate to taxpayers changes brought about by the implementation of the recommendations; and
- determining whether the ATO has addressed systemic issues identified in the reports.

2.7 In assessing the implementation status of particular recommendations, or the sub-part of a given recommendation (as appropriate), the IGT has used the following terms:

- **Implemented** — this term means that the ATO has demonstrated to the IGT that the particular agreed 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 ATO has not only commenced implementation but has made substantial progress and is actively pursuing completion.
- **Not implemented** — this term means that the ATO has, in the IGT's view, not made satisfactory progress and is falling well short of implementing the agreed recommendation.

2.8 Part of this follow up review also includes consideration<sup>1</sup> of the timeliness of publication of Decision Impact Statements by the ATO following on from the IGT's recommendations in the 2006 report *Review of Tax Office management of Part IVC litigation*.

2.9 Furthermore, the IGT's findings regarding the implementation of recommendations from the 2008 *Review of the potential revenue bias in private binding rulings involving large complex matters* has also formed part of his review into the ATO's administration of private rulings.<sup>2</sup>

## ACKNOWLEDGEMENTS

2.10 The assistance and cooperation provided by a range of ATO staff to the IGT and his team during the course of the review are acknowledged.

## STRUCTURE OF THE REPORT

2.11 Chapter 3 of this report provides a summary of what the review found.

2.12 Chapters 4 to 9 contain an in-depth analysis of the status of implementation of recommendations for the six IGT reviews.

2.13 Chapter 10 contains a brief review of how ATO systems monitor the implementation of recommendations and how progress is reported to senior management. This chapter also contains an overview of the types of processes adopted by the ATO to communicate to taxpayers, where relevant, changes brought about by the implementation of the recommendations.

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

2.15 Appendix 2 is the formal response to the review received from the ATO.

2.16 Appendix 3 lists the IGT recommendations not agreed to by the ATO.

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

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1 This part of the review is incorporated into the final segment (recommendation F) of chapter 9 of this report which reviews the implementation of recommendations from the IGT's 2008 report *Improvement to tax administration arising from the Inspector-General's case study reviews of the Tax Office's management of major, complex issues*.

2 *Review into the Tax Office's administration of private rulings* — submitted to the Minister in May 2010.



### 3. OVERVIEW

- 3.1 The ATO has implemented or made significant progress with the majority (38 of 41) of the agreed recommendations made by the IGT in reviews completed between June 2006 and October 2008 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 ATO to some extent.
- 3.2 Other matters observed during the review included a review of the monitoring and reporting of the implementation of recommendations to senior ATO management. Monitoring of the progress of recommendations from all external scrutineers of the ATO is undertaken quarterly by the ATO's Audit Committee based on reports prepared by the ATO's Internal Audit group from input by business lines (BSL). The Internal Audit group updates the ATO's Audit Committee as to the status of implementation. On the evidence of reports sampled, the IGT found these reports to contain some inaccuracy and a need for further detail. It is hoped that suggestions arising from an internal ATO review, which is currently before the Audit Committee, will increase both the level and accuracy of information provided.
- 3.3 The second ancillary matter considered by the IGT was how well the ATO has communicated the implementation of the recommendations to taxpayers. As discussed in chapter 10 of this report, the ATO has been quite proactive in undertaking appropriate forms of communication. These efforts must continue as further developments arise in connection with the implementation of recommendations.
- 3.4 In summary, this follow up review has demonstrated that the ATO has responded to reviews conducted by the IGT. This is evidenced through the number of agreed recommendations (or parts thereof) that have been implemented as well as through the improvements in ATO administrative practices and approaches. Given the number of recommendations involved, this represents a positive outcome.





## 4. REVIEW OF TAX OFFICE'S MANAGEMENT OF COMPLEX ISSUES — CASE STUDY ON SERVICE ENTITY ARRANGEMENTS

### INTRODUCTION

4.1 The review into the ATO's handling of service entity arrangements was prompted by concerns that the ATO had taken too long to identify and resolve the tax issues associated with these arrangements and that this delay had led to considerable uncertainty and (in some cases) unnecessary costs for affected taxpayers. This review was announced in October 2005 as one of three case studies culminating in the IGT's 2008 report on improvements to tax administration arising from case study reviews of the ATO's management of major, complex issues (the fourth report).

4.2 As part of the review, the IGT looked into the key events associated with the development of the ATO's compliance approach to service entities. These events started with the ATO's first significant challenge to the deductibility of fees paid under a service entity arrangement in the 1978 Phillips case<sup>1</sup> and ended with the ATO issuing its final guidance on the deductibility of service entity fees in 2006.

4.3 Overall, the review found that the compliance issue associated with service entities could have been resolved much more quickly. Public guidance on this issue could have been provided as early as 2001 instead of 2006. This would have meant far less uncertainty for taxpayers who wanted to apply the ATO's view and would have more quickly brought to account those who did not. The review also determined that the ATO's concerns should have been communicated much earlier and more effectively in order to optimise voluntary compliance.

4.4 The fieldwork undertaken for this review also enabled the IGT to identify a number of areas for improvement by the ATO. For example the ATO had not been appropriately monitoring and therefore reporting on adherence to its performance standards for the provision of public rulings. Also, certain audit practices, such as an apparent failure to appropriately consider taxpayer's individual circumstances during the course of an audit, were identified.

4.5 In January 2007, the IGT's report<sup>2</sup> was publicly released and included twelve recommendations. The ATO agreed with seven of the twelve recommendations and partly agreed with three of the remaining five recommendations. The principles behind the two recommendations not agreed, namely key recommendations 1 and 4, have been picked up again in the course of the IGT's *Review into delayed or changed Australian Taxation Office views on significant issues*.<sup>3</sup>

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1 *F C of T v Phillips* (1978) 8 ATR 783.

2 *Review of Tax Office's management of complex issues - Case study on service entity arrangements*

3 Released in March 2010.

4.6 During the course of the Service Entities review, the ATO had also implemented a number of changes to address concerns raised including:

- the provision of final guidance on service entities;
- the issue of some public guidance on the meaning and effect of the term 'general administrative practice';
- the recommencement of a process to monitor the timeliness of public rulings and determinations;
- the introduction of a feedback process for public rulings; and
- changes to its consultation and audit processes.

4.7 The status of the recommendations from the review which the ATO agreed to implement, in whole or in part, is set out below.

## KEY RECOMMENDATION 1

Not Agreed to by the Tax Office (refer to Appendix 3)

## KEY RECOMMENDATION 2

*The Tax Office's timeliness standards for public rulings should be made public in the same manner as its other service standards.*

*The content of these standards should be altered as follows.*

*Where a compliance issue arises which gives rise to the possible need to issue a ruling, the Tax Office should reach a decision to issue a ruling and then should actually issue the relevant ruling in final form no later than 12 months after the compliance issue is identified. If the ruling is to be accompanied by detailed practical guidance which contains commercial benchmark rates for a number of industries, such as occurred in the case of service entities, both documents should be issued within a maximum period of 24 months of the relevant compliance issue being identified.*

*If a ruling and any accompanying guidance material are issued more than two years after any relevant compliance issue is identified, the date of effect of both the ruling and any accompanying guidance should be prospective only.*

## ATO position

Implemented

## ATO response

4.8 The Tax Office agreed with the part of the recommendation that related to publishing timeliness standards for public rulings, noting it already did this via the Tax Office website. The Tax Office did not agree with the rest of the recommendation.

4.9 The Tax Office publishes the public rulings program each month on its website [ato.gov.au](http://ato.gov.au). This program lists details of the public rulings which are in progress, the date they were added to the program as well as projected publication dates for the draft and final versions of the ruling.

4.10 As noted by the Tax Office in Agreed Area A of the Inspector-General's report Improvement to tax administration arising from the Inspector-General's case study reviews of the Tax Office's management of major, complex issues (also known as the 'fourth report'):

For public rulings and LAPS, the Tax Office's programs on [www.ato.gov.au](http://www.ato.gov.au) reflect the agreed delivery timeframes for those products including the issuing of drafts in the case of public rulings. The Tax Office processes governing the development of both products requires referral to and approval from the relevant Band 2 SES officer for existing timeframes to be varied. The rulings program also indicates the Tax Office's 'target' timeframes for the development of taxation rulings and determinations across the different subject areas. Exceptions to these targets (for example, to allow additional consultation with industry) are advised on the program.

4.11 The program includes a note outlining the standard timeframes that we will seek to achieve in issuing first a draft and then a final ruling. Proposed public rulings which fail to meet their projected publication dates are highlighted by shading in the program. The note provides:

Shaded topics are delayed. As a general rule, we aim to issue a draft taxation ruling within 6 months of being notified on the program and a final ruling within 6 months of its issue in draft form. The relevant period for a draft and final taxation determination is 3 months. We aim to issue a draft Self Managed Superannuation Fund Ruling within 8 months of being notified and a final Self Managed Superannuation Fund Ruling within 8 months of its issue in draft form. The relevant period for a draft and final Self Managed Superannuation Fund Determination is 4 months. Exceptions to these rules (for example, to allow additional consultation with industry) are advised upon notification and the planned issue dates are reflected accordingly. These exception topics will not be shaded as delayed until the issue dates, as originally notified, pass.<sup>4</sup>

4.12 We believe that this approach allows practitioners and the community to track the progress of specific rulings and to see clearly which rulings are outside their original expected timeframes. Previous versions of the program, dating from January 2007, are maintained in the same location of the Tax Office's website should anyone wish to refer to or view them.

4.13 The public rulings program is a standard agenda item at the National Tax Liaison Group Public Rulings Steering Committee and members are given the opportunity to question and raise concerns about the progress of any public rulings on that program.

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4 A longer period is given for Self Managed Superannuation Fund Rulings and Determinations to allow consultation to be undertaken with the Australian Prudential Regulation Authority prior to issue.

4.14 We are seeking to make further improvements to the presentation of the public rulings program by separating those rulings currently in progress into two work sheets; one for drafts and one for rulings which have issued in draft form and are being finalised. This will make it clearer what stage a ruling is at in its development. The note will be maintained.

4.15 We have sought the views of the National Tax Liaison Group members through the Public Rulings Steering Committee and they support the change.

### **IGT Conclusion — Implemented**

4.16 As indicated in the above response, the ATO agreed to continue its current practices for the publishing of timeliness standards for public rulings. Therefore for the purposes of this follow up review, the ATO has implemented the recommendation to the extent that it agreed to do.

4.17 The IGT however maintains that the ATO's current practice for publishing the timeliness standards for public rulings should be made public in the same manner as its other service standards.

### **KEY RECOMMENDATION 3**

*The Tax Office should monitor and assess the degree to which public rulings are meeting its internal service standards on timeliness for these rulings on at least an annual basis. The results of this monitoring and assessment process should be publicly reported in the same way as its performance against other service standards is reported.*

### **ATO position**

Implemented

### **ATO response**

4.18 The Tax Office agreed that it should assess and monitor the degree to which public rulings were meeting its internal service standards on timeliness, noting that this information was available on the Tax Office's website.

4.19 The Tax Office considers that the recommendation continues to be met via the public rulings program which is published monthly on its website and which highlights those rulings which have not issued according to their originally notified timeframes.

4.20 This approach allows practitioners, the community and Tax Office senior officers to track and monitor the progress of specific rulings and to see clearly which are outside their original expected timeframes. Previous versions of the program dating back to January 2007 are maintained in the same location on the Tax Office's website should anyone wish to refer to or view them.

4.21 Discussion of items on the public rulings program is a standard agenda item at the National Tax Liaison Group Public Rulings Steering Committee. During discussion,

members are given the opportunity to question and raise concerns about the progress of any public rulings on that program.

4.22 Once the need for a public ruling has been identified and resources allocated, the relevant stakeholders are required to complete a resolution schedule setting out the expected key milestones for the ruling. As noted in Agreed Area A in the *fourth report*, Tax Office processes for public rulings require referral to and approval from the relevant Band 2 SES officer for existing timeframes to be varied. Delays in meeting expected publication dates are monitored and managed by the Chief Tax Counsel and Deputy Chief Tax Counsel, including through the Priority Technical Issues Committee which meets each six to eight weeks.

4.23 In the case of PTIC, prior to each PTIC meeting, the convener and the Chair (the Chief Tax Counsel) meet to discuss which issues, including any proposed public rulings, require call-over by PTIC. Follow up action is undertaken prior to the meeting by the Convener or the CTC as required. At the meeting, issues identified requiring call-over are discussed, including by contacting the relevant officer by phone. The action taken, or to be taken, is reflected in the action items and minutes of the PTIC.

4.24 In addition, reports provided to the Law and Practice Executive, the Priority Technical Issues Committee (PTIC) and the Plenary Governance Forum give senior Tax Office leaders an overview of how public rulings overall are tracking against their expected timeframes.

## **IGT Conclusion — Implemented**

4.25 As indicated in the above response, the ATO has agreed to continue its current practices for the monitoring, assessing and publishing of the timeliness of public rulings. The ATO has also introduced some new practices for the internal monitoring and management of Priority Technical Issue (PTI) cases<sup>5</sup> – which include public rulings. These changes are discussed in chapter 9 of this report.<sup>6</sup> For the purposes of this follow up review, the ATO has implemented the recommendation to the extent that it agreed to do.

4.26 Although the ATO continues to record the time that public rulings are notified to the public rulings program and the date when finalised, the IGT maintains that a statistic regarding overall performance against its timeliness standard for public rulings should be provided as occurs for other products on the ATO webpage '*Our service standards*'.

## **KEY RECOMMENDATION 4**

Not Agreed to by the Tax Office (refer to Appendix 3)

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5 PTIs are usually the most complex or significant technical issues based on risk to revenue or impact on confidence in the tax or superannuation system. They usually require resolution by way of formation and/or application of the ATO view of the law and most commonly are referred to the ATO's more senior technical staff. Public rulings are treated as PTIs.

6 Chapter 9 covers the implementation of recommendations arising from the IGT's 2008 report *Improvement to tax administration arising from the Inspector-General's case study reviews of the Tax Office's management of major, complex issues*.

## KEY RECOMMENDATION 5

*When conducting audits of any taxpayer (including any audits of prior year service entity arrangements), the Tax Office should ensure that it fully considers all the relevant taxpayer's individual circumstances. It should also, as part of the audit process, clearly demonstrate to the taxpayer that it has done so, for example, by addressing these circumstances specifically if the taxpayer has raised these circumstances in a written submission.*

### ATO position

Implemented

### ATO response

4.27 The Tax Office agreed with this recommendation and noted that it had consistently adopted this approach in relation to its active compliance activities on service entity arrangements.

4.28 Consideration of taxpayer's individual circumstances is 'hard wired' into Tax Office commitments in the Taxpayers' Charter and enterprise-wide work procedures for audits and other active compliance activities.

4.29 The Taxpayer's Charter booklet 'If you're subject to enquiry or audit' describes what taxpayers can expect if selected for a face to face review or audit. The publication is available on [ato.gov.au](http://ato.gov.au).

4.30 Enterprise-wide work procedures are in place to support Tax Office staff using our case management system (Siebel). The procedures include detailed instructions for staff undertaking active compliance activities. The instructions direct staff to consider the Taxpayers' Charter, client relationship management procedures and taxpayer's circumstances. These procedures are available to Tax Office staff on the intranet.

4.31 The case management system (Siebel) also includes a number of quality control points and manager approval points during the course of a case which extend to consideration of taxpayer's circumstances.

4.32 As a result of this IGT review, the Tax Office published in May 2010 on our Work Processes intranet site an instruction to Tax Office staff which re-states the general Taxpayer Charter commitments with the specific language of the IGT's recommendation. It states:

#### **Re-Statement of Our Policy**

**Subject: Requirement to fully consider all the relevant taxpayer individual circumstances throughout our audits**

When conducting audits of any taxpayer, tax officers including team leaders, must ensure they fully consider all the relevant taxpayer's individual circumstances, throughout our audits.

As part of the audit process, officers must clearly demonstrate to the taxpayer that we have done so, for example, by addressing these circumstances specifically if the taxpayer has raised these circumstances in a written submission.

Simplistic, “one size fits all” solutions to managing similar compliance risks across taxpayers without adequately considering the individual circumstances of each taxpayer or arrangement are unacceptable given our Taxpayer Charter commitments.

4.33 For every Tax Office audit case product, this instruction is important because it has been published as a task for auditors at the start of every audit. Furthermore, the key requirements have also been re-stated in Tax Office work procedures at the approval point prior to closing every audit

4.34 In addition, there are also more specific procedures that have been developed for certain types of cases where the nature of the compliance approach requires more detail or instruction.

4.35 The outline of the general S&ME procedures and work practices direct staff to consider people’s circumstances during the compliance action. For example, client responses are considered when presenting the initial findings in a position paper to the client. Prior to case completion the client’s contentions are considered and the team manager signs off that the compliance decision takes into account the client’s view.

4.36 A further example comes from the Superannuation business line (SPR) where client’s views and supporting documentation are addressed where the Tax Office is considering making a fund non-complying. In these cases, a show cause process is used where a position paper is sent to the client stating relevant facts, our views, the client’s position (if one is provided) and our position. This process enables the client to further address our concerns and the finalisation letter containing our reasons for decision will address the issues raised by the client.

4.37 The Tax Office has implemented an integrated quality framework (IQF). The framework includes processes for continuously improving and assuring the management of quality, capability, assessment of quality, reporting, continuous improvement and culture.

4.38 The processes included within IQF give detailed consideration to the quality of ATO decisions which includes identifying, understanding and addressing all the relevant taxpayer issues and circumstances in audits. ATO IQF processes are identifying instances where a more complete addressing of individual taxpayer circumstances is required and as a result IQF is bringing about a review of case decisions before cases are closed.

4.39 IQF is designed to ensure, amongst other things, that practices, procedures and policies, introduced or re-stated to implement this recommendation are followed, by tax officers. If they are not followed, this will be identified and acted on.

4.40 These processes assist in ensuring officers consider individual circumstances as required by the procedures. (Practice Statement Law Administration PS LA 2009/6 ‘Quality improvement and assurance: application of and conformance with the Integrated Quality Framework’).



## IGT Conclusion — Implemented

4.41 In response to this review, the ATO recently<sup>7</sup> introduced a new directive to tax officers which re-states the requirements contained in the IGT's recommendation<sup>8</sup>. To support this development, changes have been made to the ATO's case management system including a step requiring sign-off by case reviewers that the audit has been conducted in accordance with the IGT's recommendation.

4.42 The ATO also refers to the introduction of its new IQF quality assurance system<sup>9</sup> which it states is designed to ensure that the above mentioned policies and procedures are followed by tax officers.

4.43 Given the recent introduction of these measures, IGT has not had the opportunity to test their application and effect. This may form part of a future review by the IGT. Subject to future satisfactory testing of the application of these changes, the IGT considers that for the purposes of this review this recommendation is implemented.

### KEY RECOMMENDATION 6

*The Tax Office should issue comprehensive guidance to its staff, in the form of a practice statement which is made publicly available, on the meaning of the term 'general administrative practice' and on the implications with regard to penalties, interest and primary tax which arise if the Tax Office has changed such a practice. This guidance should also provide practical examples and should be subject to public consultation prior to being issued.*

### ATO position

Implemented

### ATO response

4.44 The Tax Office agreed to this recommendation and as noted in its original response considered it had been addressed in issuing Taxation Ruling TR 2006/10.

4.45 Taxation Ruling TR 2006/10, which issued on 4 October 2006 outlines the public rulings system under Division 358 of Schedule 1 of the *Taxation Administration Act 1977*. Paragraphs 70 to 74 of that public ruling deal with the Commissioner's view of the term 'general administrative practice'.

4.46 Since the review, on 28 February 2008 the Tax Office also issued Law Administration Practice Statement PS LA 2008/3 which provides comprehensive guidance on the Tax Office's advice and guidance framework. The practice statement also

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7 Introduced in May 2010.

8 This has also been included as a specific instruction that appears when auditors open a new case.

9 The IQF is the ATO's principal corporate means of testing and assuring the quality of work.



deals with how the Commissioner will communicate and manage a change in general administrative practice. See in particular paragraphs 31 to 33 and 66 of PS LA 2008/3.<sup>10</sup>

4.47 In the Inspector-General's recent *Review of the Tax Office's administration of public binding advice* it was agreed (Recommendation 4) that the Tax Office would seek independent legal advice on the meaning of the term 'general administrative practice' and following receipt of that advice would issue further guidance to staff on that term. This advice has now been obtained. To complete work on this, the Tax Office is to prepare and issue additional guidance on the term for staff.

4.48 In relation to penalty, interest and primary tax, PSLA 2008/3 provides guidance to staff on the different levels of protection afforded by the Commissioner's different advice and guidance products. See in particular paragraphs 30 to 74, 222 to 257, paragraph 271 and Attachment A of that Practice Statement.<sup>11</sup> In addition, Law Administration Practice Statement PS LA 2008/12 sets out the manner in which the protection afforded by a particular document should be communicated, such as via the protection statement for that particular document.

### **IGT Conclusion — Partly Implemented**

4.49 Taxation Ruling TR 2006/10<sup>12</sup> provides general guidance on a general administrative practice (GAP). However, this guidance does not assist tax officers to determine whether a GAP exists or not. Therefore the advice is not comprehensive.

4.50 The issue underlying this recommendation, regarding the degree of certainty on the circumstances that will give rise to a GAP and the protection afforded in those circumstances, was examined as part of the IGT's review into delayed or changed ATO views on significant issues and recommendations were made in respect of this issue.<sup>13</sup>

4.51 The IGT will maintain a watching brief over the development of the ATO's administrative practice.

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10 See also Law Administration Practice Statement PS LA 2009/5 in relation to the provision of advice and guidance by the ATO in relation to the application of the *Superannuation Industry (Supervision) Act 1993* and the *Superannuation Industry (Supervision) Regulations 1994* to self managed superannuation funds (SMSFs).

11 See also paragraphs 4 to 11 of Law Administration Practice Statement PS LA 2009/5 regarding the level of protection afforded by SMSF advice or SMSF guidance and paragraphs 111 to 126 regarding the weight to be given to the fact that an SMSF trustee has relied on the SMSF advice or SMSF guidance.

12 TR 2006/10 *Income tax, fringe benefits tax and product grants and benefits: Public Rulings*

13 Released March 2010.

## KEY RECOMMENDATION 7

*The Tax Office should ensure that when it is dealing with a compliance issue that affects a significant segment of the taxpayer population it employs appropriate communication processes to ensure that its concerns on this compliance issue are made known to that population directly and as soon as possible. The Tax Office should not seek to rely on communicating these concerns only in publications or speeches to limited audiences.*

### ATO position

Implemented

### ATO response

4.52 This recommendation has been implemented to the extent agreed with.

4.53 Communication is fundamental to effectively managing the tax and superannuation systems, helping ensure taxpayers and their representatives understand their rights and obligations.

4.54 We routinely employ direct, targeted communication strategies on particular compliance issues to maximise the effective use of our resources and support taxpayers. A continual challenge is communicating with a large, diverse audience that only engage with the system when they need to.

4.55 Depending on the compliance issue we are dealing with, the demographic characteristics of the audience and our budget, we may use a mix of different communication channels.

4.56 These include routine business communication channels that form part of business strategy – such as in-person visits, phone calls, letters to affected audiences, seminars, and paper and online information products, tools and calculators. Our emphasis is often based on the mantra – prevention is always better than cure.

4.57 We explain the choices we make with our resources and the risks the revenue system faces by publishing our Compliance Program every year. By publishing what we see and what we are doing about it, we seek to influence the decisions people make in their approach to meeting their obligations. The program is targeted directly to media and tax professionals who eagerly await the program's release each year. As such, our compliance messages reach a wide and varied portion of the community.

4.58 Each year we assess the compliance risks we see in the individuals market. This work before people lodge individual tax returns is a good example of direct, business as usual communication to a large, demographically diverse audience.

4.59 For example in 2008-09 we identified undeclared rental income as a significant compliance risk. We wrote to over 130,000 people with new investment properties with information on how they should correctly report their investment income on their tax return. In addition we wrote to people we identified at risk of not meeting their obligations, reminding them to check the accuracy of their claims before lodging their returns. We also

sent letters to over 420,000 people we considered at risk of not claiming work related expenses correctly with information on how to do so.

4.60 Our taxpayer alerts are another example of our approach to warning taxpayers early about specific risks. We publish all alerts to our website and, given the often technical and sophisticated arrangements covered in the alert, we send them directly to tax agents and other tax professionals who represent many taxpayers. Taxpayer alerts are generally supported by media releases and, where appropriate, targeted articles for industry media.

4.61 Of course, our direct business as usual communication is often supported by concerted marketing communication efforts. Our marketing communication tools include electronic, online and paper based tools, paid advertising and media activities across all broadcast and specialist media.

4.62 Our business as usual approach is also supported with direct communication to tax agents. They are a large and important audience as around 75 per cent of the community use tax agents to assist with their tax obligations. We use a mix of e-newsletters, broadcasts, seminars, web information and booklets and calculators to target information we also provide to the larger community.

4.63 Where funding is provided, we can conduct advertising campaigns, turning relatively complex issues into simple, early warnings. For example, our 'Don't take the bait campaign' dealt with mass marketed schemes directly targeted in areas where we knew promoters to be active. Using press advertising supported by intensive media work in the targeted region, we got a warning message to a large audience at a time when they needed it – that is, before they invested in the new financial year.

4.64 We have around 50 community consultative forums which help us better understand the needs of particular segments of the taxpaying community and the compliance issues they face. We also use these forums to communicate our compliance concerns.

4.65 We also provide high quality advice directly to taxpayers through the public and private rulings program. In 2009, we issued 360 private rulings and 18 public rulings. We also responded to a further 5,285 requests for guidance, providing practical assistance rather than technical advice.

## **IGT Conclusion — Implemented**

4.66 As highlighted in the Service Entities report, this recommendation was made to ensure that the ATO employed appropriate communication processes to let taxpayers know its view of the application of the law on matters that directly affected them. In the case of service entity arrangements the ATO had relied on media releases, speeches given to private audiences or minutes of liaison meetings, all of which are principally directed at tax advisers (who were then relied upon to communicate the ATO view to taxpayers with these arrangements). Although the IGT recommended communicating directly to affected taxpayers, it is noted that the ATO only agreed in part with reference to the approach it took with service entity arrangements by approaching members of the legal and accounting professions.

4.67 The importance of alerting taxpayers directly has been re-raised in the IGT's *Review into delayed or changed Australian Taxation Office views on significant issues*<sup>14</sup>. As indicated in that review, the IGT observed that the ATO had made efforts to issue taxpayer alerts on specific arrangements with which it is concerned.

4.68 The ATO's response for this recommendation refers to continuing efforts to communicate its concerns to taxpayers and notes the challenge it faces in identifying those that only engage with the tax system when they need to do so. During the course of this follow up review, the ATO provided the IGT with examples of its efforts to alert affected taxpayers to changes in real time and to make them aware of the need to review their tax position.

4.69 The ATO has now refined its approach by introducing guidelines in August 2009 for staff regarding the need to communicate directly to affected taxpayers, and or their advisers, where a risk relating to a major compliance issue arises. The ATO is also now in the final stages of publishing its newly approved Risk Management Instruction to ensure that the agreed requirements set out in the above guidelines are met. Assurance is to be achieved by assigning senior tax officers at the Senior Executive Service (SES) Band 2 level with accountability and sign-off that the minimum requirements relating to the effective management of risk categories is complete.

4.70 The ATO's Risk and Issues Management corporate practice statement has been updated to incorporate the introduction of the above mentioned Risk Management instruction. In particular, reference is made to the new responsibilities held by SES Band 2 officers and to the requirement that they provide evidence to the ATO's Chief Knowledge Office (CKO) regarding their adherence to the corporate instruction. The practice statement notes that the CKO is responsible for providing assurance of conformance and also for actioning non-conformance. The CKO is also required to provide an annual Risk Management Certificate of Assurance. The practice statement says that ongoing monitoring and analysis to ensure that issues are being effectively identified, recorded, managed and escalated in the ATO will also be undertaken by a First Assistant Commissioner.

4.71 At a higher level, the ATO Audit Committee oversees internal governance and assurance policy to monitor and evaluate internal controls (such as risk management) to support the ATO's Integrity Framework.

4.72 Given that these changes are yet to be finalised, IGT is currently unable to test their application and effect in terms of the recommendation. However, the IGT recognises the changes being made by the ATO and the work it has undertaken in response to the recommendation. For example, the introduction of guidelines for staff in August 2009 which has now been reinforced through the Risk Management certificate of assurance processes. Subject to future satisfactory testing of the application of these changes, the IGT considers that this recommendation is implemented.

## KEY RECOMMENDATION 8

*The Tax Office should, in the interest of providing maximum certainty to taxpayers in a self assessment environment, ensure that all guidance which is of a significant nature and which applies to a substantial segment of the taxpayer population is, to the maximum extent possible, embodied in the form of guidance which is legally binding on the Tax Office.*

### ATO position

Implemented

### ATO response

4.73 As noted in the original response to the *Service Entity Review*, the Tax Office agreed in principle with the recommendation. While the Tax Office continues to agree with the broad principle underlying the recommendation, it is satisfied that the current advice and guidance framework strikes the right balance between appropriate levels of guidance and appropriate levels of protection for taxpayers.

4.74 As advised during the Inspector-General's recent *Review of the Tax Office's administration of public binding advice* the Commissioner considers that providing advice and guidance on the application of the laws administered by the Commissioner is central to the role of the Tax Office. It enables taxpayers to understand and meet their obligations and to be aware of their rights and entitlements in a self-assessment system. However, the assistance provided must be relevant to the intended audience.

4.75 The community is quite diverse when it comes to its need for assistance on taxation matters. Our experience is that most taxpayers, especially individuals and small businesses, are looking for guidance that is simply expressed and provides practical step by step assistance. This guidance does not readily lend itself to being legally binding.

4.76 'Binding' means that if the Commissioner provides favourable advice that is wrong, taxpayers who rely on that guidance are advantaged relative to those that comply with the law. That is, errors made by the Commissioner in binding material exact a high price on the community, which must forgo the related revenue. Because of this risk, the process in preparing binding advice needs to be rigorous and it needs to be expressed in precise, often legalistic terms. While Tax Office public and private rulings provide this type of advice, they often do not meet the needs of those taxpayers seeking simply expressed guidance. Of course, any taxpayer who wants a private ruling can seek one.

4.77 PS LA 2008/3, PS LA 2009/5 and PS LA 2008/12 together provide guidance to staff on the Tax Office's advice and guidance framework and on the processes to be followed in selecting, developing, clearing, approving, publishing and reviewing public advice and guidance products. Similarly, the class, product and public rulings regimes are used to ensure that guidance which is of a significant nature and which applies to a substantial segment of the taxpayer population is embodied in the form of guidance which is legally binding on the Tax Office. Individual taxpayers can also continue to seek a private binding ruling if they feel it is warranted.

## IGT Conclusion — Not Implemented

4.78 Following the IGT's 2007 report, the ATO has released three practice statements that provide guidance to its staff on the processes to be followed for preparing public advice and guidance. However, a review of these practice statements does not indicate any change in the ATO's approach in response to the IGT's recommendation.

4.79 The IGT also notes that the ATO changed the extent to which its most prominent guidance product, TaxPack, is considered legally binding. Specifically, the 2008 version is considered to be a binding public ruling, whereas only the 'Special circumstances and glossary' section of the 2009 version is considered to be a binding public ruling.<sup>15</sup>

4.80 The issue regarding the level of binding advice has also been raised in IGT's 2009 review<sup>16</sup> into the ATO's administration of public binding advice.

### KEY RECOMMENDATION 9

*The Tax Office should ensure that when any form of draft guidance is issued to taxpayers, that draft always contains a very clear statement of the intended date of effect of that guidance. This requirement should be set out in a Tax Office practice statement or other internal document which provides guidance to its staff.*

### ATO position

Implemented

### ATO response

4.81 The Tax Office agreed with this recommendation.

4.82 It has been our consistent practice to include a paragraph in our draft rulings and determinations setting out the intended date of effect. See for example, draft Taxation Rulings TR 2006/D4 (paragraph 53; issued 29 March 2006); TR 2007/D2 (paragraph 25; issued 11 April 2007); TR 2008/D6 (paragraph 187; issued 27 August 2008) and TR 2009/D8 (paragraphs 54 to 57; issued 16 December 2009).

4.83 Paragraphs 37 to 39 and 69 of Law Administration Practice Statement PS LA 2008/12 (issued 26 June 2008) provide guidance to staff on including a date / period of effect for all public advice and guidance products, including drafts of those products. In particular, paragraph 37 states:

All public advice and guidance products (including drafts of those products), must specify one ... of the following:

- date of effect — either:

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15 TaxPack Supplement for both 2008 and 2009 were not legally binding.

16 Review of the Tax Office's administration of public binding advice (publicly released April 2009)

- from a specified date (for example, the date that the product is published, or, if the law has been amended, the date from which that amendment applies)
- the product applies both before and after the date of issue
- period of effect — where the advice or guidance is effective for a specified period (for example, a product that deals with a fixed period of time, such as a tax-time product, a consultative document that will cease to be effective from the release of the final product, or a product that relates to an amnesty or review for compliance purposes).

4.84 TR 2006/10, at paragraphs 59 to 77, provides guidance on the date of effect to be adopted in a public ruling noting that rulings will generally have both a past and future application because they represent the Commissioner's opinion as to what the correct interpretation of the law has always been.

4.85 The Public Rulings Manual (at paragraph 7.4.2.1.4) — which sets out the corporate processes for authors and approvers of public rulings — also provides guidance for authoring teams in determining an appropriate date of effect for a public ruling. In relation to income tax draft rulings and determinations it states:

All draft and final rulings and determinations issued publicly must have a date of effect section.

There are two standard 'Date of effect' paragraphs for a ruling or determination, depending on whether the ruling is to have retrospective application or not. In devising a date of effect, the Ruling team is to conform with the ROSA recommendation that where the Tax Office is changing a public interpretation or long standing practice to the detriment of taxpayers, that change should become effective prospectively and, where necessary, from a future date that allows affected taxpayers reasonable time to become aware of, and act upon, that new interpretation. See TR 2006/10 for more guidance.

In the vast majority of cases, a ruling will have a past and a future application, as it will ordinarily represent the Tax Office's view of the law as it has always been.

Draft rulings and determinations set out what the date of effect will be when the ruling or determination finalises. There are two standard 'Date of effect' paragraphs depending on the circumstances.

The standard 'Date of effect' paragraph in a draft ruling or determination that will have past and future application is:

*Date of effect*

It is proposed that when the final Ruling/Determination is issued, it will apply both before and after its date of issue. However, the Ruling/Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling/Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

The standard 'Date of effect' paragraph for a draft ruling or determination that will have prospective application only is:

*Date of effect*



When the final Ruling/Determination is issued, it is proposed to apply to arrangements begun to be carried out from [date of issue/alternate date].

## IGT Conclusion — Implemented

4.86 As noted in the ATO response, the requirement referred to in the IGT's recommendation has been appropriately incorporated into ATO practice statement PS LA 2008/12<sup>17</sup>.

4.87 In response to IGT's queries regarding how the ATO ensures that its officers comply, the ATO referred to a process undertaken in the PTI and Public Rulings Branch (PTIPRB) whereby a final review of rulings and determinations is undertaken to ensure adherence to the ATO's publication requirements, including PS LA 2008/12.

### Subsidiary Recommendation 1

*The Tax Office's consultation processes with the community for public rulings should be conducted openly at all times and should commence as soon as possible during the drafting process. These processes should not involve, to any significant degree, consultation with only a select group of taxpayers that may be affected by the ruling.*

## ATO position

Implemented

## ATO response

4.88 In its original response to the *Service Entity Review*, the Tax Office agreed in part with the recommendation and noted that it had announced that future consultation would not generally involve confidential processes.

4.89 As noted in that original response, there may be instances where confidential consultation will still be necessary or where preliminary consultation with select groups may be required before the Tax Office is in a confident position to publish material suitable for broader public consultation. Accordingly, in some limited circumstances, the Tax Office may undertake more targeted and limited consultation. This may occur where the topic in question is very specific to a particular industry or group or where assistance on shaping the Tax Office view is needed before consulting more widely.

4.90 Depending on the issue, consultation may occur with affected industry groups or practitioners early in the development of a public ruling. Ruling topics are often raised through the NTLG sub-committees and issues covered by a proposed draft ruling may be discussed at sub-committee meetings. Minutes of these meetings are available on the Tax Office website.

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17 Specifically, paragraphs 37 to 39 and 69 of PS LA 2008/12 *Public advice and guidance products: selection, development, publication and review processes*. It is mandatory for staff to search for and follow LAPS relevant to the tasks they are performing (PS LA 1998/1 *Law Administration Practice Statements*).



4.91 Where the need for a public ruling has been identified and agreed, it is added to the public rulings program and includes details of the ruling authoring team and the proposed issue date. Members of the public are able to contact a member of the authoring team should they have any questions or comments about the proposed ruling.

4.92 Public rulings listed on the public rulings program first issue in draft form for comment by any interested parties. A compendium of all comments received, including how they have been addressed in the final ruling, is prepared and published when the final ruling is issued.

## **IGT Conclusion — Implemented**

4.93 The IGT's subsidiary recommendation was made to ensure that consultation on public rulings was open and did not involve confidential processes to any significant degree. As noted in the above response, the ATO has announced that future consultation will not generally involve confidential processes.

4.94 The change in the ATO's approach since the Service Entities review has been evidenced through the Division 7A consultation process. However, at the same time the IGT is aware that there remain other concerns regarding this particular consultation process not relating to the strict terms of the subsidiary recommendation.

### **Subsidiary Recommendation 2**

*The Tax Office's key decision makers on any proposed public ruling (or any proposed ruling which is to be accompanied by detailed practical guidance) should be engaged in the process of developing the ruling no later than the time when that ruling and any accompanying guidance is subject to public consultation processes.*

## **ATO position**

Implemented

## **ATO response**

4.95 As noted in the Tax Office's original response to the review, the recommendation was consistent with the Tax Office's management processes for priority technical issues which may lead to the preparation of a public ruling.

4.96 Since the time of the review, process improvements have been made which address this recommendation and ensure key decision makers are engaged in developing a ruling before public consultation commences. Resources, the key decision makers and other stakeholders to be involved in the development of a public ruling are generally identified at the outset, such as when it is identified as the resolution strategy for a priority technical issue.

4.97 In particular, any potential public ruling topic is first considered by one of three Deputy Chief Tax Counsel (all Band 2 SES officers) as well as the Chief Tax Counsel before it is added to the public rulings program.

4.98 In addition, prior to issuing in either draft or final form most rulings (TRs) are considered by a Public Rulings Panel which is chaired by a Deputy Chief Tax Counsel. Determinations (TDs) are either considered by a Public Rulings Panel or must be reviewed and approved for issue by a Deputy Chief Tax Counsel. Furthermore, Tax Office, membership of the Public Rulings Panel now includes Senior Tax Counsel officers who are assigned to work with the respective authoring team to progress the ruling or determination following the panel meeting.

4.99 Where appropriate, the relevant Second Commissioner, and even the Commissioner, may become involved in considering the draft ruling or determination prior to issue for public consultation.

### **IGT Conclusion — Implemented**

4.100 During the course of fieldwork for this review, the ATO referred to the above mentioned involvement of the Chief Tax Counsel and a Deputy Chief Tax Counsel as the change in process that addresses the subsidiary recommendation. Furthermore, the ATO referred to the above response as indicating that where the Commissioner or relevant Second Commissioner is considered the relevant decision-maker or stakeholder, then they will be identified as such at the outset of the process. In saying this however, the ATO noted that it may not be evident that a decision at those levels is warranted until further into the process, and potentially only after public consultation (as a result of issues coming out of that consultation).

4.101 The ATO assured the IGT that its position is to identify the appropriate decision-makers and/or stakeholders as quickly as possible, and involve them as appropriate once they have been identified. On the basis of these assurances, the IGT considers that the subsidiary recommendation is implemented.

### **Subsidiary Recommendation 3**

*The Tax Office should state in a practice statement or other guidance document that is issued to its staff that prior year advices given to taxpayers will not be considered to have been withdrawn unless the withdrawal is specifically brought to the attention of affected taxpayers.*

### **ATO position**

Implemented

### **ATO response**

4.102 While the Tax Office agreed to consider providing guidance to staff on the circumstances in which taxpayers are entitled to rely on prior year advice, it has since decided that existing guidance, as outlined below, is adequate. Further, the recommendation seemed to envisage specific communication to each affected taxpayer and this part of the recommendation was not agreed to.

4.103 All Tax Office advice and guidance contains a date or period of effect of that advice. The requirement for this is set out at paragraphs 37 to 39 and 69 of PS LA 2008/12.

4.104 In relation to private rulings, TR 2006/11 explains the operation of the law covering private rulings and states that the ruling will usually specify the time it begins to apply and the time it ceases to apply. The specified start or end time of a private ruling may be before, when or after the private ruling is made. This time may be specified by reference to the occurrence of a particular event (for example, commencement of the relevant scheme). Where no date or event is specified, the private ruling applies from when it is made. If no end time is specified, it ceases to apply at the end of the income year or accounting period in which it started to apply. (See paragraph 54 of TR 2006/11). In addition, paragraphs 41 to 48 of TR 2006/11 explain what happens in circumstances where there are inconsistent rulings applying to a particular taxpayer.

4.105 In relation to public rulings, as set out in TR 2006/10, all rulings contain a date of effect. If the ruling does not specify the time at which it ceases to apply, the ruling will apply until it is withdrawn, either in part or whole by a notice in the Gazette. (See paragraphs 43 to 48 of TR 2006/10).

4.106 In relation to Tax Office guidance material, these publications will state their period of effect and include a commitment statement on the protection that taxpayers have when following advice in the publications.

4.107 Paragraph 76 of PS LA 2008/12 sets out that Tax Office advice and guidance products should be regularly reviewed to ensure that they remain current and accurate, with consideration given to withdrawing those products which are no longer relevant. Paragraphs 86 to 92 of PS LA 2008/12 set out the process for withdrawing a publication. For public rulings, this is dealt with in the Public Rulings Manual (Chapter 14.3 in particular).

### **IGT Conclusion — Implemented**

4.108 This subsidiary recommendation was aimed at preventing situations arising whereby the ATO rescinds prior advice without specifically bringing this to the attention of affected taxpayers. In response to IGT's subsidiary recommendation, the ATO agreed to give consideration to providing guidance to staff on the circumstances in which taxpayers are entitled to rely on prior year advice.

4.109 The ATO has since given consideration to this and decided that the existing guidance referred to in the above response is adequate. For the purposes of this follow up review, the ATO has completed what it agreed to do.



## 5. REVIEW OF TAX OFFICE'S MANAGEMENT OF COMPLEX ISSUES — CASE STUDY ON LIVING AWAY FROM HOME ALLOWANCES

### INTRODUCTION

5.1 This review<sup>1</sup> had been prompted by concerns expressed by tax professionals and certain sectors of the community that the ATO had taken too long to come to grips with and satisfactorily resolve the tax issues associated with arrangements involving the payment of living-away-from-home allowances (LAFHAs) to foreign nationals. The review had been announced in October 2005 as one of three case studies culminating in the IGT's 2008 report on improvements to tax administration arising from case study reviews of the ATO's management of major, complex issues.<sup>2</sup>

5.2 In response to community information relating to the alleged abuse of LAFHAs by a labour hire organisation, the ATO commenced enquiries and investigative work in 1998 to gather information about these arrangements. Following further media reports in 1999 about foreign visitors failing to pay tax on income earned in Australia, ATO auditors prepared a project plan. Between 1999 and 2004 the ATO adopted at least five different strategies, including the mass application of Part IVA, test case litigation, a re-write of Miscellaneous Taxation Ruling MT 2030 and the release of further taxation rulings and determinations. The ATO never pursued a particular strategy to finality because of its inability to conclude and maintain a corporate position on how the law should apply. The ATO's audit project team appropriately escalated technical issues, but these took far too long to be resolved. Ultimately, the ATO sought to work with particular industry groups to develop self-regulatory guidelines.

5.3 Overall, the IGT's review found that the time frames for resolving the technical and compliance issues arising from the LAFHA project were excessive and not reasonable in the circumstances. The IGT concluded that the following factors contributed to the excessive timeframes:

1. an inability to conclude in a timely manner a corporate position on how the law should apply;
2. prolonged internal differences of opinion on the legal position and compliance strategies, sometimes at very senior levels;
3. objective interpretation of the law clouded by attempts to deliver particular enforcement strategies;

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1 *Review of Tax Office's management of complex issues – Case Study on living-away-from-home allowances* (publicly released May 2007).

2 The final report was released in May 2007.

4. lengthy, delaying diversions to consider the potential application of Part IVA as a 'silver bullet' compliance strategy;
5. on again off again test case strategies that were eventually abandoned (at the cost of more timely and objective resolution);
6. plans to pursue one size fits all, anti-avoidance enforcement action against a large number of working holiday visa employees based on a view of the law that the ATO subsequently withdrew and on very little casework that examined the individual circumstances of those taxpayers receiving LAFHAs; and
7. there was no single senior tax officer that had overall ownership of the technical and compliance issues until late in the dispute.

5.4 Taxpayers involved in the ATO's compliance processes incurred higher than necessary costs as a result of the ATO's protracted and prolonged timeframes. There were also instances where the taxpayers were treated unfairly, not only through the excessive timeframes in resolving the dispute, but also in the ATO's handling of various aspects of the disputes, contrary to the ATO's stated values.

5.5 The IGT made two key recommendations seeking to ensure that the ATO provides greater certainty to taxpayers on key technical issues relating to its administration of the LAFHA provisions. The ATO agreed with both recommendations, however it stated that implementation of recommendation 2 was subject to the outcome of recommendation 1. The status of implementation of the recommendations is set out below.

## KEY RECOMMENDATION 1

*The Commissioner of Taxation should conclude a corporate view on whether the Tax Office should formally advise the Treasury, in accordance with Practice Statement CM 2003/14, that legislative change is required or not.*

## ATO position

Partly implemented

## ATO response

5.6 In response to the IGT recommendations the Tax Office wrote to Treasury on 28 May 2007, advising that in order to have Living Away From Home Allowances (LAFHAs) dealt with appropriately, changes to the LAFHA provisions are required. Treasury responded on 29 August 2007 with a discussion paper. The discussion paper canvassed a number of options for ATO consideration and discussion. The covering minute indicated 'particular interest in obtaining information and risk analysis of industry development that the ATO is able to provide.'

5.7 The discussion paper and options were considered and discussed with Treasury. The outcome was that while the issues were acknowledged, further information and risk analysis was requested.

5.8 Further Tax Office work was undertaken to review the Treasury discussion paper and a range of preferred and workable options were developed – see October 2008 LAFHA work shop talk book. The workshop also explored approaches for progressing the project. These included the undertaking of research to gather information and intelligence in respect of industry LAFHA practices.

5.9 A background briefing for Treasury on FBT issues for the purpose of identifying issues for consideration by the Australia's Future Taxation System<sup>3</sup> review included reference to LAFHA as an area of FBT requiring reform.

5.10 Due to competing priorities and limited resources, the research was delayed.

5.11 However, work commenced in July 2009, with the aim of providing a greater understanding of commercial practices and arrangements including the quantum involved and the extent of LAFHA arrangements.

5.12 The research was completed in early 2010 and a copy of the research results was formally provided to the Treasury in May 2010.

5.13 The key findings of the research are:

1. The law is unclear and not aligned with the policy intent.
2. There is a high degree of confusion in the community as to how the law operates.
3. There is a high degree of community concern with the ATO's administration of the law.
4. There is a strong community perception of unfairness and an uneven playing field.
5. There is deliberate and growing exploitation of the law as it currently stands.
6. LAFHA is the cause of a growing cost to revenue demonstrated by the practices of some and the figures currently to hand which we consider are very likely to be understated.

5.14 Recommendation 9 of the Review into Australia's Future Tax System (the Review) is to transfer the incidence of the taxation of fringe benefits from the employer to the employee. This will have a direct impact on the issues identified in our research. However, the Government has not directly responded to this recommendation and has stated that

'In the coming months we will have more to say on a number of other areas considered by the review...'<sup>4</sup>

5.15 In light of the Government's pending response to the Review it is considered that further work in this area await the Government's response.

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3 The Henry review of the Australian taxation system.

4 Joint Press Release by the Prime Minister and Treasurer of 2 May 2010.

## IGT Conclusion — Partly Implemented

5.16 The IGT's 2007 report made two recommendations aimed at ensuring that the ATO provides greater guidance and certainty to taxpayers on the key technical issues relating to its administration of the LAFHA provisions.

5.17 Following the release of the IGT's 2007 report, the ATO prepared a minute to Treasury recommending that both parties 'engage' with a view to progressing a full review of the LAFHA provisions. The ATO noted that the provisions were:

'...problematic for the Tax Office, Tax professionals and employers...'<sup>5</sup>

5.18 However, in terms of the IGT's recommendation, the minute to Treasury did not comply with Practice Statement CM 2003/14<sup>6</sup>. For example, the minute did not include a 'comprehensive' assessment of all internal and external impacts affecting the issue. Furthermore, an option to note that the advice is qualified or incomplete due to a lack of preparation time was not taken up by the ATO<sup>7</sup>.

5.19 In August 2007, the Treasury prepared a paper to facilitate further discussion with the ATO and requested further information, including risk analysis of industry developments.

5.20 In 2008, the ATO canvassed a number of options to progress the project and a background briefing on FBT issues, including LAFHA, was prepared for Treasury to assist with identifying issues for consideration by the *Australia's Future Tax System Review*<sup>8</sup>. However, the ATO indicates that other priorities then took over and the project was delayed until it was recommenced in July 2009.

5.21 This research was completed and approved in April 2010 and a copy of the research results and key findings was formally provided to the Treasury the following month. The ATO minute concluded that the ATO would await the Government's pending response to recommendation 9 of the *Australia's Future Tax System Review*.

5.22 Further work by the ATO in accordance with IGT's recommendation is therefore dependent on the Government's actions. The IGT's recommendation therefore remains partly implemented. The IGT will continue to monitor the progress of this matter.

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5 ATO Minute to Treasury 28 May 2007 (page 4).

6 PS CM 2003/14 *Provision of formal ATO Advice to Treasury*.

7 See paragraph 18 of PS CM 2003/14 which provides this option.

8 The Henry review of the Australian tax system.



## KEY RECOMMENDATION 2

*In the absence of the Tax Office providing such formal advice to Treasury or any legislative change, then the Tax Office should issue a new public ruling to replace Miscellaneous Taxation Ruling MT 2030. The new public ruling should provide community-wide guidance and certainty on the Tax Office's interpretation, administration and practical application of the LAFHA provisions, and should include clarification of the key technical issues arising from this review such as:*

- usual place of residence;*
- meaning of the term 'additional';*
- factors the Tax Office would take into consideration in determining what was 'reasonable' for the purposes of a LAFHA including guidance on methods which would be acceptable to the Tax Office; and*
- causation between employment and entitlement to receive a LAFHA, in particular, whether there is a requirement for a pre-existing employee/employer relationship for a LAFHA entitlement.*

### ATO position

Not implemented

### ATO response

5.23 Since the Tax Office is continuing to pursue recommendation 1, recommendation 2 has not become applicable.

### IGT Conclusion — Not Implemented

5.24 As indicated in the above response, recommendation 2 has not yet been considered. The IGT notes that even today MT 2030, which was issued in 1986, continues to represent the ATO's view on LAFHAs despite its numerous identified shortcomings. This remains a source of frustration, not only for taxpayers and their advisers, but also for the tax officers themselves.



## 6. REVIEW OF TAX OFFICE'S MANAGEMENT OF COMPLEX ISSUES — CASE STUDY ON RESEARCH AND DEVELOPMENT SYNDICATES

### INTRODUCTION

6.1 On 3 May 2007, the IGT released his report on the case study of the ATO's handling of research and development (R&D) syndication. This case study was within a broader review conducted by the IGT on the ATO's handling of major, complex issues.

6.2 The R&D tax concession was introduced in the late 1980s as part of a package of measures to encourage innovation in Australian companies. Claimants needed to be registered to be eligible to claim. This registration process involved complete taxpayer transparency as to the facts of the arrangements and the resulting tax effects. Eligibility for registration was considered by the Taxation Concession Committee, which drew on ATO advice.

6.3 The ATO was aware that core technology valuations were a potential compliance issue at least as early as 1991 when the specific anti-avoidance provisions were introduced. It commenced an audit project specifically on R&D syndication in 1994. In 1996 amid widespread concerns of exploitation, particularly through inflation of core technology values, the then government closed the concession to new syndicates. Until late 2004, the ATO stuck to an approach that led to zero or negative core technology values, which would effectively wipe out syndicates.

6.4 Following an unsuccessful lead case litigation strategy, the ATO entered a mediation agreement on 30 July 2003 with a purpose of producing guidelines for the review of other R&D syndication cases. On 10 December 2003, the ATO entered into settlement with a taxpayer without informing them of the mediation or its purpose.

6.5 The mediation process concluded in July 2004 and guidelines were published which signalled a settlement offer in September 2004. The ATO looked into the various settlement options and decided to target the 40 investors with the largest claims, the remainder of investors were not pursued. In late 2004, the ATO offered a general settlement to those investors: settle on a 50 per cent basis with no questions asked, or prove to the ATO's satisfaction compliance with the ATO's recently issued guidelines. For 19 of these investors, it was the first time that the ATO advised them that they had to prove that they were compliant and had to evidence that compliance in order to retain their claims which were made 8 to 12 years prior. If they did not settle, the ATO would review the claim made with the possibility of full general interest charges, penalties and the application of Part IVA. As the ATO did not disclose the mediator's full guidance on the approach to determining the reasonable value for the arm's length amount (the mediator had rejected the ATO's prior approach which led to zero or negative core technology values) taxpayers were not disavowed of their belief that the ATO would adopt its prior approach in this regard.

6.6 The IGT concluded that not only had the ATO taken far too long to deal with the issue, it had acted unfairly. In relation to the some investors who had entered into settlement

prior to (and on less favourable terms than) the September 2004 offer, this was because they had entered into settlement without being informed by the ATO of the mediation process that was occurring. In relation to the above mentioned 19 investors, apart from not contacting them earlier, the ATO had been aware of all the relevant facts before the arrangements in question had been entered (including the details of the syndication arrangements and their tax effect). Furthermore, the ATO were aware that there had been a significant compliance issue for 12 to 14 years and also that losses had been utilised by these investors at least 8 years prior.

6.7 The IGT therefore recommended that the ATO fully reconsider whether it had fairly struck settlements with both groups of taxpayers.

### KEY RECOMMENDATION 1

*The Inspector-General recommends that the Tax Office fully reconsider whether it has fairly struck settlements with:*

*(a) the 19 investors that the Tax Office did not formally advise that their investments made more than 8 years previously would be subject to review; and*

*(b) those investors with whom the Tax Office negotiated settlements without telling them that at the same time it was mediating a case to develop guidelines for the resolution of R&D syndicate cases.*

### ATO position

Implemented

### ATO response

6.8 The Tax Office agreed to consider whether it should review certain cases. The Tax Office has fully reconsidered its position and concluded that the settlements in question should not be disturbed. The review covered all settlements that were made prior to the making of the general settlement offer in late 2004 and concluded that it was not appropriate to re-open any of these settlements. The taxpayers in question were advised of this review and the outcome (copies of letters available on request).

6.9 The Commissioner was informed on 1 November 2007 of the approach proposed in considering whether these settlements should be revisited. The Commissioner approved this approach on 7 November 2007.

6.10 The Second Commissioner Compliance on 30 November 2007 made the decision that the settlements should not be revisited. This decision was made after receiving a minute from the Deputy Commissioner S&ME and a supporting document containing information and options for consideration in reaching a decision as to whether equity concerns warrant re-opening of certain settlements in relation to R&D syndication arrangements.

6.11 The relevant documents are available on request.

## IGT Conclusion - Partly Implemented

6.12 The recommendation above is directed at instances where the IGT concluded that taxpayers were treated unfairly by reason of the ATO's excessive timeframes and handling of various aspects of the disputes. The recommendation had two components being part (a) and (b).

6.13 The ATO did not agree to implement part (a) of the recommendation.

6.14 In a more recent IGT review<sup>1</sup>, the underlying systemic tax administration issue that recommendation part (a) sought to address, being early ATO communication of its compliance concerns and the extent of retrospective application has been considered further. Specific recommendations were made in that report that, if implemented, should address these underlying systemic issues.

6.15 The ATO agreed with part (b) of the recommendation undertaking to review and reconsider those cases that were settled on less favourable terms than the general settlement offer made towards the end of 2004. As a result, this would ensure that the cases falling within the scope of part (b) of the recommendation would be reconsidered.

6.16 The IGT in conducting this follow up review requested copies of all the ATO's review materials. The ATO review consulted a specialist panel<sup>2</sup> made up of senior tax officers on the proper application of the ATO's own guidelines<sup>3</sup> for the settlement of widely-based tax disputes. The panel advised that it is generally not appropriate to re-open settlements entered into by 'fully informed' investors in good faith, unless warranted by subsequent exceptional events. In concluding that some investors were fully informed, the ATO relied on the recollection of a tax auditor that an advisor of these particular taxpayers had said that he was aware of the mediation.

6.17 The IGT is concerned that such an approach, based on the limited evidence and corroboration, is difficult to reconcile with the notion that a taxpayer is fully informed. Another concern may be the notion of what should be considered a 'subsequent exceptional event'.

6.18 The overall experience for the majority of taxpayers in this context was a very unhappy one. However, as taxpayers have not invested in these particular arrangements for some considerable time, the IGT will conclude the follow up review process at this point.

6.19 In addition this recommendation's underlying systemic tax administration issues are also considered in more detail in a recent IGT report<sup>4</sup> that outlines a range of changes that, if implemented, should minimise the potential for unfair settlements.

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1 *Review into the Implications of any Delayed or Changed ATO Advice on Significant Issues* (publicly released March 2010).  
2 The Widely-Based Settlement Panel.  
3 PS LA 2007/6 *Guidelines for settlement of widely-based tax disputes*.  
4 *Review into Aspects of the Tax Office's Settlement of Active Compliance Activities* (publicly released December 2009).



## 7. REVIEW OF THE POTENTIAL REVENUE BIAS IN PRIVATE BINDING RULINGS INVOLVING LARGE COMPLEX MATTERS

7.1 On 7 February 2005, the then Minister for Revenue and Assistant Treasurer asked the IGT to review and report on whether there is a ‘pro-revenue’ bias evident in private binding rulings (PBRs) issued by the Commissioner of Taxation under Part IVAA of *Taxation Administration Act 1953*. As a result of this request and industry representations to do so, the IGT then conducted a review of the potential revenue bias in private rulings involving large complex matters. This review focussed on private rulings involving large business taxpayers.

7.2 The review<sup>1</sup> found that because of the ATO’s dual role as a rulings administrator and a revenue collector it was generally accepted that the ATO would have an inherent revenue bias in finely balanced matters. However, the review found that there was no evidence of undue revenue bias in large complex PBRs.

7.3 Based on a representative survey, however, around 70 per cent of large business PBR applicants perceived the ATO to have a revenue bias in its PBRs. A major cause of these perceptions was identified as being a lack of transparency – taxpayers observed unexplained ATO behaviours and in the absence of cogent explanations interpreted those behaviours as being motivated by a revenue bias. The IGT made ten recommendations to address this. The ATO fully agreed with six of these recommendations and partly agreed with four.

7.4 The ten recommendations suggested improvements in the following areas:

- ATO transparency, communication and objectivity – Recommendations 1 to 6 (Recommendations 1 and 2 were partly agreed to by the ATO)
- The interactions between the ATO and Treasury – Recommendations 7 and 8 (Recommendation 7 was partly agreed to by the ATO)
- The time frames for private rulings – Recommendations 9 and 10 (Recommendation 10 was partly agreed to by the ATO).

7.5 The status of the recommendations from the review which the ATO agreed to implement, in whole or in part, is set out below. This chapter is also included as part of the IGT’s *Review of aspects of the Australian Taxation Office’s administration of private rulings*<sup>2</sup>.

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1 *Review of the potential revenue bias in private binding rulings involving large complex matters*, IGT, February 2008.

2 Final report submitted to the Minister in May 2010.

## RECOMMENDATION 1

*Informing taxpayers when it sees a need for external input, including from the Treasury, on interpretive matters that relate to their PBR applications and the reasons why.*

### ATO position

Implemented

### ATO response

7.6 Recommendation 1 was agreed in part, because in situations where external input is required from Treasury, it would not be appropriate to disclose the reasons why the Tax Office is seeking Treasury input. The Tax Office considers such communications to be confidential.

7.7 The agreed aspect of the recommendation has been primarily addressed by the Tax Office through the development and delivery of an Interpretative Assistance (IA) training package which educates Tax Office staff on 'effective communication' and their 'roles and responsibilities' in providing rulings to taxpayers. The foundational level training, 'IA Processes and Case Management (foundation)' was developed and delivered prior to the IGT's 2008 *Review of the potential revenue bias in private binding rulings involving large complex matters*. It was delivered as a workshop to staff in the latter half of 2007 on a first come first in basis and focussed on active case management and communication. As a pre-requisite to this workshop, attendees who registered were required to have at least twelve weeks experience in the Tax Office.

7.8 Subsequently the intermediate level training, 'IA Framework, Case Management and Procedures (Intermediate)' was developed as a two-day course which was piloted on the 26<sup>th</sup> and 27<sup>th</sup> of May 2009 and rolled out across the relevant Tax Office IA sites in late May/early June 2009. The course consists of three modules: (1) Roles and Responsibilities of an IA case officer/team leader, (2) Practices and Procedures in doing IA case work, and (3) Case studies. This intermediate level training was deemed mandatory to all IA staff engaged in rulings work by the Large Business and International (LBI) Executive. Small and Medium Enterprise (SME) staff also attended the intermediate training.



7.9 The following table sets out the numbers of staff who attended the IA training:

**Table 5.1: Numbers of ATO staff who attended the IA training**

**IA Processes and Case Management (foundation)**

Date	Sites	Participant numbers
3 and 4 July 2007	Hurstville	19
2 and 3 August 2007	Melbourne	19
6 and 7 August 2007	Perth	16

**IA Framework, Case Management and Procedures (Intermediate)**

Date	Sites	Participant numbers
27 May 2009	Parramatta	28
3 June 2009	Albury	15
11 June 2009	Brisbane	14
5 and 16 June 2009	Sydney	33
19 June 2009	Northbridge	18
23 June 2009	Moonee Ponds	23
24 and 25 June 2009	Box Hill	26
30 June 2009	Waymouth	26

7.10 The need to keep taxpayers informed of any external input sought on interpretative matters has also been presented to the IA network by the network leaders in late 2008. Those who comprise the IA network include the LBI IA Directors; thus the presentation to the IA network ensures that the key messages will be channelled down to those staff working on rulings. Since 1 July 2009, the IA network has become part of the LBI IA Business Management Committee.

7.11 The Practice Statement PS LA 2008/3 which was issued during 2008 reflects the need for communication with taxpayers where external input is sought. Paragraph 90 of PS LA 2008/3 now reads:

The Commissioner can take into account information provided by an entity other than the applicant, provided that the Commissioner tells the applicant what the information is and that the Commissioner intends to take the information into account. The applicant must be given a reasonable opportunity (ordinarily 28 days) to comment on the use of that information before the ruling is made.

7.12 The Tax Office decided that an update for Online Resource Centre for Law Administration (ORCLA)<sup>3</sup> was not required.

7.13 In terms of current ATO processes, when a business line case officer encounters an issue, that may or may not ultimately involve discussion with Treasury, the case officer will follow the established escalation procedure. The Tax Counsel Network(TCN) /Centre of Expertise (CoE) gatekeeper will allocate the issue to the TCN/CoE with the relevant expertise. Those officers have access to relevant materials and registers. It would be TCN/CoE that would consult with Treasury on an issue arising in a case and they would inform the case officer that is happening. The case officer would, in turn, keep the taxpayer informed by advising them that it has been necessary to have discussions with Treasury. However, as the

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3 ORCLA is a 'virtual' manual of policies, procedures and other instructions for staff who make technical decisions in respect of laws administered by the Commissioner of Taxation.

content of discussions with Treasury is confidential, the case officer would be unable to advise the nature of those discussions.

## **IGT conclusion — Implemented**

7.14 The ATO partly agreed to this recommendation because it considers that it is not appropriate to disclose the reasons why the ATO is seeking external input from Treasury. The ATO-Treasury protocol states that:

Communications between the Tax Office and Treasury on tax and superannuation matters are confidential as they are, effectively, in the nature of communications between an agency and the government.

7.15 The IGT considers that there are generally two categories of ATO-Treasury communications in this context. One category of communications discusses the implications of the ATO's views — for example, the identification of circumstances in which the law is not aligned with current Government policy or where there would be economic consequences if the ATO adopted a certain view of the law. The second category of communications is where the ATO considers that there are two or more interpretations open on a reasonable reading of the law, but the underlying purpose for the law is not clear.

7.16 The IGT agrees that there should not be a disclosure of the content of ATO-Treasury discussions where they fall within the first category of communications. There are strong public policy reasons to keep confidential the advice to Government on implications of policy.

7.17 However, where the communications fall within the second category, there are strong reasons why these communications should be disclosed as they will otherwise place taxpayers at a significant disadvantage. The IGT had also specifically identified the lack of transparency of ATO-Treasury dialogue on interpretative matters as one of the underlying causes of perceptions of revenue bias in PBRs. This concern was also raised by the Joint Committee of Public Accounts and Audit (JCPAA) in its questioning of the Commissioner and Second Commissioner on the ATO's unwillingness to agree to the full implementation of this recommendation<sup>4</sup>.

7.18 The IGT also notes that before this review was finalised, the Government publicly released the *Australia's Future Tax System Review* report that was presented to the Treasurer on 23 December 2009. Recommendation 114 of this report is as follows:

Information or advice provided by Treasury to assist the ATO in determining the purpose or object of the law, or materials used by the ATO to determine policy intent (other than correspondence with or from government) should be made public.

7.19 The Government has not provided a response to this recommendation.

7.20 In relation to the implementation of what the ATO agreed to implement, the IGT undertook case work which showed that the ATO was advising taxpayers when it was discussing the technical issue with Treasury (although not the reasons why it was discussing

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4 Federal Parliament's Joint Committee of Public Accounts and Audit *Biannual hearing with Commissioner of Taxation*, 30 April 2008, Sydney, Proof Committee Hansard, pages 17-23.

the matter with Treasury). Also, as noted in the 'ATO response' section for this recommendation, the ATO has procedures in place for taxpayers to be kept informed by case officers, although not contemporaneously, where Treasury input has been sought regarding their PBR application.

7.21 On this basis, the IGT concludes that the ATO has completed what it has agreed to implement.

## **RECOMMENDATION 2**

*Informing taxpayers of the outcomes of external input, including from the Treasury, and internal deliberations on matters that affect them, especially where an unfavourable ruling is likely.*

### **ATO position**

Implemented

### **ATO response**

7.22 Recommendation 2 was agreed in part, because it would not be appropriate to disclose the nature or outcomes of discussions with Treasury, as the Tax Office considers such communications to be confidential. [The Tax Office's evidence supporting this position is the same as that contained in paragraphs 7.6 to 7.13.]

### **IGT conclusion — Implemented<sup>5</sup>**

7.23 As discussed in the IGT's analysis in recommendation 1 above, the IGT notes that the ATO did not agree to implement this recommendation in full. The IGT had specifically identified the lack of transparency of ATO-Treasury dialogue on interpretative matters as one of the underlying causes of perceptions of revenue bias in PBRs.

7.24 In respect of informing taxpayers of the outcomes of internal deliberations, a sample of the relevant ATO files demonstrates that the ATO informs applicants of the outcomes of internal deliberations (such as TCN and CoE deliberations) before the ATO concludes the ruling. The ATO also provides similar messages to its staff to do so in PS LA 2008/3<sup>6</sup> and its Interpretative Assistance (IA) Intermediate training package.

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5 This recommendation was implemented only to the extent that the ATO agreed with the original recommendation.

6 See paragraphs 198 and 201.

### RECOMMENDATION 3

*Where an understanding of purpose is a factor in the decision in large business unfavourable PBRs, including a statement of the underlying purpose of the legislative provisions on which the interpretation is based and the source for that purpose (for example, how the legally permissible extrinsic materials have been relied upon to ascertain that purpose and in concluding its view).*

#### ATO position

Implemented

#### ATO response

7.25 This recommendation has been primarily addressed through the IA Intermediate training package [referred to in paragraph 7.8]. This training covers the need for Tax Office staff to communicate to taxpayers the policy intent used to interpret the law, provide full explanation of why this is the better view and the extrinsic material used to make this decision.

7.26 To further enhance staff knowledge of statutory interpretation, the trainer conducting the intermediate level training requested attendees to complete the existing Ilearn package (self-paced) on statutory interpretation. Also, the Law and Practice business line is developing a more detailed statutory interpretation course that is planned to be rolled-out in 2010. The pre-requisite to the detailed statutory interpretation course will be the existing Ilearn package.

#### IGT conclusion — Implemented

7.27 The ATO confirmed that the new quality assurance process (the ATO's Integrated Quality Framework system) does not directly assure adherence by tax officers to the requirements of the recommendation. The ATO's ILearn package on statutory interpretation does not contain any instruction to tax officers in line with recommendation 3. A more detailed statutory interpretation course is currently being developed for IA staff.

7.28 However, the IGT reviewed 6 LBI PBRs finalised during 2008/09 where the underlying purpose of the legislative provision was a material factor for deciding the ATO view in unfavourable decisions. The IGT found that all included a statement and source in line with the recommendation.

## RECOMMENDATION 4

*More widely adopting the key principles of the Priority PBR process in relation to large business PBRs:*

- *Centralised point of reference (process owner) responsible for marshalling resources and taking remedial action to ensure cases are not delayed;*
- *Alignment of taxpayer and Tax Office priorities;*
- *Front end engagement of all expertise to avoid sequential processing; and*
- *Taxpayers and Tax Office working together to clarify the ruling.*

### ATO position

Implemented

### ATO response

7.29 In addressing the need for a centralised point of reference for rulings and front-end engagement of expertise, the priority rulings system has been expanded to allow certain class rulings into the priority process. As a result PS LA 2005/10 was withdrawn and a new practice statement PS LA 2009/2 has been published to redefine the way the priority process works. The changes to PSLA 2005/10 were substantial and involved extensive internal and external consultation.

7.30 To communicate the release of PS LA 2009/2, a multi-level communication strategy was developed. Internally, articles were placed in ATO Extra (an ATO staff newsletter) and Business Service Line newsletters. Externally the Commissioner mentioned the change in his speech to the Corporate Tax Association, which is a speech reported extensively in the media.

7.31 The IA training package covers this recommendation by providing directions for staff around 'roles and responsibilities' in providing rulings, in both the foundational and intermediate level training [referred to in paragraphs 7.7 and 7.8].

7.32 The advice guidance material in ORCLA has been updated with a link to the new practice statement PS LA 2009/2. This recommendation has also been enhanced by the creation of the new Interpretive Advice segment in LBI on 1 July 2009, which allows for holistic management of the IA function.

### IGT conclusion — Implemented

7.33 The purpose of the recommendation is to increase transparency, improve communication and to clearly demonstrate objectivity in large business PBRs by improving the quality of the application process. The ATO response has been to expand the Priority PBR Process to certain class rulings. Although class rulings are not PBRs, this action is welcome. However, it does not help to implement the recommendation. This is because the

recommendation is directed at extending the principles of the priority process towards other large business PBRs.

7.34 However, the IGT notes that the ATO created a new IA Group in LBI on 1 July 2009. This change is part of a new model for IA work arrangements to deliver productivity improvements relating to the four key principles of the Priority PBR Process.

7.35 The IGT notes that an internal ATO review, conducted in 2009, has also recommended that the key principles of this priority process should be extended to other large business PBR applications. As at the end of 2009, the findings and recommendations from the internal review remain part of the ATO's continuing improvement work. The IGT observes that the ATO is implementing a differentiated service model for large business PBR applications and implementing an 'early engagement model' for those applications involving more complex issues and/or significant risk to the ATO and/or taxpayer – for example, where Part IVA sign-off is requested, or where a ruling involves a known problematic area of the law. The processes involved in this model require, amongst other things, early engagement of relevant ATO expertise, regular call overs (with senior executive interventions if time frames are not met) and discussions with the PBR applicants.

7.36 Although the ATO is still in the early stages of bringing about change to more widely adopt the Priority PBR process in relation to large business PBRs the work outlined above and the trend in improving timeframes for finalising large business PBRs<sup>7</sup> indicates that the ATO's approach is having the desired effect. The recommendation is therefore considered implemented.

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7 The ATO has advised that the average timeframe to complete a large business PBR in 2003/04 to 2004/05 was 174 days, while the average timeframe to complete a large business PBR in the first eight months of 2009/10 is around 130 days. It also states that the total average timeframe for the year is expected to decline due to the declining average timeframes for large business PBRs currently in progress – around 80 days as at end of February 2010.

## RECOMMENDATION 5

*Increasing transparency, improving communication and more clearly demonstrating objectivity in relation to PBR technical decision making by:*

- before an adverse decision is made, communicating to the applicant the basis for the likely Tax Office view (including external opinions where relevant), an explanation of why the Tax Office's view is to be preferred over the applicant's, indicating the relevance of information provided by the applicant, and providing the applicant an adequate opportunity to comment;*
- vetting requests for additional information and (if requested) providing reasons why the information is relevant and identifying the specific aspect of the technical issue that turns on the requested information;*
- if requested by the applicant, providing applicants with written reasons for delay if the PBR has not issued after three months, including contact details for the relevant LBI segment leader, CoE Manager and Deputy Chief Tax Counsel;*
- where necessary, engaging recognised independent external subject specialists to supplement Tax Office capability to respond to large, complex PBRs; and*
- where requested by the PBR applicant, ensuring that the Case Manager provides the applicant with a free and quick flow of direct contact with those technical decision makers (whether in TCN, CoE or LBI) that determined, or are determining, the technical issues relating to the application.*

### ATO position

Implemented

### ATO response

7.37 Senior leaders in the Law and Practice business line have reinforced the key messages of 'access to decision makers' to the senior staff of the CoE, such as ensuring that CoE staff are available when requested by applicants of rulings to discuss the outcome or specific issues. In LBI the key messages have been presented to the IA network by the network leaders in late 2008. As the forum consists of LBI IA Directors, the messages are channelled down to IA staff.

7.38 The IA training package covers the five elements of this recommendation through the foundational and intermediate level training [referred to in paragraphs 5.9 and 5.10]. At the intermediate level training, the trainer provided attendees with copies of Recommendation 5 and 6.

7.39 Also the advice guidance material in ORCLA has been updated and practice statement PS LA 2008/3 has been issued. In regards to sub issue (2), paragraph 90 of PS LA 2008/3 now reads:

Generally, if additional information is necessary to make a private ruling it must be requested from the applicant. ... provided that the Commissioner tells the applicant what the information is and that the Commissioner intends to take the information into account. The applicant must be given a reasonable opportunity (ordinarily 28 days) to comment on the use of that information before the ruling is made.

## **IGT Conclusion**

7.40 The original IGT recommendation has five separate parts, each of which is commented on separately below.

### ***Part i) – Implemented***

7.41 Case testing, which included the obtaining of feedback from taxpayers and their advisers, demonstrated that the ATO complied with this part of the recommendation. However, in withdrawn PBR applications, the IGT was unable to conclude whether aspects of this recommendation (such as, explaining why the ATO view was preferred over the taxpayer's, or providing an adequate opportunity to comment) were implemented. Feedback from applicants asserted dissatisfaction with the ATO's conduct in this regard. This indicates to the IGT that although finalised unfavourable PBRs exhibit these ATO behaviours (and on this basis the IGT concludes that this part of the recommendation is implemented) there is room for the ATO to improve its processes by focussing on exhibiting these behaviours closer to the point in time at which it communicates its likely unfavourable view.

7.42 A review of the IA Intermediate training package revealed a reference to the first part of recommendation 5 and to the need for ATO officers to communicate with taxpayers where the issuing of an unfavourable ruling is being considered. Participants are also referred to the ATO business segment in PS LA 2008/3 which deals with tax officers engaging in informal discussions with taxpayers. Paragraphs 201 and 202 of the practice statement encourage officers to inform applicants of concerns which may lead to an unfavourable response.

7.43 Neither the IA training package or PS LA 2008/3 mentions the need to provide an explanation of why the ATO's view is preferred over the applicant's, or to indicate the relevance of information provided by the applicant. A review of PS LA 2008/3 confirmed that no change has been made to the practice statement to implement this aspect of the recommendation.

### ***Part ii) – Implemented***

7.44 An ATO internal review has recommended that a process be implemented that monitors and approves requests for further information from taxpayers, where the ruling request is more than two months old or where there have already been more than one or two requests for information issued.

7.45 Specific reference to, and discussion of, the requirements of this part of the recommendation regarding information requests has been included in the IA Intermediate training package. The IGT notes that paragraph 2 of PS LA 2003/9 requires ATO technical decision making staff (including those that handle PBR applications) to follow the policies and



procedures set down in ORCLA. The ATO has updated its ORCLA manual to reflect the requirements to explain why the information is relevant. The ATO has assured the IGT that inherent to this explanation is a communication of the technical issue which turns on the requested information. On this basis the IGT considers that the recommendation is implemented.

### *Part iii) – Implemented*

7.46 In conducting the follow up review, the IGT determined that a number of PBRs have taken more than three months to issue. However, the ATO advises that in none of these cases did the applicant ask for written reasons for the delay. This may be a result of applicants being unaware of this option.

7.47 The IGT considers that although not essential to the implementation of this recommendation, that the ATO should alert applicants of this option – for example, by alerting applicants to this option in the acknowledgement letters that the ATO sends to PBR applicants.

### *Part iv) – Implemented*

7.48 The requirement to engage independent external subject specialists has been highlighted in the IA Intermediate training package. Sample testing by the IGT evidenced that independent external subject specialists had been appropriately engaged.

### *Part v) – Implemented*

7.49 Direct reference to this part of the recommendation is made in the IA Intermediate training package to encourage effective communication with applicants. This commitment has also been referred to by the Commissioner in a number of speeches<sup>8</sup>:

We will re-emphasise that the responsibilities of our case managers include ... arranging dialogue between the company and our decision makers on the case.

7.50 The IGT observed, in the unfavourable PBR cases that were reviewed, in almost all cases access was provided to PBR applicants where requested by the applicant or their representative. However, the IGT is aware of circumstances where applicants or their representatives feel this engagement could operate more effectively. On balance, the IGT concludes, based on the material reviewed, that this part of the recommendation is implemented where PBR applicants have made requests.

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8 D'Ascenzo M, *A New Dimension*, speech to the Corporate Tax Association Convention, Sydney, 12 May 2008

## RECOMMENDATION 6

*Ensuring that tax officials involved in interpretive matters are aware of the accepted principles of the purposive approach to statutory interpretation (including the accepted materials to ascertain that purpose) and that they should not rely on advice of what policy developers or legislative drafters intended.*

### ATO position

Implemented

### ATO response

7.51 This recommendation has been primarily addressed through the IA Intermediate training package [referred to in paragraph 5.10]. This training covers the need for Tax Office staff to communicate to taxpayers the policy intent used to interpret the law, provide full explanation of why this is the better view and the extrinsic material used to make this decision. At the intermediate level training, the trainer provided attendees with copies of Recommendations 5 and 6.

7.52 To further enhance staff knowledge of statutory interpretation, the trainer conducting the intermediate level training requested attendees to complete the existing Ilearn package (self-paced) on statutory interpretation, which covers the purposive approach to interpretation. Also, the Law and Practice business line is developing a more detailed statutory interpretation course that is planned to be rolled-out in 2010. A pre-requisite to the detailed statutory interpretation course will be the existing Ilearn package.

### IGT conclusion — Implemented

7.53 The ATO response primarily relies on the IA Intermediate training package which was developed to provide attendees with a more in-depth understanding of the statutory framework of interpretative assistance work, the practices and procedures supporting that work, as well as officer's roles and responsibilities. A review of the package reveals that attendees were made aware of the IGT recommendation and of a self-paced ILearn package *Statutory Interpretation: An Introduction*:

... which all IA officers should complete.<sup>9</sup>

7.54 The IGT considers that, one exception aside, the ILearn package should impart a well-rounded understanding of the accepted principles of statutory interpretation. This exception concerns the use of advice given by policy developers and legislative drafters in resolving interpretative matters.

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<sup>9</sup> *Interpretative Assistance Framework, Case Management & Procedures* (ATO training package — version 01/2009, p 5).

7.55 The only reference in the ILearn package to ATO-Treasury interaction on interpretation matters appears on page 35 of that package:

Advice from Treasury to the Tax Office on the policy intent of a provision would not generally be considered extrinsic material for the purposes of the Acts Interpretation Act 1901. These policy advices should be used carefully when determining the legislative purpose of a provision. It will usually be best practice to use the same extrinsic materials as the Court would use.

7.56 Although the above instruction recognises that such advice is impermissible according to the rules of statutory interpretation, it also indicates to staff that there may be circumstances where they are able to use Treasury advice on the 'policy intent' of a provision as a basis for making an interpretative decision. This clearly does not align with discussion in the IGT's 2008 report at paragraphs 5.20 to 5.25 and 5.35 to 5.56 – as the IGT had specifically identified the treatment of policy advice in interpretative matters as one of the underlying causes of perceptions of revenue bias in PBRs.

7.57 In relation to whether the ATO has ensured that tax officials involved in interpretative matters are aware of these principles, the IA training package was designed primarily for case officers and authorising officers in the business lines, although:

... it should also be attended by staff from specialist areas, for example Centres of Expertise, Tax Counsel Network members, or Business Line specialists who will contribute to IA casework ...<sup>10</sup>

7.58 However, the ATO response to the recommendation indicates that only LBI staff and SM&E staff attended. Staff from CoE and TCN are also involved in interpretative matters in the resolution of large complex matters, being the ATO's senior technical officers. Given that TCN and CoE staff deal with statutory interpretation on a daily basis, the IGT would not expect that they be required to attend this level of training.

7.59 On this point the ATO assures the IGT that it has reinforced with its senior technical officers that the proper interpretation of the law is not determined by advice of what policy developers or legislative drafters intended in relation to interpretative matters. On this basis the IGT considers that the recommendation is implemented.

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10 *Interpretative Assistance Framework, Case Management & Procedures* (ATO training package – version 01/2009, p 1).

## RECOMMENDATION 7

*Clarifying, preferably in its interagency protocol, the Tax Office's and Treasury's expectations of the purpose and nature of their interactions on technical matters that relate to already enacted law. This clarification should include:*

- that PBRs should not be delayed because the technical issues relating to those PBRs are the subject of discussions with Treasury; and*
- that in relation to interpretive matters, the Tax Office may invite comments on the purpose or object of the legislative provisions in question, while recognising that any Treasury comments are not determinative.*

### ATO position

Implemented

### ATO response

7.60 The revised protocol was posted on the ATO's website on 25 March 2008. The relevant section under the heading 'For enacted law' states that the Tax Office routinely consults with Treasury, the professions, affected taxpayers and the public in forming its view of the interpretation of the enacted law.

### IGT Conclusion

7.61 The original IGT recommendation has two separate parts, each of which is commented on separately below.

#### *Part i) – Implemented*

7.62 The ATO has completed two revisions of the ATO-Treasury protocol since the IGT's report was released in February 2008. The ATO has not included a commitment that PBRs are not to be delayed because a technical issue relating to the particular PBR is the subject of discussions with Treasury. The ATO has indicated that the clarification was too detailed to incorporate into the ATO-Treasury protocol. This is because the ATO considers that protocol to be a high level document. However, the ATO has undertaken to incorporate the clarification into an internal corporate document within the immediate future.

7.63 The ATO also provided the IGT with examples of cases where the PBRs were issued before Treasury consultations had concluded on the technical issues. In line with the discussion in paragraph 5.46 to 5.50 of IGT's 2008 report, the ATO has acted without awaiting Treasury's final response in the cases viewed by the IGT.

#### *Part ii) – Implemented*

7.64 In relation to the second part of the recommendation, an appropriate revision has been made to the protocol.

## RECOMMENDATION 8

*Ensuring that the Tax Office follows the formal protocol processes in every case where it sees a need for dialogue with Treasury on potential implications of its view of the law. This would include providing a comprehensive administrative impact statement (including details on how it will administer the law if there is no law change).*

### ATO position

Implemented

### ATO response

7.65 This formal process has been in place since July 2007. All ATO minutes that suggest a law change must be cleared by the ATO's Chief Tax Counsel before they are sent to Treasury. The ATO's Governance and Government Relations (GGR) group ensures this happens because all minutes to Treasury must also be cleared by the First Assistant Commissioner GGR or the Assistant Commissioner Policy and Practice. Moreover, GGR controls the issue of minute numbers so that all minutes go through this central point.

### IGT conclusion — Implemented

7.66 The IGT sample-tested relevant ATO-Treasury formal communications, and in all cases ATO Minutes had been prepared in line with the recommendation.

## RECOMMENDATION 9

*Issuing PBRs irrespective of whether the matter involves consideration of a technical issue that is the subject of a developing or contemplated public ruling.*

### ATO position

Implemented

### ATO response

7.67 The message that private binding rulings should be issued, irrespective of whether a public ruling has been completed, has been reinforced by senior leaders in LBI and Law and Practice through the quarterly aged case call over processes. Also the network leaders of the LBI IA network discussed this recommendation with the IA Directors in meetings in late 2008. The presentation to the IA network ensures that this recommendation is channelled down to IA staff.

7.68 The IA foundation training package [referred to in paragraph 5.9] covers this recommendation through good case management. The subsequent IA Intermediate training

package [referred to in paragraph 7.8] covers this recommendation in module (1) Roles and Responsibilities of an IA case officer/team leader.

### **IGT conclusion — Implemented**

7.69 The ATO has verbally reinforced via the call over process and through presentations to senior IA staff that PBRs 'should' not be delayed because of a contemplated or developing public ruling. The IA Intermediate training package advises participants to 'note' the IGT recommendation. The ATO confirmed that the 2007 Foundation training package contained broad messages regarding good case management and officer responsibilities, but did not refer to the IGT recommendation. The IGT confirmed that there is no further communication or instruction to tax officers regarding the recommendation. Although, not essential to the implementation of this recommendation, the IGT considers that these messages to ATO staff should be reinforced through a binding staff instruction. In any event, the IGT has confirmed with the ATO that even where a technical issue is the subject of a developing or contemplated public ruling, a PBR involving the same issue will not be delayed because of this. Once the ATO precedential view on the issue is decided, the PBR will continue to be processed, independently of the public ruling. The IGT considers that this approach would appropriately implement the recommendation.

7.70 The IGT sought to sample test cases in line with the recommendation but the ATO confirmed that there were no such cases. It is noted that the ATO's own internal review conducted in 2009 indicates that, in 16 of 34 LBI PBRs not completed within the 90-day corporate timeframe, there were issues associated with unsettled or contentious areas of the law. However, the ATO assures the IGT that the analysis of those aged complex and difficult cases did not show those cases to have been delayed due to the development of a public ruling.

## **RECOMMENDATION 10**

*Reporting achievements against performance standards and elapsed timeframes of PBRs in Tax Office annual reports.*

### **ATO position**

Implemented

### **ATO response**

7.71 This recommendation was agreed to in part because while the Tax Office already reports achievements against performance standards, the question of elapsed time is not so clear. A private binding ruling requires a joint effort by the Tax Office and the taxpayer. Accordingly, the elapsed time from the date of application to the date of issue of the ruling is not a good measure of the Tax Office's performance as some delays can be due to the taxpayer.

7.72 Where the ATO adopts the principles of the Priority PBR process, it engages with the taxpayer when the arrangement is being developed. Much of the work in these cases is done before the ruling is lodged and the time elapsed from the date of lodgement is largely an irrelevant measure.

7.73 Therefore, to the extent agreed, this recommendation has been implemented and no further action is required.

#### **IGT conclusion — Implemented**

7.74 The ATO agreed in part to the IGT's recommendation by stating that reporting on elapsed time can be skewed because of delays due to taxpayers. Just a few months following the IGT's 2008 report, the JCPAA tabled<sup>11</sup> a report that included two recommendations relating to the subject matter of the IGT's Recommendation 10. One of the JCPAA's recommendations was that the ATO publish the elapsed timeframes for large business PBRs in the Commissioner's annual reports. Both JCPAA recommendations were implemented by the ATO in its 2007-08 Annual Report.

7.75 Therefore, although the ATO stated that it would only partially implement the IGT's recommendation, it did fully implement it following the JCPAA's reiteration of this recommended action.

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11 *Report 410 - Tax Administration* - tabled by the JCPAA on 26 June 2008.





## 8. REVIEW OF THE TAX OFFICE'S ADMINISTRATION OF GST AUDITS FOR LARGE TAXPAYERS

### INTRODUCTION

8.1 This review was prompted by concerns raised by large taxpayers on the following key issues:

- the nature of the GST audit adjustments that have been reported by the ATO as being the results of its GST audit activity on large taxpayers;
- the ATO's imposition of penalties and interest in large taxpayer GST audits; and
- other issues concerning GST audits, including the ATO's approach to margin scheme valuation cases and to cases involving classification issues, the length of time of GST audits, ATO communication processes during GST audits and the training of GST auditors.

8.2 The first area reviewed was the nature of GST audit adjustments that had been reported by the ATO as being the result of its GST audit activity on large taxpayers. Sampling undertaken by the IGT showed that only 32 per cent of the dollar value of GST audit adjustments being reported for large taxpayers involved a positive net revenue gain. It also found that 42 per cent of the dollar value of all reported GST audit adjustments for large taxpayers arose as a result of unprompted voluntary disclosure. Neither of these results had been readily apparent from the GST audit results reported by the ATO.

8.3 The ATO's reports were therefore failing to provide a clear indication of the real contribution to revenue obtained through GST audit results. This situation appeared to have been compounded by the ATO's use of liabilities raised as a basis for reporting performance, unadjusted by the difference between liabilities and actual collections. One result of the ATO's failure to adequately identify the source and overall revenue outcomes of its GST adjustments was that it had not matched its identification of risks for large cases and the allocation of resources towards its compliance work with true outcomes from its compliance activities.

8.4 The second key concern examined during the review involved the ATO's imposition of penalties and interest in large taxpayer GST audits. In respect of penalties, the IGT review found that, although the overall level of penalties being charged to large taxpayers as a result of GST audits was low, there were a number of systemic issues adversely affecting the imposition of these penalties. For example, a number of cases were identified by the IGT where penalties were imposed even though the taxpayer had followed credible legal advice that the position they were adopting was correct. The review also found that the ATO's internal and external reports on penalties were limited in nature.

8.5 In respect of interest, the review found that the ATO was imposing high amounts of interest on taxpayers in cases where no GST revenue had in fact been lost. Furthermore, the review found that the ATO did not prepare reports on the actual general interest charge (GIC) imposed, remitted or ultimately collected in GST audit cases.

8.6 Timeframes for the finalisation of some GST audit cases was also found to be excessive. In some cases, this had been contributed to by a lack of adequate governance by the ATO of its planning and management of audit activities. Technical decisions were also found to be taking too long and communication with taxpayers regarding the commencement and finalisation of audits had not occurred in a number of cases.

8.7 In relation to margin scheme cases, the IGT identified examples where the ATO failed to provide taxpayers with both the reasons why their valuation was not accepted and also the alternative valuation amount obtained from the Australian Valuation Office (AVO).

8.8 Other areas identified as requiring improvement included:

- ATO practices which change the GST classification of a product;
- training of GST auditors;
- ensuring that taxpayers and/or their advisers have access to the ATO decision maker for their case; and
- the application of materiality guidelines in cases where Customs conducts GST audits on imported items.

8.9 The ATO agreed with 12 of the IGT's 14 recommendations included in the IGT's final report.<sup>1</sup> The ATO, however, did not agree with the recommendation that it should administer the GIC so that full remission becomes the norm rather than the exception in cases of one-off revenue-neutral transactions and that any undesirable behaviour on the part of taxpayers in failing to account for GST on such transactions should be addressed via the penalty regime. The ATO considered that this course was not open to it under the law and therefore the IGT made a recommendation to the government that it should consult with the community on the need for legislative change.

8.10 The other recommendation not agreed to was for the ATO to review all GST audit cases for large taxpayers which had arisen from an unprompted voluntary disclosure where GIC was charged at the full rate, rather than at the lesser rate which appeared to represent ATO policy. The IGT made a number of subsidiary recommendations to address communication and other issues associated with GST audits and all were agreed to by the ATO.

8.11 The status of the recommendations and subsidiary recommendations which the ATO agreed to implement, in whole or in part, are set out below.

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1 *Review of the Tax Office's administration of GST audits for large taxpayers* (publicly released June 2008).

## KEY RECOMMENDATION 3.1

*The Tax Office should ensure that there is greater transparency in the presentation of its GST audit results to the community by:*

- identifying those GST audit adjustments which have arisen from unprompted voluntary disclosures and those that have not;*
- identifying how much of reported GST audit adjustments which have not arisen from unprompted voluntary disclosures involve a net contribution to the revenue and how much of these adjustments involve revenue-neutral or other kinds of adjustments which do not; and*
- identifying the quantum of credit amendments made by taxpayers to prior year GST returns which the Tax Office has not included as GST audit adjustments.*

### ATO position

Implemented

### ATO response

8.12 The Tax Office has implemented a range of procedures and enhanced its corporate reporting capabilities to improve its reporting of audit results, communication of audit findings and technical decisions.

8.13 In relation to dot point one, identifying those adjustments that have arisen from unprompted voluntary disclosures and those that have not, we are able to identify the case type against which adjustments are recorded. Any adjustment that is recorded against a voluntary disclosure case product is an unprompted voluntary disclosure. Any other adjustments, included prompted voluntary disclosures, are recorded against the case type that prompted them. An extract from the GST Report Against Plan (RAP) has been provided showing reporting of voluntary disclosures within the two categories: pre and post notification of audit commencement.

8.14 In identifying the revenue contribution made by audit adjustments and VDs, a report 'GST LAC Sticky, Wash, Timing Extract' provides a break up of audit adjustments and voluntary disclosures into the categories Sticky, Wash and Timing. This then enables identification of the amount of adjustments that contribute to the net revenue and the amount that is revenue neutral. This is also reported on within the RAP and has been provided.

8.15 Regarding dot point 3, we have worked with the GST Reporting and Data Services Team to produce a report which calculates the amount of credit adjustments made in or around the time the actual audit adjustment is made and the audit case is closed. We believe that this report provides a figure of the amount of 'related' credit amendments. We have tested the report for the quarter period 1 October 2008 to 31 December 2008 and believe the results provide an accurate picture of related credit amendments. Although we have produced and provided a report for the 2008-2009 period that specifically satisfies the requirements of the third dot point of this recommendation we have been, at this stage, unable to publish this report as the data is un-assured data. Following more recent

discussions with the IGoT we have undertaken to continue to work on trying to get this data assured so that reporting of such credit amounts can be included in future GST reports.

## **IGT Conclusion — Partly Implemented**

8.16 As indicated in the above response, the ATO has worked to improve its reporting capabilities for GST audit results. However, this recommendation was made for the ATO to ensure the transparency of GST audit results by publicly identifying, preferably in its annual report, all the items listed. During the course of this review, the ATO advised the IGT that it is investigating how this can be achieved. The recommendation therefore remains partly implemented.

### **KEY RECOMMENDATION 3.2**

*The Tax Office should ensure that, for risk management purposes, it fully understands the nature of the GST audit results it is achieving for large taxpayer GST audits with a view to ensuring that the resources it allocates to these audits are being appropriately balanced against the risk management outcomes of these audits.*

## **ATO position**

Implemented

## **ATO response**

8.17 The Tax Office has implemented the recommendation and evidence was provided to Internal Audit during the 31 March 2009 quarter status report cycle.

8.18 The GST Risk Management Sub Committee selects, approves and prioritises risks and the appropriate compliance treatment strategy. The GST Executive is satisfied that it focuses on appropriate risks and we have received feedback from Top 4 Advisers concurring that the integrity of business systems is one of the significant risks to GST compliance.

8.19 From July 2008 to March 2009, GST reviewed case selection methodologies and previous audit adjustments in the large and small/medium markets for our key registered GST risks.

8.20 Previous audit adjustments from the 2006-07 and 2007-08 financial years were reviewed in February 2009 for four key GST risks:

- Integrity of Business Systems;
- Financial Supplies — Meaning of Creditable Purpose;
- Financial Supplies — Apportionment risks; and
- International and Cross Border.

8.21 The outcome of the review was the identification of key risk attributes for each risk and how these attributes manifest across markets and industries.

8.22 A review of case selection methodologies and audit adjustments for key risks will be undertaken on a quarterly basis to inform current risk management activities.

8.23 The historical audit analysis, in addition to current intelligence and business knowledge ensures:

- improved understanding of the risk (risk identification and assessment);
- more targeted mitigation strategies (risk treatment); and
- GST can appropriately allocate resources to areas of high risk.

8.24 In addition, GST is enhancing its compliance approach by introducing a more comprehensive case refinement activity and risk reviews prior to initiating audit activity in the large market:

8.25 The new approach is more strategic than previous years, is less obtrusive for clients and assists in appropriate targeting of audit activity.

8.26 The project outcomes and changes to our approach to active compliance in the large market have been discussed with the Corporate Taxpayers' Association as well as with stakeholders during our visits to Top 4 advisers in 2009. Initial feedback has welcomed the new approach.

### **IGT Conclusion — Implemented**

8.27 This recommendation followed analysis undertaken in IGT's 2008 report<sup>2</sup> which revealed the ATO's failure to fully analyse how its actual GST audit results negatively affects the processes it uses to determine which risks to address through future audit activity. It was also noted in the 2008 report that this finding had confirmed the results of other reviews<sup>3</sup> which found that the ATO's overall risk assessment processes for GST were under-developed.

8.28 In response to these reviews, the ATO examined how the GST business line could maximise outcomes and a project team was established to review case selection methodologies and previous audit adjustments for four key risk areas in the large and Small to Medium Enterprise (SM&E) markets. The review was completed in 2009.

8.29 Following the completion of the internal review, a refined planning tool was introduced to enable senior management to better assess the results of its audit work and to use this understanding in determining how best to allocate resources against risk. The IGT has conducted a high-level review of the operation of this system which is the final step in an extended planning process for the allocation of resources against risk. The ATO's GST Risk Management Sub-Committee has responsibility for the completion of this process with final approval by the GST Executive.

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2 *Review of the Tax Office's administration of GST audits for large taxpayers* — at page 26.

3 See: Deloitte, *Final Report: Review of the GST Large Corporate Compliance Program and Appendix prepared for the Australian Taxation Office*, 23 March 2005 and also Australian National Audit Office, *Administration of Goods and Services Tax Compliance in the Large Market Business Segment* — Australian Taxation Office, Audit Report No. 13 2005/06, 18 October 2005.

8.30 Given the scope of this follow up review and the extended timeframes involved with the above planning process, the IGT has been unable to test the effectiveness of the new system. However, based on the above mentioned high-level review, the IGT considers that the ATO is taking appropriate action towards continual improvement in line with the recommendation. The IGT considers that the recommendation is implemented.

### **KEY RECOMMENDATION 3.3**

*The Tax Office should provide the whole community with a consolidated statement or guide on how they can make voluntary disclosures and how they will be treated in terms of tax, penalties and GIC when they do so.*

#### **ATO position**

Implemented

#### **ATO response**

8.31 In order to provide certainty to the whole community across all taxes, a fact sheet on making voluntary disclosure and what a taxpayer can expect when they make a voluntary disclosure has been finalised and published on the Tax Office website. The fact sheet provides taxpayers with information on who to contact, and how GIC and penalties apply to voluntary disclosures.

8.32 Prior to finalisation, the fact sheet was sent for consultation to the Active Compliance Working Group (includes representatives of Tax Institute of Australia, Corporate Taxpayers' Association, Accounting Institutes and some practitioners).

8.33 In addition to the fact sheet, Client Relationship Managers have been allocated to large market taxpayers. These Client Relationship Managers assist clients to meet their tax obligations, and facilitate voluntary disclosures by alerting clients to new risks, new Tax Office views and/or changes in legislation that may affect their business. They also assist taxpayers through the voluntary disclosure process. Systems reference data to measure the effectiveness of our Client Relationship Manager strategy has been established for the 2009-10 year.

#### **IGT Conclusion — Implemented**

8.34 In November 2009, the ATO released the guide *Correcting your tax return or activity statement* which provides taxpayers with detail on the manner in which a voluntary disclosure can be made, the type of information to be provided by the taxpayer and the resultant effect on tax, penalties and interest charges. The recommendation is therefore implemented.

## KEY RECOMMENDATION 4.1

*The Tax Office should enhance its processes for the proper application of penalties in GST large taxpayer audits by:*

- issuing GST-specific guidance for its staff on the application of penalties which arise as a result of a GST audit;*
- ensuring that this guidance covers what kinds of disclosures will give rise to a reduction in penalties, when a disclosure will be considered to have been voluntary and when any voluntary disclosure will be considered to have been made before or after the start of an audit;*
- continuing to conduct periodic reviews of the extent to which penalties in large taxpayer GST audits are being applied appropriately; and*
- ensuring that, where a penalty is reduced after the issue of an audit report as a result of either an internal or external review process, feedback on the reasons for the reduction is provided to all Tax Office staff who were involved in the initial setting of the penalty.*

### ATO position

Implemented

### ATO response

8.35 This recommendation was implemented when the final action item (a guiding principles document developed for GST audit staff) was published on the Tax Office intranet.

8.36 The Tax Office developed several strategies to implement the recommendation, including a new tax ruling, guidelines and training packages for GST auditors and the creation of a specialist penalty and interest area within GST.

8.37 The previous penalty ruling TR 94/4 has been withdrawn and specific guidance for the application of penalties is now contained in Miscellaneous Tax Ruling MT 2008/1. Guidance for staff on the remission of General Interest Charge (GIC) on 'revenue neutral' corrections is contained in Practice Statement Law Administration PSLA 2008/9 and this guidance has been supplemented by an update to the penalty and GIC letter templates to assist decision making.

8.38 As laws change, the Tax Office will update rulings and practice statements and work with externals and staff to ensure the changes are understood. For example, following Royal Assent of the new 'Safe Harbour' penalty provisions the Tax Office will review and update PS LA 2006/2 (Administration of shortfall penalty for false or misleading statements). This will involve workshops with external representatives and the Tax Office. It is expected that further guidance on when tax officers should remit penalties will be an outcome from the workshops.

8.39 To improve the application of penalties and GIC, a Penalty & Interest Practice team and a network of penalty and interest specialists has been established within GST. These



officers conduct skilling workshops on penalty imposition and GIC remissions and provide timely advice and feedback to auditors on any errors identified.

8.40 GST active compliance staff undertook penalty workshops in 2007, 2008 and March 2009.

8.41 Audit decisions, including penalty decisions, continue to be subject to internal quality control and review in the form of:

- a six monthly review of application of penalties in the large market;
- bi-annual technical quality reviews where large active compliance audits are included in sample of cases; and
- implementation of Integrated Quality Framework (IQF) from April 2009 which has assisted in standardising quality approaches, particularly in regard to continuous improvement of case assessment and reporting.<sup>4</sup>

8.42 Since the establishment of the Penalties and Interest Practice we have seen a steady improvement in the application of penalties by GST auditors:

- There has been a 50 per cent reduction in objections against penalty impositions since the workshops were conducted in 2007.
- The number of penalty decisions overturned on review has reduced by 42 per cent since the quarter ended 30 June 2007 and the number of penalty only litigation cases has also reduced by more than 50 per cent since the workshops.
- The number of penalty objections overturned on review has reduced by 61 per cent since the quarter ended 30 March 2008.
- The number of penalty only litigation cases has reduced by a further 18 per cent since 30 June 2008.

8.43 To ensure GST auditors are made aware of any changes that are made to their decision regarding the application of penalties, they receive feedback on objection and appeal decisions. When a GST review officer is allocated a case it is mandatory for the compliance officer to be advised. The proposed objection decision is sent to the compliance officer and any feedback from the compliance officer is considered by the review officer. If a decision is overturned in part or in full, the reasons for that decision are given to the compliance officer and their manager. This feedback loop also applies to litigation cases. Procedures are in place where at litigation the compliance officer is advised when the litigation case is received and also when the litigation case is finalised.

## **IGT Conclusion**

### ***Part i) – Implemented***

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4 IQF is a real time review of end to end processes for current audits, measuring for example, administrative soundness, transparency, correctness, appropriateness to clients' requirements and circumstances, consistency and timeframes. The aim of the IQF system is to ensure that tax officers are following correct procedures, in addition to ensuring the quality of penalty decisions.



8.44 In response to the IGT's recommendation, the ATO has provided its staff with an appropriate GST-specific guidance document on the application of penalties arising from GST audits. Importantly, the document separately deals with the remission of penalties in respect of statements made during the three separate periods 1 July 2000 to 31 July 2001, 1 August 2001 to 31 March 2004 and post 1 April 2004.

8.45 The guidance is available to staff via the ATO internal website and provides linkages to other supporting materials.

#### *Part ii) – Implemented*

8.46 The ATO has provided staff with a guidance document titled *Guiding principles to Voluntary Disclosures* that summarises the core principles found in the ATO's miscellaneous tax ruling on shortfall penalties and voluntary disclosures (MT 2008/35). A review of these documents, together with other support material available on the ATO's internal website, revealed an appropriate level of guidance in accordance with this part of the IGT's recommendation.

#### *Part iii) – Implemented*

8.47 This part of the recommendation was made so that the ATO would continue the work it had completed during the 2006/07 year involving an internal review of the application of penalty policy in large GST audit cases. The focus of the 2006/07 review had principally been on whether internal processes for levying penalties had been correctly carried out.

8.48 During the course of this follow up review, the IGT requested the ATO to indicate how it undertakes a periodic review in line with the recommendation. In response the ATO provided a report, prepared every 6 months for the GST Executive setting out actions taken to ensure the continuous improvement of penalty and GIC decisions for GST audits for large taxpayers. This document is the product of the monthly quality improvement and assurance reports prepared following a sample test of cases using the ATO's Integrated Quality Framework (IQF) system.<sup>6</sup>

#### *Part iv) – Implemented*

8.49 In response to the IGT's original report in 2008, the ATO has introduced new processes and procedures to enhance the provision of feedback to auditors where a penalty is reduced.

#### *Feedback regarding penalty reduction following an internal review process*

8.50 In February 2009, an internal practice note<sup>7</sup> was introduced to formalise the responsibilities of staff regarding the provision of feedback following an internal review process (such as an objection). These responsibilities have also now been incorporated into a revised staff procedural manual.

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5 MT 2008/3, *Shortfall penalties: voluntary disclosures* – this updated the ruling that was in place during the conduct of the IGT's 2008 review.

6 IQF is the ATO's principal corporate means of testing and assuring the quality of work including the application of penalties.

7 GST Practice Note 2009-01 *Post audit reviews*.

8.51 To facilitate the provision of feedback a new procedure has been introduced whereby a case summary template containing the reasons for a decision, including where penalty is reduced, together with other feedback. The template is provided to the relevant audit officer and his or her manager who then has 48 hours to raise any concerns. Any disputes that arise can be escalated.

8.52 Once a finalised objection decision is reached a further case summary template is completed and sent to the auditor containing any further feedback. A checklist listing steps in the above processes is completed by the review officer and reviewed by a team leader.

8.53 The IGT reviewed files evidencing the above processes and procedures in operation.

#### ***Feedback regarding penalty reduction following an external review process***

8.54 A somewhat different process is undertaken where an external review has occurred, such as through litigation. The initial template referred to the audit officer, and his or her manager, contains only limited details of the case including the amount of tax disputed and the basis of the claim. This is completed and provided by the review officer upon allocation of a case.

8.55 The next step is for the audit officer to be invited to attend an 'Introduction' strategic internal litigation committee (SILC) meeting<sup>8</sup> where relevant feedback is provided. However, it is noted that the procedural manual only specifies that the original decision maker (that is, the audit officer) *should* be invited. The manual then states that participation of the original decision maker at future SILC meetings '*can be considered*' on a case-by-case basis. This indicates that there is scope for an auditor not to receive feedback through the 'Decision SILC' which occurs within 24 hours of a decision being handed down by a Court or Tribunal.

8.56 Upon completion of a case, be it through the Court or Tribunal handing down its decision or because of the withdrawal of a case, a second template is referred to the audit officer and his or her manager. This template is essentially the same as the second template used following an internal review process, but includes the result of the Court or Tribunal case. A checklist is completed by the review officer evidencing completion and referral of the template to the relevant auditor.

8.57 The IGT reviewed files evidencing the above processes and procedures in operation.

### **KEY RECOMMENDATION 4.2**

Not Agreed to by the Tax Office (refer to Appendix 3)

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8 The SILC process involves a number of strategic litigation meetings held between tax officers involved with the litigation. The first such meeting is the 'Introduction' SILC meeting which is held at the outset of an appeal.

## KEY RECOMMENDATION 4.2A

*The Inspector-General recommends that the Government consults with the community on the need for legislative changes which have the effect of requiring or allowing the Tax Office to:*

- adopt a default position of fully remitting the general interest charge in GST audit cases which result in adjustments that involve no net loss to the revenue such as wash transactions, cases involving documentation issues and cases where GST has been paid by the wrong entity; and*
- where warranted, address any undesirable behaviour on the part of the relevant taxpayer in relation to failing to account for GST on such transactions through a form of penalty.*

### ATO position

This recommendation is for Government.

### IGT Conclusion

8.58 This recommendation was made to Government in the IGT's 2008 report.

## KEY RECOMMENDATION 4.3

Not Agreed to by the Tax Office (refer to Appendix 3)

## KEY RECOMMENDATION 4.4

*The Inspector-General recommends that the Tax Office enhance its processes for ensuring that GIC imposition and/or remission decisions in large taxpayer GST audits are being made appropriately and consistently by:*

- issuing detailed GST-specific guidance for its staff on GIC remissions which arise as a result of a GST audit;*
- ensuring that large taxpayer GST auditors are appropriately trained on the Tax Office's guidelines for GIC imposition and remission; and*
- ensuring that GIC remission decisions for large taxpayer GST audits are subject to adequate internal quality controls.*

### ATO position

Implemented

### ATO response

8.59 This recommendation was fully implemented with the completion of GIC workshops for GST auditors on 16 July 2009.

8.60 GIC matters are closely aligned with penalty matters and as with the application of penalties in GST, the Tax Office embarked on several complementing strategies to implement the recommendations. These included a new ruling, practice statements, guidelines, training packages for auditors, a GIC calculator and the creation of a specialist penalty and interest area within GST.

8.61 As previously mentioned the Penalty & Interest Practice team and a network of penalty and interest specialists were established to provide advice to auditors on penalty and GIC matters. Further guidance to staff is facilitated by:

- Compulsory approvals by the Penalty and Interest Network of certain penalties and interest decisions. All interest decisions must be approved by a Penalty and Interest Network representative. Where the audit has exceeded its expected completion date and a decision is made not to remit on the basis the taxpayer contributed to that delay, this decision must be authorised by a Senior Executive Officer.
- Practice Statement Law Administration PSLA 2006/8 provides guidance to Tax Officers by outlining the circumstances the Commissioner considers it appropriate to partially or fully remit interest accrued during shortfall periods.
- Internal guidance products issued for staff also include:
  - Practice Statement Law Administration PSLA 2008/9 was issued 5 May 2008 and provides guidance to Tax Officers by outlining the circumstances the Commissioner considers it appropriate to partially or fully remit the GIC payable in respect of underpaid GST where a GST 'revenue neutral' correction is made;
  - Interest charge remission support tool – designed to guide auditors through a hierarchy of questions in order to determine the appropriate remission decision;
  - 'Questions and Answers' – designed to assist in the administration of PS LA 2006/8;
  - Interest decision 'standard text' to ensure consistency;
  - Periodic articles / instructions via GST Technical Alerts delivered to all GST staff;
- A GIC calculator, which facilitates the calculation of GIC remission using calendar dates has been trialled within GST and results are currently being reviewed.

8.62 Interest decision making and remission workshops were held for GST officers in 2007, 2008, February/March 2009 and again in June/July 2009 to improve quality and consistency of interest remission decisions.

8.63 Effectiveness of the above mentioned strategies will be reviewed by our Integrated Quality Framework teams.

## **IGT Conclusion**

### ***Part i) – Implemented***

8.64 In response to the IGT's recommendation, the ATO has provided its staff with a number of products and support tools. For example, practice statement *PS LA 2008/9*<sup>9</sup> which deals with the remission of GIC policy for GST revenue neutral corrections. The ATO also refers to guidance on the remission of shortfall interest charge (SIC) and GIC which is included in practice statement *PS LA 2006/8*<sup>10</sup>.

8.65 During the course of the follow up review, the IGT discussed the issue raised in the original recommendation – that guidance should be issued in a GST-specific document to better assist officers carrying out GST audits. In reference to the above materials, the ATO indicated that although it was originally agreed that a GST specific document would be produced, this was overtaken by a whole of ATO approach in certain circumstances.<sup>11</sup>

8.66 However, having reviewed the materials that are now available for ATO staff, the IGT considers that there is adequate guidance for this part of the recommendation.

#### *Part ii) – Implemented*

8.67 During June and July 2009, the ATO conducted a series of facilitated workshops focusing on GIC imposition and remission. The workshops were conducted around Australia and around 400 tax officers attended. The course was developed in response to the IGT's recommendation and included an examination and discussion of audit case studies.

8.68 Following a review of the relevant training materials by the IGT, it is considered that this part of the recommendation is implemented.

#### *Part iii) – Not implemented*

8.69 As part of its procedure, all GIC remission decisions arising from an audit must be reviewed by the ATO's Penalty and Interest Network (PIN). A review of audit cases by the IGT evidenced this process in operation.

8.70 However, a concern raised in the IGT's original report<sup>12</sup> regarding the ATO's processes for reviewing GIC remission decisions for large taxpayer audits remains. In particular, the ATO's processes still do not require either auditors or PIN reviewers to ascertain the actual total amount of GIC initially imposed or the amount involved in any remission. A Senior Executive Service Band 1 (SES1) officer (or above) is required to review cases where the audit adjustment is \$1 million or more, however, there is no set procedure to be followed and the matter of considering the actual dollar amount for GIC is at the discretion of the reviewer.

8.71 The ATO confirmed during the course of this review that the amount of GIC posted on a taxpayer's account is calculated automatically following data entry by the ATO Operations staff. There is no formal quality check of the accuracy of the amount of GIC posted.

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9 PS LA 2008/9, *GST 'revenue neutral' corrections*.

10 PS LA 2006/8, *Remission of shortfall interest charge and general interest charge for shortfall periods*.

11 As evident from the ATO's continued use of *PS LA 2006/8* which is a document covering both income tax and GST.

12 IGT's 2008 report *Review of the Tax Office's administration of GST audits for large taxpayers* – at paragraph 4.142.

8.72 Therefore, there remains the possibility that very sizeable remissions of GIC could be occurring without appropriate senior scrutiny and so the recommendation remains not implemented.

## KEY RECOMMENDATION 5.1

*The Inspector-General recommends that the Tax Office takes steps to:*

- *ensure that taxpayers are supplied with reasons why their valuations do not meet Tax Office requirements as soon as possible during the course of a GST audit involving a margin scheme valuation issue and that these reasons include the alternative valuation amount the Tax Office has obtained from the Australian Valuation Office, whether that amount is set out in a 'critique' or in a full valuation; and*
- *ensure that disputes on margin scheme valuations are confined to the difference between what the Tax Office considers to be an acceptable valuation amount and what the taxpayer contends is an acceptable amount.*

### ATO position

Implemented

### ATO response

8.73 This recommendation was implemented on 1 March 2010, when the GST Determination MSV 2009/1, became effective. This determination ensures that any disputes on margin scheme valuations are confined to the difference between what the Tax Office considers to be an acceptable valuation amount and what the taxpayer contends is an acceptable amount.

8.74 Audit Guidelines and advice for Tax Office staff in the margin scheme audit method were updated to ensure auditors engage the Australian Valuation Office to provide a critique in situations where it is considered that the Valuation utilised by the client is non-compliant. The AVO then undertakes the critique and determines whether the taxpayer has provided an approved valuation for the property transaction.

8.75 In cases where the AVO has been engaged to review the taxpayer valuation and it has been determined to be non complying, a copy of the AVO full critique is provided to the taxpayer. The critique will identify areas within the taxpayer's valuation which are not in accordance with professional standards and/or assumptions used by the valuer in determining the value of the property that are doubtful or unsubstantiated. On occasions, there may be sufficient information within the taxpayer valuation for the AVO to be able to provide an alternate valuation range as part of their critique. However this is not requested or required at the initial critique stage. In order to provide an alternate valuation in every instance, full valuations would need to be obtained from the AVO. A full valuation takes more time, is more costly and is not considered appropriate in every instance. A full valuation will be obtained by the Tax Office if any further valuation provided by a taxpayer in response to a formal MSV 2009/1 notification, is found not to be a complying valuation.

8.76 Prior to the introduction of MSV 2009/1 on 1 March 2010, taxpayers were provided with the opportunity to provide an alternative complying valuation and advised of the



consequences if they did not. That is, the cost base would be calculated on the consideration paid for the property in accordance with the Tax Office view contained in paragraph 16A of GSTR 2000/21.

8.77 To assist taxpayers, their advisers and valuers to meet their obligations, the Tax Office:

- has consulted with the Australian Property Institute on the development of an agreed set of guidelines for valuers undertaking valuations for the application of the margin scheme;
- issued a fact sheet for property sellers titled Valuations for the Margin Scheme which was released as NAT 73397-04.2010 in April 2010;
- developed a Margin Scheme guide that was released as NAT 15145-02.2010 in February 2010; and
- published a detailed explanation of what is required for margin scheme valuations (this document is to be linked to the Australian Property Institute website).

8.78 Prior to the implementation of MSV 2009/1 on 1 March 2010, in circumstances where we considered a 1 July 2000 property valuation to be invalid the Commissioner was required to adopt the original cost for the purposes of the margin scheme. It was recognised that this may produce an outcome which was inconsistent with the intent of the margin scheme.

8.79 MSV 2009/1 provides for the resolution of valuation disputes between a taxpayer and the Tax Office. The determination allows the Commissioner to substitute a value for the calculation of the margin scheme and applies retrospectively. The taxpayer will be supplied with a copy of the valuation obtained by the Commissioner. Feedback from the Institute of Chartered Accountants, Australian Valuation Institute, National Tax Liaison Group sub committee and the Property and Development Working Group including Tax Institute of Australia and Property Council of Australia on the draft Margin Scheme Valuation Determination was considered when drafting this determination.

8.80 With the finalisation of the determination, feedback providers were briefed and notification was provided by E Link (a Tax Office initiative for communicating real time updates to tax agents electronically), and to industry associations. This recommendation has been implemented.

## **IGT Conclusion**

### ***Part i) – Implemented***

8.81 This recommendation followed the IGT having identified a number of GST audits involving margin scheme valuation issues where the ATO had failed to adequately inform taxpayers of the requirements that such valuations needed to be met in order to be considered acceptable by the ATO. Part of the reason for this was because the ATO practice was to provide only extracts of ‘critiques’<sup>13</sup> from the AVO.

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13 In most cases, the ATO does not obtain a full independent valuation and therefore obtains a critique from the AVO. This provides the ATO with a preliminary view of the client’s valuation processes for risk assessment purposes. The critique identifies those areas which the AVO considers that the

8.82 In October 2009, the ATO released a new determination<sup>14</sup> in relation to the requirements for making valuations for the purposes of applying the margin scheme. The determination commenced on 1 March 2010. The ATO has accordingly revised its guidelines for ATO staff to now notify taxpayers in writing of the reasons for not accepting a taxpayer valuation as a ATO approved valuation and to provide taxpayers with a full copy of an AVO critique (or AVO valuation where obtained). As part of this notification, taxpayers are asked to:

- address the concerns raised in the critique/valuation report;
- rectify these areas of concerns;
- obtain a new valuation for ATO consideration; or
- use one of the other valuation methods available via the determination.

8.83 If the taxpayer does not produce a ATO approved valuation within eight weeks (or any extended time which the Commissioner may allow) the determination now enables the Commissioner to substitute a valuation.<sup>15</sup>

8.84 Consultation leading up to the release of the determination was undertaken with industry by the ATO. The determination is a relatively recent development. Accordingly, the IGT has not had the opportunity to review the administration of it in practice. The ATO has advised the IGT that quality assurance of these practices will be undertaken using its IQF quality assurance system.

8.85 A number of residual concerns were raised by stakeholders with the IGT during the course of this follow up review, including whether an appropriate form of valuation will be obtained in all cases by the ATO.

8.86 The IGT also notes that the Government has recently agreed to introduce a package of GST reform measures to both clarify the law surrounding the margin scheme and to simplify compliance. The Government's intention is for these measures to apply from 1 July 2012.<sup>16</sup>

8.87 The IGT considers that this part of the recommendation is implemented. As noted previously, the IGT will maintain a watching brief over the ATO's administrative practice in this area.

### *Part ii) – Implemented*

8.88 This part of the recommendation was made following the IGT identifying a ATO practice of challenging and invalidating taxpayer valuations using AVO critiques and then

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taxpayer's valuation is inadequate. The IGT recognises that a critique will not always provide an alternative valuation amount.

14 *A New Tax System (Goods and Services Tax) Margin Scheme Valuation Requirements Determination MSV 2009/1.*

15 The Commissioner's ability to now substitute a valuation is referred to in part ii) of this recommendation.

16 Assistant Treasurer Media Release No. 95, 11 May 2010.



using the original purchase price of a property, even from many years earlier, as a basis for adjustment under the margin scheme. This has now been addressed for assessments issuing from 1 March 2010 with a new legislative determination that has been issued.<sup>17</sup> The new determination provides the Commissioner with an alternate method to obtain a valuation, in specified circumstances, ensuring that GST is only payable on the value added to the real property after the commencement of, or entry into, the GST system.

8.89 As mentioned in the first part of IGT's analysis for this recommendation, the determination is a relatively recent development and the IGT has not had the opportunity to review the administration of it in practice.

8.90 The IGT considers that this part of the recommendation is implemented. As noted previously, the IGT will maintain a watching brief over the ATO's administrative practice in this area.

## KEY RECOMMENDATION 5.2

*Because of competitive winners/losers as a result of different GST classifications in the market place, the Tax Office must review its current approaches to ensure binding GST decisions in relation to new products coming onto the market are made and communicated quickly into the market to ensure that there is improved through-the-chain certainty, better compliance and lower costs.*

### ATO position

Implemented

### ATO response

8.91 This recommendation was implemented on 30 June 2009, when the Food classification database and classification decision tool to help taxpayer to classify food and beverages for GST went live on the Tax Office website.

8.92 To provide further certainty and communicate changes in GST classifications, a Food Classification Working Party with external stakeholders was established in November 2007. The working party is currently meeting biannually. The purpose of the working party is to resolve food and beverage classification issues for GST purposes. Its main agenda items include:

- lack of clarity regarding interpretation of the law;
- different opinions in relation to classifications.

8.93 Independent of the working party, the Tax Office developed tools to provide certainty to taxpayers about their food and beverage products as well as the following to assist taxpayers to classify their new food and beverage products:

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17 A New Tax System (Goods and Services Tax) Margin Scheme Valuation Requirements Determination MSV 2009/1.

- a 'Food classification' database to replace the existing 'Detailed food list' — this is an on-line database accessed via the Tax Office website and updated more efficiently as new products come on the market;
- an on-line 'Food classification' decision tool which will assist taxpayers classify food and beverage products that do not appear in the 'Detailed food list' or 'Food classification' database; and
- a 'Food classification' flow chart has been included in the GST food guide.

8.94 Details of the tools will be communicated to the industry forum and a communiqué published on E Link and an article will be published in the Tax Agents' Magazine.

### IGT Conclusion — Implemented

8.95 The ATO response refers to the release of a binding Food classification database<sup>18</sup> and a non-binding Food classification decision tool<sup>19</sup> that were both introduced on to the ATO website in July 2009. The introduction of the database to provide binding decisions for taxpayers regarding food products has been a welcomed development in line with the recommendation. On this basis, the IGT has determined that the recommendation has been implemented. The IGT also notes that legislation has been introduced<sup>20</sup> to include indirect tax rulings in the general rulings regime from 1 July 2010.

8.96 The ATO has advised the IGT that the binding status of the above mentioned database will be affirmed with it being officially labelled as a public ruling on the ATO website prior to 30 June 2010.

### KEY RECOMMENDATION 5.3

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

- *expeditiously resolves GST large taxpayer audits experiencing significant delays;*
- *clarifies in a public statement its position on when a GST audit has started and the circumstances in which this will occur orally or by letter;*
- *takes steps to ensure that technical decisions which impact audits are made without delay; and*
- *should review, in consultation with taxpayers and their representative associations, the existing benchmark times to complete GST audits and should also work with other countries to develop appropriate approaches to comparing benchmark times to complete a GST/VAT audit.*

18 This is currently referred to as the *Detailed food list* on the ATO website.

19 This classification decision tool has replaced the 'Food Classification Flow Chart' referred to in the *Evidence supporting the ATO position* section.

20 *Tax Laws Amendment (2010 GST Administration Measures No. 2) Bill 2010* has been passed by the Senate without amendment and now awaits Royal Assent.

## ATO position

Implemented

## ATO response

8.97 The Tax Office has implemented the recommendation.

8.98 The Tax Office is continually addressing the causes of delays to taxpayer audits and related technical decisions and we have put in place specialist areas and processes to improve communication with, and provide greater certainty and clarity for the taxpayer. We are also continuing to examine comparative cycle times and benchmarks with other jurisdictions. These strategies have had a significant positive effect on our management of audits.

8.99 A working party was established to review existing information on cycle times and aged cases to identify principal causes for case delays and aging, determine if strategies underway are sufficient to address causes and make any required recommendations to the LAC exec. Following a review of the information that we had from our own internal sources, it was decided to seek external opinion also. On 13 August 2008 a workshop was held with internal and external stakeholders. The external invitees included Telstra, Visy, Deloitte, EY, KPMG, PWC and Greenwoods & Freehills. This was then followed up with a phone conference on 11 November 2008. The result of this was the paper – *Improving GST Large Market Active Compliance*.

8.100 GST Case Leadership Team was established to identify the causes of aged audit cases and to work with stakeholders to treat the causes. The Case Leadership Team assists with significant cases one on one as well as undertaking formal case call overs. The main causes of aged cases identified included:

- poor planning and active case management;
- delays in gathering information;
- poor handovers when there is a change of auditor;
- delays in obtaining internal advice;
- poor practices in the use of our case management system.

8.101 Treatment strategies included:

- active Case Management skilling for all Large Market Audit teams and the publication of a Practice Note on Active Case Management;
- training on appropriate use of formal information and access powers which has been delivered to GST compliance officers;
- training on negotiation and influencing skills and communication skills which has been delivered to GST compliance officers;
- GST Case Leadership intervention in cases where there is a delay in the provision of internal advice;

- improved procedures and practices for using the case management system; and
- monthly a review is undertaken of cases that are going to become aged within the next thirty days and then strategies are put in place to, where possible, finalise the case before it becomes aged.

8.102 GST reduced delays in resolving large taxpayer audits by monitoring all 'aged' cases and alerting audit teams to cases which were approaching the end of their cycle time. In addition, a range of strategies have been put in place to ensure large market audit cases are actively managed and the causes of delays are addressed. For example:

- Every Large Market case that has exceeded cycle time is referred to Case Leadership. The main causes are identified and treatment strategies are developed in conjunction with stakeholders.
- Significant Large Active Compliance (LAC) cases are called over by GST Case Leadership at least every 6 months. These call overs involve SES officers, the audit team leaders, auditors and internal Tax Office specialists.
- Monthly reports are prepared for the Large Active Compliance Executive team on audit cases over 100 days past cycle time. Blockers are identified and strategies to move cases forward developed. This high level focus maintains accountability and resolves issues as quickly as possible.

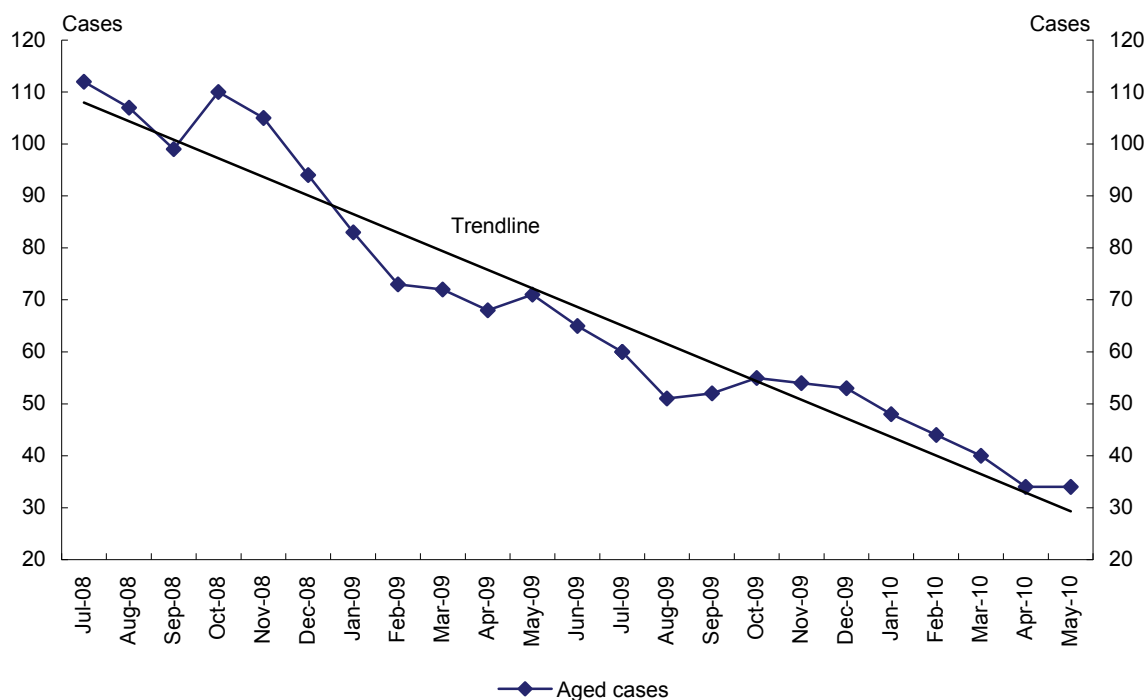
8.103 Procedures are also in place that makes it mandatory for auditors to confirm, in writing, when an audit commences and is finalised. This expectation has also been published on the Tax Office website under the heading 'GST Audits and Reviews – Tax Audit Timeframes'. Checks will be undertaken as part of the Integrated Quality Framework process.

8.104 An escalation process has been put in place to reduce delays on technical decisions which impact on audit decisions.

- Interpretative Assistance has a service standard of 21 days to provide advice to the compliance officer or if the issue is referred to a Centre of Expertise or Tax Counsel, a turnaround timeframe is negotiated.
- Case Leadership monitors these escalations on a monthly basis and follows up on cases that have exceeded the 21 day turnaround time.
- Interpretative Assistance has also adopted the Active Compliance strategies of reviewing cases monthly and conducting formal call overs.

8.105 The strategies have resulted in a significant decrease in aged cases in the large market:

**Chart 8.1: LAC Audit (3.4.3 only) Aged cases by month 2008-2010**



*Benchmarks for audit case cycle times have been examined for appropriateness:*

8.106 We consulted with taxpayers and advisors via the Corporate Tax Association, meetings with the Top Four advisers and during a workshop conducted on Case Timeframes/Cycle Times. While audit timeframes was an issue for most external participants it was not the major issue for many of them. In some cases they were looking for the Tax Office to extend the cycle time of an audit to take account of the issues facing a business. The main concerns raised by taxpayer representatives and advisers were:

- lack of understanding of their business;
- lack of discussion about the reasons for information requests;
- lack of discussion around audit activity timelines;
- lack of clarity about the process for clarifying technical issues that arise;
- consideration of materiality of risk; and
- lack of communication around commencement, the issues and progress of audits.

8.107 These concerns have been addressed and are discussed under Subsidiary Recommendation 5.3.

8.108 The Tax Office conducted an international benchmarking exercise on audit cycle times with the tax authorities in the United Kingdom, New Zealand and Canada. This has opened dialogue with these jurisdictions and all countries are interested in continuing to share information on cycle times and other performance measures. It is not possible to provide an absolute comparison between the various tax authorities due to the differences in audit approach. However, it was found that the cycle times being met by overseas jurisdictions are very similar to Australia (180-405 days). The conclusion reached is that in

most cases cycle times are appropriate and areas for improvement include active case management, communication and negotiation. Our Learning and Development plans have focussed on these areas with large market audit staff attending debriefs and workshops.

8.109 In addition to the above strategies, a restructure of GST business line in July 2009 has established a Compliance Improvement Business Excellence and Relationships section that brings together expertise in Interpretative Assistance, Case Leadership, Penalty and Interest Practice, Quality, Compliance Support and External Relations to enable compliance areas to manage their business more effectively.

## **IGT Conclusion**

### ***Part i) – Implemented***

8.110 As indicated in the above chart (chart 8.1) there has been a continued decline in the numbers of aged cases in the large market.

8.111 As indicated in the ATO's above response, procedures and systems are in place to enable the monitoring of the progress of cases. Part of this includes monthly reviews and the re-setting of milestones to move cases that are experiencing delay towards completion.

### ***Part ii) – Implemented***

8.112 The ATO has included in paragraphs 60 and 61 of Miscellaneous Taxation Ruling MT 2008/3<sup>21</sup> an appropriate clarification of its position on when a GST audit has started and the circumstances in which this will occur orally or by letter.

### ***Part iii) – Implemented***

8.113 The ATO has introduced a process to address any delay in the finalisation of any technical decision which affects the progress of an audit. This process is managed by ATO executives who monitor the progression of requests by auditors for technical assistance from technical divisions. Any request that exceeds the 21-day corporate timeframe (or a negotiated timeframe where relevant) is then followed through by the ATO executive. To assist ATO executives, reporting is maintained by the ATO's Interpretative Assistance group.

### ***Part iv) – Implemented***

8.114 As indicated in the ATO's response, a benchmarking exercise with overseas tax authorities was conducted in 2008 and the conclusion reached was that in most existing cases cycle times are appropriate. The ATO has advised the IGT that a decision has been made not to undertake any further benchmarking exercise at this time.

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21 Titled *Shortfall penalties: voluntary disclosures*.

### **Subsidiary Recommendation 5.1**

*The Inspector-General recommends that large taxpayer GST auditors should always confirm the date of commencement and finalisation of an audit in writing. If advice of the commencement or finalisation of an audit is given orally this advice should be confirmed in writing within a reasonable time thereafter.*

#### **ATO position**

Implemented

#### **ATO response**

8.115 The Tax Office has implemented the recommendation and evidence was presented to Internal Audit in the 30 June 2008 quarter status report.

8.116 To provide certainty to taxpayers and to ensure the taxpayer is afforded the opportunity to make a disclosure, clarification on when an audit commences has been published on the Tax Office website and in the update to the Large Market Compliance booklet. This public statement has also been communicated to taxpayers via external forums such as the Corporate Tax Association.

8.117 Procedures are also in place that make it mandatory for auditors to confirm in writing when an audit commences and is finalised. Assurance checks to confirm the process is being followed are being undertaken as part of the Integrated Quality Framework process which commenced in April 2009.

#### **IGT Conclusion — Implemented**

8.118 Procedures are in place requiring auditors to confirm in writing when an audit commences and is finalised. This includes confirmation in writing within seven days where taxpayers initially receive oral notification. The ATO tests cases using its IQF quality assurance system to ensure these practices are followed.

8.119 Sample testing of cases by the IGT demonstrated adherence to this practice.

### **Subsidiary Recommendation 5.2**

*The Tax Office should ensure that GST auditors facilitate access by large taxpayers who are subject to a GST audit to the key technical decision makers involved in their case and also ensure that the large taxpayers are made aware of the senior officer they can escalate issues or concerns to.*

#### **ATO position**

Implemented

## ATO response

8.120 The Tax Office has implemented the recommendation and evidence was presented to Internal Audit in the 30 June 2009 quarter status report.

8.121 Taxpayers can escalate issues or concerns to a senior officer. The Audit Management Plan prepared at the commencement of an audit provides details of the senior contact officer. Procedures have been implemented whereby compliance officers also advise taxpayers that they will be provided with access to key technical decision makers as required. To provide assurance these procedures are being followed, a question has been added to the Client Feedback Questionnaire and a specific check will be undertaken as part of Integrated Quality Framework assessments.

8.122 The Client Feedback Questionnaire is generally forwarded to a client after an audit interaction.

8.123 This data will provide a benchmark to measure the success of our strategies to improve compliance collaboration between the Tax Office and taxpayers.

## IGT Conclusion — Implemented

8.124 As indicated in the above response, the ATO's Audit Management Plan, which is provided at the initial meeting for taxpayers subject to an audit, includes contact details for both the case officer and a senior contact officer. Sample testing of cases demonstrated adherence to this practice.

8.125 Regarding access to ATO technical decision makers, the above response specifically refers to the Audit Management Plan which provides for details of the senior contact officer to be included (being the person to whom concerns may be escalated about the progression of the audit). However, this is not the ATO's technical decision maker. Sample testing of Audit Management Plans by the IGT demonstrated that details of technical decision makers are not included as such. However, the IGT notes that the accompanying guide to audit management plans states that taxpayers can expect audit officers to:

‘... facilitate access to the Tax Office technical decision maker to discuss your views on the technical issues **if required.**’ [emphasis added]

8.126 This guideline indicates that the recommendation is implemented in principle and has outlined the position here to ensure that taxpayers are also aware.



### Subsidiary Recommendation 5.3

*The Inspector-General recommends that the Tax Office takes steps to:*

- ensure that auditors better understand the businesses they are auditing by providing more training on business process and activity and on how to focus on issues that involve a real net gain to the revenue;*
- ensure that auditors understand that businesses may want to exercise their legal rights to correct their GST liabilities for previous years in cases where they have overpaid and that such claims are not, per se, evidence of an attitude of non-compliance with the GST law; and*
- ensure that GST auditors are in all cases provided with individual feedback on the results of the cases they have audited, in terms of the final outcome of cases after they have gone through the appeal process.*

### ATO position

Implemented

### ATO response

8.127 The Tax Office has implemented the recommendation and evidence was accepted by Internal Audit in the 31 March 2009 quarter status report.

8.128 As with several other key recommendations, the Tax Office embarked on several complementing strategies to implement this sub recommendation. These include training packages, liaison with industry and other external bodies, intelligence gathering and feedback processes for appeal cases.

8.129 The Learning and Development plan governing the training needs of Large Active Compliance auditors has been updated taking into consideration the recommendations in the Review. Some examples of GST's strategies include:

- Large Active Compliance continues to deliver training on Financial Supplies and Property and Construction issues such as margin scheme.
- A project to improve GST's Client Relationship Management has provided a more structured approach towards assisting large taxpayers to meet their tax obligations. Teams are given responsibility for particular industries and Client Relationship Managers are required to assist compliance officers in developing and maintaining industry knowledge. Client Relationship Managers provide specific advice about the client's business to audit teams and encourage full and frank communication between the auditors and clients on audit process and progress.
- Knowledge Centre Gatekeepers are in place to brief compliance officers on industry/commercial practices both prior to and during an audit, as required. The purpose of knowledge centres is to capture industry-based knowledge and experience and to provide audit assistance with technical issues, risk areas, audit techniques and common business practices across different industries and focus areas.

8.130 The ATO continues to collect industry and business knowledge through external forums such as industry meetings, Top Four accounting firm visits, National Tax Liaison Group meetings and other meetings/industry contacts. GST has also formed projects on subjects such as motor vehicle holdbacks, developing significant expertise in this area.

8.131 For example, a Property Taskforce has been established to:

- understand the property sector across all markets;
- bring together people experienced in property issues;
- collaborate and co-design a strategic approach to compliance; and
- identify and treat risks.

8.132 The intelligence function informs risk managers about behaviours in market segments and threats to revenue, community confidence and other planned objectives. Within GST risk owners, managers and decision makers use this information to assess levels of risk and develop appropriate treatment strategies. GST risk owners are responsible for the development of case treatment pools based on parameters identified through intelligence and risk scoping activities. The intelligence gathered assists auditors to better understand compliance drivers and behaviours and the case selection methodology targets cases on a prioritised basis.

8.133 The Inspector General of Taxation expressed concern that Tax Office auditors may have viewed corrections by businesses of their GST liabilities for previous years where they have overpaid as evidence of an attitude of non-compliance with the GST law. The Tax Office does not consider that all retrospective claims for Input Tax Credits are indicative of non-compliance. If a taxpayer or their adviser proposes a new apportionment methodology for claiming Input Tax Credits, the Tax Office will examine the methodology to determine whether it is fair and reasonable. For example, guidance on what is fair and reasonable for financial supply issues, including detailed examples, is outlined in GSTR 2006/3. We are also working with the Retirement Village Industry to develop principles for fair and reasonable apportionment methodologies.

8.134 In the past, GST Large Active Compliance did not undertake risk reviews and therefore such an examination of an apportionment methodology was undertaken as an audit. We acknowledge that this may have created a perception that retrospective claims were considered evidence of non-compliance. Now, any such examination or review of apportionment methodologies will be undertaken as a risk review.

8.135 Protocols have been developed to ensure feedback on objection and appeal decisions are provided to compliance officers. When a GST review officer is allocated a case it is mandatory for the compliance officer to be advised. The proposed objection decision is also sent to the compliance officer and any feedback from the compliance officer is considered by the review officer. If a decision is overturned in part or in full, the reasons for that decision are given to the compliance officer and their manager.

8.136 Processes have also been put in place to ensure that compliance officers and their team leaders are advised:

- when an audit case has gone to litigation;
- the outcome of litigation; and
- of court outcomes via technical bulletins, adverse decision reports and decision impact statements.

8.137 As noted at recommendation 4.1 internal analysis of closed litigation cases completed between July and November 2009 shows that in 89 per cent of cases the compliance officer had been notified of the outcome of litigation.

8.138 The compliance officer may also be involved in the litigation process, for example, if the litigation team needs some clarification as to the facts presented in the audit. All of these procedures ensure that feedback is provided at a strategic level to all compliance areas and is provided to the compliance officer responsible for the case.

## **IGT Conclusion**

### ***Part i) – Implemented***

8.139 Following a request for further details regarding the strategies referred to in the above response, the ATO provided the IGT with a report containing statistics of the amount of training provided to GST Large Active Compliance (LAC) auditors nationally as well as a list of the training courses conducted.

8.140 Secondly, details were also provided that outlined a new structured approach introduced in 2009 to enable the ATO's client relationship managers (CRMs) to better capture, record and then pass on to auditors the intelligence gathered during client engagements. As part of this approach, new procedures have been introduced for CRMs to complete. In addition, the recording of intelligence and interactions has been enhanced through new capability in the ATO's systems.<sup>22</sup>

8.141 Thirdly, reference was also made to a review and reallocation of the network of GST directors who each have a particular industry specialisation. ATO audit staff refer to these directors for assistance as required.

8.142 These continuing efforts to increase the level of auditor's understanding and knowledge of particular industries is encouraging and therefore IGT considers that the recommendation is implemented. This work could be further enhanced with the ATO arranging structured training conducted by experts in industry or from leading advisers who are in a position to provide ATO auditors with a first hand appreciation of the issues faced by taxpayers.

### ***Part ii) – Implemented***

8.143 As indicated in the ATO's response, risk reviews are now undertaken instead of audits where a taxpayer or their adviser proposes a new apportionment methodology as part

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22 Including the ATO's Siebel case management system.

of a retrospective claim to correct an entitlement to input tax credits (ITCs). This step has been taken in response to the IGT's original report which found that the ATO's reappraisal of apportionment methodologies (following a taxpayer's retrospective ITC claim) had created a perception that the ATO viewed this as evidence of non-compliance.

8.144 It is noted that the ATO's above response acknowledges that its previous approach may have created that perception.

### *Part iii) – Implemented*

8.145 As discussed in recommendation 4.1 (part iv), the ATO has introduced new processes and procedures to enable the provision of more information to GST auditors. This includes providing the original auditor with the result of a Court or Tribunal case. The IGT reviewed files that evidenced these changes in operation.

#### **Subsidiary Recommendation 5.4**

*The Inspector-General recommends that tolerance or materiality levels are aligned across both Australian Customs Service and Tax Office administration of GST.*

### **ATO position**

Partly implemented

### **ATO response**

8.146 There have been some technical and practical issues in aligning materiality/threshold levels across the Australian Customs x Office has been working with Customs and Border Protection and Customs Brokers and Forwarders Council of Australia (CBFCA) on a 'common sense' solution which has ramifications as to the interpretation of section 13-20 of the Goods and Services Tax Act 1999 (relating to GST payable on taxable importations).

8.147 The opportunity to align tolerance and materiality levels across the Australian Customs and Border Protection Service and the Tax Office (beyond that which has already been achieved) is limited by the incompatibility of the Customs & Border Protection Service and GST Systems and mode of inputting data into those systems; that is, the lodgement of an import declaration per each importation on the Customs and Border Protection's Integrated Cargo System as opposed to the aggregation of transactions for a given period that are recorded in a Business Activity Statement and lodged on the Tax Office's system.

8.148 Notwithstanding this, the progression of the underlying issue is now being managed by the GST Interpretative Advice Significant Issues Team in consultation with Customs and Border Protection and Transport Industry representatives. To this end, a 'co-design' meeting involving all stakeholders was held on 19 May 2009, to progress the development of a preferred option for addressing the current problems being experienced by Importers / Customs Agents. The Meeting established a preference for an 'agreed rates' approach to form the basis of a proposed Legislative Determination, and resolved that the Tax Office would provide an opinion as to its appropriateness under the GST Law. This opinion will rely heavily on industry information to be sourced from Transport Industry Representatives.

8.149 The co-design meeting also identified the benefit of aligning the start date of the Legislative Determination with that currently being proposed for measures that will amend the Value of Taxable Importation provisions of the GST Act.

#### **IGT Conclusion — Partly Implemented**

8.150 During the course of this review, the IGT sought an update and the ATO advised that discussions continue with Customs with regard to aligning materiality levels. The subsidiary recommendation therefore remains in progress and partly implemented.



## 9. REPORT ON IMPROVEMENTS TO TAX ADMINISTRATION ARISING FROM THE INSPECTOR-GENERAL'S CASE STUDY REVIEWS OF THE TAX OFFICE'S MANAGEMENT OF MAJOR, COMPLEX ISSUES

### INTRODUCTION

9.1 In October 2005, the IGT announced his intention to review the ATO's ability to identify and deal with major, complex issues within reasonable timeframes. This followed concerns raised by taxpayers and their representatives that the ATO took too long to come to grips with and satisfactorily resolve these types of issues. This, they argued, caused significant uncertainty whilst operating under a self-assessment environment, and also unnecessary costs in dealing with the ATO on these types of issues.

9.2 A number of examples illustrating these concerns were provided to the IGT by stakeholders. The IGT decided to focus on three of these examples as case studies for the overall review. The three examples shared similar features of scale and complexity, and all had taken an exceedingly long time to resolve.

9.3 For each case study review, the IGT examined the timeframes taken to identify and to deal with the issues, the causes of uncertainty, the ATO's approach to the issues and the costs to the community. Reports for the three case study reviews were released as follows:

- *Review of Tax Office's management of complex issues – Case study on service entity arrangements* – (publicly released 24 April 2007)
- *Review of Tax Office's management of complex issues – Case study on living-away-from-home allowances* – (publicly released 10 May 2007)
- *Review of Tax Office's management of complex issues – Case study on research and development syndicates* – (publicly released 16 August 2007).

9.4 The implementation of the recommendations arising from these three reports has been considered earlier in chapters 4, 5 and 6 of this report.

9.5 The three reports showed that the ATO can have difficulty grappling with the interplay between complex interpretational issues, and complex internal and legal administrative frameworks in equally complex and dynamic commercial settings. The case studies also highlighted the challenges for the ATO's top management in ensuring that espoused values are maintained throughout a large, complex and culturally evolving organisation.

9.6 In responses to the case study reports, the ATO referred to measures aimed at improving timely consideration and resolution of complex issues, for example, case management leadership, aged case management, the Priority Technical Issues (PTI) process and alternative processes to the statutory dispute resolution Part IVC process. Nevertheless, the case studies showed that despite the introduced measures prolonged delays were still experienced, indicating further changes are needed.

9.7 The IGT summarised the generic issues arising from the case study reviews and worked progressively with ATO senior management to distil key areas where there was scope for improvement in the management of major, complex issues. The following four inter-related areas were identified and agreed upon:

- Timeliness – reducing the risk and consequences of delayed resolution.
- Compliance and risk management strategies – balancing efficiency and differentiation.
- ATO values and obligations in a self-assessment system.
- Communication and transparency.

9.8 A final report<sup>1</sup> (the fourth report) was then prepared to summarise the systemic issues identified in the case study reviews and to detail the improvements agreed for implementation by the ATO. The fourth report was released in August 2008 and a review of the status of implementation of recommendations arising from the report is set out below.

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1 *Report on improvements to tax administration arising from the Inspector-General's case study reviews of the Tax Office's management of major, complex issues.*



## RECOMMENDATION A

*There needs to be clear guidance for Tax Office staff and the community on what timeframes the Commissioner expects to be achieved in resolving complex issues, noting the income tax and other tax time-cycles that taxpayers must work within. Corporate time limits or performance standards need to be set for the Tax Office to conclude its view of how the law applies in respect of priority technical issues (PTIs) and other issues requiring precedential views.*

*The Tax Office agrees that there is a need for standards for the timeframes allowed to reach a considered ATO technical view of the law for all PTIs.*

*The Tax Office will implement and work to a benchmark maximum of six months for establishing the Tax Office view. If at the outset of identifying or progressing a PTI it is clear that it will take longer than six months to establish the Tax Office view, a business case will need to be made and agreed by the relevant Band 2 SES officers.*

*The Tax Office will continue to improve the current processes for PTIs and ensure that agreed timeframes (including significant milestones) are in place when those PTIs are registered. In addition, approval from the relevant Band 2 SES officers in both the Law Sub-plan and relevant Risk area will be required during the resolution of a PTI before those agreed timeframes are extended.*

*For public rulings and LAPS, the Tax Office's programs on [www.ato.gov.au](http://www.ato.gov.au) reflect the agreed delivery timeframes for those products including the issuing of drafts in the case of public rulings. The Tax Office processes governing the development of both products requires referral to and approval from the relevant Band 2 SES officer for existing timeframes to be varied.*

*The rulings program also indicates the Tax Office's 'target' timeframes for the development of taxation rulings and determinations across the different subject areas. Exceptions to these targets (for example, to allow additional consultation with industry) are advised on the program. The 'target' timeframe for a LAPS is six months from notification on the program with an additional three months allowed when public consultation is involved.*

### ATO position

Implemented

### ATO response

9.9 In relation to major, complex issues that fall within the above PTI process, there has been a reduction in timeframes which points to an increased Tax Office urgency in relation to the resolution of these PTIs. However, it is unclear whether timeframes that occur outside of this process (i.e. the identification and escalation of a major complex issues during compliance/ provision of advice activities, and the drafting and public communication of the ATO view) have reduced in a corresponding manner.

9.10 As set out within the Tax Office response to this recommendation, the Tax Office public ruling and practice statement programs on [www.ato.gov.au](http://www.ato.gov.au) set out the agreed

delivery timeframes for public rulings and practice statements. These programs also identify those rulings and practice statements that have not met these delivery timeframes and provide reasons for delays. Existing processes and timeframes continue to apply to public rulings and practice statements.

9.11 On 28 July 2008, the Chief Tax Counsel and First Assistant Commissioner Law and Practice issued a Minute outlining practice management changes to priority technical issues. These changes principally applied to priority technical issues involving advice, publications, Treasury advice preparation and addenda to public rulings. This was in recognition of the governance arrangements already in place for public rulings and practice statements and the other imperatives driving the timeliness of litigation and legislation. In addition, priority technical issues involving litigation are generally considered to have a view upon registration, with the litigation being to test or defend that view.

9.12 The Minute issued to all senior staff involved in priority technical issue work including Band 2 SES officers in the Law, Compliance and Operations sub-plans and all SES officers in the Centres of Expertise and Tax Counsel Network. The Minute set out:

- a benchmark of six months for establishing the ATO view, unless additional time is agreed to at the outset by the relevant SES Band 2 officers; and
- that approval the relevant Band 2 officer in both the law and risk areas would be required before those dates could be extended.

9.13 The practical implications of the proposed changes and how best to implement them were discussed by relevant key stakeholders including representatives of the Centres of Expertise, Tax Counsel Network, business lines / risk areas, the Tax Office's Technical Network (TechNet)<sup>2</sup> and the Priority Technical Issue and Public Rulings Branch.

9.14 The key messages in this Minute were communicated to staff via the Priorities in Focus newsletter (a quarterly newsletter prepared by the Priority Technical Issues and Public Rulings Branch within the Law sub-plan) for the September 2008 and December 2008 periods. This newsletter was emailed to SES officers in the Centre of Expertise and Tax Counsel Network as well as Priority Technical Issues co-ordinators in each Centre, Tax Counsel Network region and risk area. It was also published to the Tax Office intranet.

9.15 In implementing these improvements, the Tax Office has reviewed and updated guidance provided for staff in Practice Statement Law Administration (PS LA) PS LA 2003/10 (about the priority technical issues process) the Priority Technical Issues Process Guide (which provides detailed procedures for prioritising, approving and managing priority technical issues), the Public Rulings Manual (about the public rulings process); PS LA 1998/1 (about the practice statement process) and the Information Kit for Authors and Sponsor of Law Administration Practice Statements.

9.16 In relation to managing litigation, PS LA 2005/22 (Litigation and PTIs), PS LA 2007/12 (Conduct of Tax Office Litigation) and PS LA 2007/16 (Risk management in

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2 TechNet is a forum that focuses on improvements to and assurance of the quality of technical decision making. Technical decision making involves the interpretation and application of the laws administered by the Commissioner. Given that technical decision making is undertaken in the Law, Compliance and Operations sub-plans. TechNet membership is drawn from those sub-plans – usually at the SES or EL2 level.

litigation) provide guidance and instructions to staff in relation to the conduct of litigation including project planning (which involves setting timeframes and milestones).

9.17 The Priority Technical Issues Process Guide lists, for clarity for Tax Office staff, the categories of priority technical issue work to which the 6 month benchmark (unless otherwise agreed) does apply. This includes priority technical issues involving advice (eg private ruling, audit position paper); Treasury advice preparation; publications and Class Rulings that are escalated as priority technical issues. This encompasses the priority technical issues that involve a resolution strategy other than public ruling, practice statement, litigation or legislation.

9.18 To further assist staff in planning and managing the work involved in resolving a priority technical issue, the Tax Office has also developed a suite of pro forma project plans (or 'resolution strategies'). These set out the key steps and milestones involved in each resolution strategy, with suggested timeframes where appropriate. A resolution strategy, with key milestones, including a completion date, must be agreed before the priority technical issue is registered.

9.19 In addition, enhancements to the Priority Technical Issues Proposal (which initiates work on a technical issue) have been made, together with system enhancements to the priority technical issues Register. Enhancements to the Register include the ability to input key milestone dates and to attach project plans and other relevant documentation. This allows for better work management and for progress against milestones to be monitored.

9.20 Beyond the processes for Public Rulings, practice statements and PTIs, the Tax Office has a range of "Corporate time limits or performance standards... for the Tax Office to conclude its view of how the law applies in respect of ... other issues requiring precedential views".

9.21 For both class and product rulings, there is a clear expectation that Tax Officers will liaise regularly with applicants to discuss issues arising with each application and the expected timeframe for its completion. Timeframes vary considerably and can depend on the complexity of issues under consideration, any need for information from the applicant and the time taken to respond and, in some cases, changes to the arrangements under consideration (in some circumstances, material changes may constitute a new arrangement and so be considered a new application).

9.22 There are no externally reported service standard benchmarks for class or product rulings however the Tax Office currently reports internally against a notional benchmark similar to the one used for private rulings. For the 2008-09 and 2009-10 years, the benchmarks for private rulings were as follows:

- 80 per cent of cases to be completed within 28 days of receipt of all necessary information or within negotiated due date
- 99 per cent of cases to be completed within 90 days of receipt in the office or within negotiated due date.

9.23 This benchmark has yet to be fully tested for class and product rulings and so the internal benchmark is still described as 'notional'. In formalising an external performance standard, additional consideration for timeframes needs to account for the requirement to provide draft product and class rulings to the applicants for consent, the range of complexity of issues (e.g. escalation to a PTI would generally indicate greater complexity, and bring the

matter under PTI timeframes) and also to consider community expectations for these types of rulings.

9.24 ATOIDs do not have separate timeframes, as they are not generally considered stand-alone products, but rather are produced to provide the ATO view as part of another product, such as a position paper in an audit or a response to a private ruling request. Those processes and products are subject to corporate time limits and service standards, which also then extend to the cover the creation of an ATOID. More complex issues within an ATOID are likely to be covered by the PTI process (as similarly noted above for class or product rulings).

## **IGT Conclusion — Implemented**

9.25 In the 2008 fourth report, the IGT stated that there was a need to increase a general sense of ATO urgency for providing guidance on matters where taxpayers need to make decisions or may be making decisions that do not comply with the ATO view. The case studies on which the report was based, showed that the ATO took too long to finalise its view of how the law applied and did not recognise the impact of the delays on taxpayers who are faced with making decisions during protracted periods of uncertainty about the ATO's technical and compliance position. The case studies showed that delays also compounded the negative impact of compliance strategies, entrenched taxpayer resistance and exacerbated management complexity for the ATO.

9.26 In responding to recommendation A, the ATO only agreed that there was a need for standards for the time taken to reach an ATO view for priority technical issues (PTIs) and not otherwise. There is more discussion of the implications of this in paragraphs 9.28 to 9.39. A number of changes have been introduced to address this and these are discussed below. However, these changes do not apply outside of the PTI process. This point is noted with reference to the ATO's above response that it is unclear whether timeframes outside of the PTI process have reduced.

9.27 The resolution of a technical issue is just one of a number of stages involved with resolving a complex issue. There are activities leading up to and after the time when a technical issue is handled. For example, the identification and escalation of the issue during the compliance phase and the stage involving the drafting and public communication of the ATO view. Extended timeframes to resolve complex issues outside of the PTI process were highlighted as a key issue in the case studies that lead to the fourth report. For example, the IGT's case study on living-away-from-home allowances<sup>3</sup> (LAFHAs) revealed that over a five year period, the ATO adopted at least five different strategies to address the issues and not one of these was pursued to finality.<sup>4</sup>

## **PTI Classification**

9.28 PTIs are usually the most complex or significant technical issues based on risk to revenue or impact on confidence in the tax or superannuation system. They usually require resolution by way of formation and/or application of the ATO view of the law and most commonly are referred to the ATO's more senior technical staff. For the purposes of

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3 *Review of Tax Office's management of complex issues – Case study on living-away-from-home allowances* (2007).

4 The LAFHA case study is addressed in chapter 5 of this report.

managing PTIs, an 'ATO view' is considered to have been established once the ATO's preliminary view has been communicated to a taxpayer (e.g. where a draft public ruling is published).

9.29 At the lower end, an issue would be classified as a PTI where the ATO's risk mitigation strategy is at least 'very heavily' dependent on resolution of the issue and if left unresolved, could result in (for example) missed collections of between \$50 to \$250 million per year and at least some minor criticism of the ATO. As noted in the fourth report, complex issues usually involve a significant number or class of taxpayers, significant amounts of revenue or would attract substantial community attention. Therefore, in view of these two sets of thresholds, complex issues would generally be classified as PTIs.

### Changes to PTI timeframes

9.30 In addressing the IGT's recommendation, the ATO has limited its actions to a certain type of PTI – 'advice PTIs'. These types of PTIs involve:

- advice (private rulings and audit position papers);
- publications;
- Treasury advice preparation;
- addenda to public rulings; and
- class rulings and product rulings (that are escalated to PTIs).

9.31 In response to this recommendation, the ATO has established a corporate expectation of communicating to taxpayers the ATO's preliminary or final view in respect of 'advice PTIs' within six months of an issue being registered as a PTI.

9.32 Other types of PTIs (non-advice PTIs) are PTIs that involve public rulings (including drafts) and practice statements. For these items, the ATO referred to its existing timeframes which are:

- Draft public rulings and determinations – finalisation within six months of being notified on the ATO's rulings program.
- Final public rulings and determinations – finalisation within twelve months of being notified on the ATO's rulings program.
- Practice Statements – finalisation within six months of being notified on the program (unless external consultation is required in which case it will be nine months).

9.33 Also there are PTIs that involve litigation and legislation which do not have corporate timeframes because the ATO considers that these timeframes are dependent on matters outside of their control.

## Other precedential ATO views not captured by the PTI process

9.34 As part of fieldwork for this follow up review, the IGT investigated whether there was a timeframe or performance standard set for ATO Interpretative Decisions (ATO IDs).<sup>5</sup> The ATO did not provide any timeframe or performance standard for ATO IDs. However, under the ATO's advice framework, ATO IDs document precedential views<sup>6</sup> that officers are required to apply, unless the matter is escalated to a technical-decision maker for reconsideration.

9.35 Furthermore, the IGT notes that there are circumstances where an ATO ID can have significant impact on the tax administration system either because of the revenue implications (not just for taxpayers but also for the government) and/or because of the numbers of taxpayers involved. This situation is exacerbated where there is no other ATO guidance available on the technical issue in question. Therefore the IGT remains of the view that a timeframe expectation in line with this recommendation should be set by the ATO.

9.36 The IGT also reviewed how the ATO had set time limits for tax officers to conclude the ATO view for class and product rulings that are not escalated to a PTI. The ATO advised IGT that a set timeframe for these two products has yet to be established.

## Clear guidance on timeframes

9.37 As discussed above, following the IGT's fourth report the ATO established a six month benchmark for 'advice PTIs' and communicated this to staff. Furthermore, a suite of pro forma project plans and enhancements of the ATO's PTI systems and documents, which are discussed in recommendation C, ensures that tax officers are aware of timeframes and performance standards.

9.38 For PTIs involving public rulings, determinations and practice statements, the ATO makes available the expected timeframes for tax officers via internal instructional guides and for taxpayers via the ATO website. However for taxpayers, there is a bit of work involved in locating the relevant information on the ATO website. For example, in relation to public rulings (including drafts), taxpayers are required to locate a public rulings program spreadsheet and then browse through the spreadsheet to determine the performance standards for these products. Similarly for practice statements, taxpayers are required to locate the program and then identify the paragraph specifying the timeframe.

9.39 In relation to other precedential ATO views not captured by the PTI process, a timeframe has not been set for ATO IDs or for class and product rulings not escalated to a PTI.

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5 An ATO ID is a summary of a decision on an interpretative issue and is indicative of the Commissioner's view on the interpretation of the law on that particular issue. ATO IDs are produced to assist tax officers to apply the law consistently and accurately to particular factual situations.

6 ATO IDs are listed in the ATO's instructional guide for staff as a precedential document (paragraph 3 of PS LA 2003/3 *Precedential ATO View*)

## Summary

9.40 The ATO's agreement to the IGT's recommendation was limited to PTIs.

9.41 The ATO has introduced some welcomed changes to the PTI process in line with what it had agreed to implement. For example, the setting of a six-month corporate expectation for communicating the ATO's preliminary or final view to taxpayers in respect of 'advice PTIs' and the introduction of project plans for all PTIs to ensure that staff are aware of the timeframes for PTIs.

9.42 The IGT concludes that the ATO's agreed changes are implemented. However as demonstrated by the extended timeframes involved with the resolution of the complex issues in the case studies that lead to the fourth report, the IGT remains of the view that change should also be introduced outside of the PTI process.

9.43 Also as discussed earlier, the absence of a timeframe or performance standard for ATO IDs and for class and product rulings not captured by the PTI process should be addressed.

## RECOMMENDATION B

*Ways to increase early top management awareness and hands on management of complex issues that are unresolved for unreasonable periods of time need to be developed. Circuit-breakers are needed to cut across processes and procedures where they are not leading to the timely establishment of the Tax Office technical view.*

*The Priority Technical Issues Committee (PTIC) process, under the leadership of the Chief Tax Counsel, regularly monitors the progress of all PTIs and governance of the PTI process.*

*The Tax Office has now introduced a '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.*

*The intervention is by the relevant existing SES Band 2 officers in both the Law Sub-plan and Risk areas, such as a Deputy Chief Tax Counsel, or the Chief Tax Counsel and the Deputy Commissioner responsible for the issue as part of the PTIC process which meets every six to eight weeks. If necessary/appropriate, issues can be further escalated to the relevant Second Commissioners.*

## ATO position

Implemented

## ATO response

9.44 As noted at the time of the report, the Tax Office has introduced a 'top down' intervention mechanism in the management of major/complex issues, including priority technical issues. Under the leadership of the Chief Tax Counsel and Deputy Chief Tax Counsel, and through the Priority Technical Issues Committee (PTIC) priority technical issues, including governance arrangements are regularly monitored.



9.45 PTIC meets every 6 to 8 weeks and is attended by senior officers from Law and Practice and Compliance, including the Senior Assistant Commissioner Centres of Expertise, all Deputy Chief Tax Counsel, the Chief Tax Counsel as well as the Second Commissioner Law and at least one Band 2 officer representing the Compliance and Operations sub-plans.

9.46 The Committee reviews all issues aged over 4 months without an ATO view, giving particular attention to those issues that appear to have stalled and require intervention. Where a strategy is not agreed at the meeting, a member of the Committee is assigned to follow up on that issue and report back to the Committee. This process acts as a circuit breaker for issues that are not being resolved in a timely manner. Prior to the meeting, individual areas, such as the Centres of Expertise and the respective risk areas, may undertake separate call-overs of issues.

9.47 The Tax Office Minute of 28 July 2008 referred to above, outlines escalation processes for issues at risk of not meeting key milestones. The Minute outlined that two months before the Tax Office view planned date, the PTI and Public Rulings Branch would contact staff involved in resolving those issues seeking confirmation that due date would be met. The Minute also stated that if it was apparent the milestone could not be met, the officers working on the issue would be required to escalate the issue to the relevant Band 2 officers, advising how the issue would be resolved and specifying a revised date. Given existing approval and escalation processes for rulings and practice statements, this process was implemented for those priority technical issues to be resolved by way of advice, a publication other than a public ruling or practice statement, advice to Treasury and addenda to public rulings.

9.48 One such exercise has been undertaken, complemented and supplemented by the PTIC process. The outcome was that strategies were agreed to bring the matters to completion. These processes will continue to be run in parallel with PTIC assisting in identifying strategies for resolving issues and any other escalation that is necessary. PTIC has SES Band 2 membership from Compliance so that individual PTIs that are slipping on the program can be and are discussed at the meeting. Through PTIC, opportunities for improvement continue to be explored. Transfer of the priority technical issues to Siebel is also expected to deliver the opportunity for further business improvements.

*Data in relation to improvement in figures since implementing these improvements:*

9.49 As at 30 June 2008, there were 60 priority technical issues without an ATO view.<sup>7</sup> Of these, 26 were aged over 6 months, 3 of which were aged over 24 months. There were 4 issues with advice as a resolution strategy (1 of which involved a priority private binding ruling) and aged between 4–6 months. In addition, a further 4 were in the 7–12 month category, 1 was aged 13–24 months and 2 were aged over 24 months.

9.50 As at 30 June 2009, there were 48 technical issues without an ATO view.<sup>8</sup> Of these, 20 were aged over 6 months; there were no issues aged over 24 months. There were 5 issues with advice as a resolution strategy and aged between 4-6 months. A further 5 (2 of which involve priority private binding rulings) were in the 7-12 month category and a further 1 was aged 13-24 months. PTIC is continuing to monitor all of these issues.

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7 At June 2008, total priority technical issues on hand was 192.

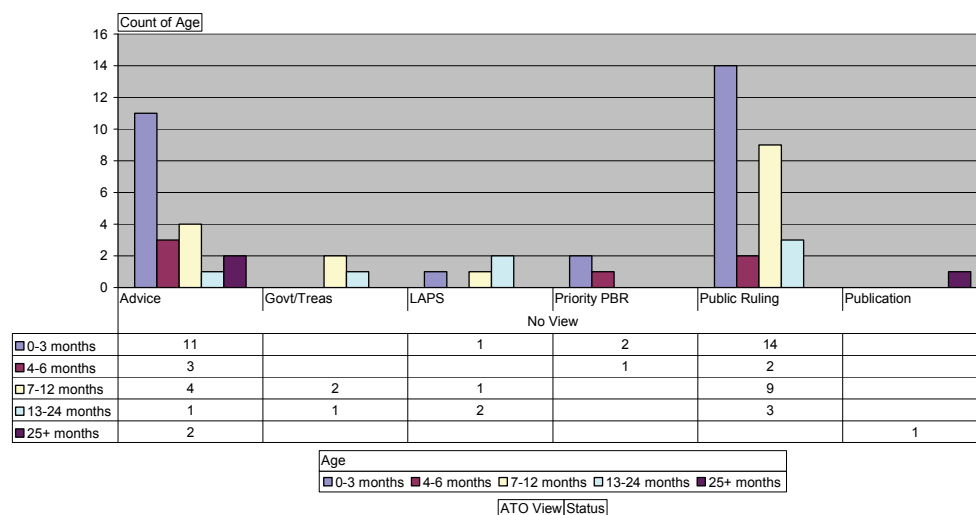
8 At June 2009, total priority technical issues on hand was 172.



9.51 Graphs showing the resolution types at 30 June 2008 and 2008 and the age profile for those PTIs are attached.

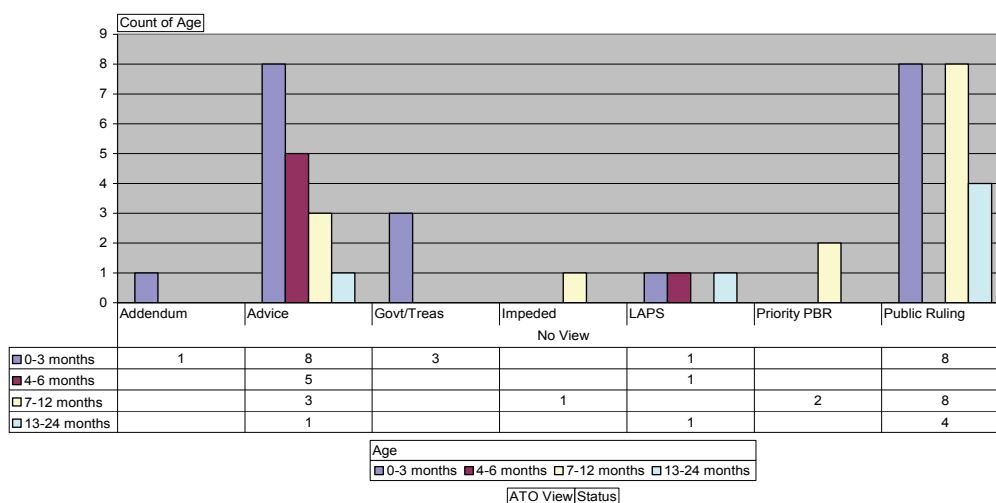
### PTIs with no ATO View by Age and Status (as at 30 June 2008)

Current PTIs with no ATO View by Age and Status @ 30 June 2008



### PTIs with No ATO View by Age and Status (as at 30 June 2009)

Age by No View and Status @ 30 June 2009



9.52 Note — in 2009, the Tax Office added a work type of 'Addendum' separate to 'public ruling' to separately identify those priority technical issues that involved amendments to an existing ruling from new rulings. Priority technical issues that are 'impeded' are those where resolution of the issue cannot move forward for reasons outside Tax Office control such as where it is the subject of a review by the Board of Taxation.

## IGT Conclusion — Implemented

9.53 As discussed in IGT's 2008 fourth report, the reason for this recommendation was to reduce ATO delay in the resolution of complex issues through increasing senior management's awareness and involvement. The case studies, on which the report was based, demonstrated that resolution is faster when very senior managers become directly involved. This suggested that strong disciplines were required to guarantee early intervention at top management levels where resolution is not being achieved within expected timeframes.

9.54 In response to the recommendation, the ATO has introduced a series of processes and procedures to promote earlier awareness, and in turn hands on management, of matters affecting the resolution of PTIs. The IGT observed the appropriate application of these changes in the PTI cases reviewed during fieldwork and a summary of the introduced changes is provided below.

9.55 However, as in key recommendation A, these changes do not apply to the activities involved with the resolution of a complex issue which fall outside of the PTI process. In addressing the implementation of what the ATO agreed for this recommendation, the IGT is limited to a consideration of change to the PTI process.

### Changes to the management of the PTI process

9.56 The first key change (discussed in detail in recommendation C<sup>9</sup>) has been the introduction of a suite of project or resolution plan templates<sup>10</sup> which specify the proposed activities and target dates for a PTI case. These plans are created and submitted to ATO executives<sup>11</sup> when a request is initially made for a matter to be classified as a PTI. The introduction of these plans has provided ATO executives with a reference point to use when undertaking a number of the below mentioned activities.

9.57 Also at the time of registration of a PTI, Senior Executive Service (SES) Band 2 officer approval is now required where it is apparent that the six-month timeframe to reach the ATO view will not be met. Senior ATO executives therefore have up-front knowledge of these cases and have the discretion to approve or not approve registration as a PTI.

9.58 The project or resolution plan must be regularly<sup>12</sup> reviewed by the ATO's PTI and Public Rulings Branch (PTIPRB) which manages the operation of the PTI process (and on a monthly basis by PTI case officers). Where at any review point it is apparent that a milestone will be missed, requiring a change to the expected completion date, the relevant ATO executive<sup>13</sup> must be provided with an explanation and a revised resolution schedule for the completion of the case. Their approval to extend the key milestone and completion dates must be obtained.<sup>14</sup>

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9 See paragraph 9.104.

10 Referred to by the ATO as 'resolution schedules'. No update was made to the project management approach of the ATO for litigation matters.

11 Two officers at the SES Band 2 level.

12 PS LA 2003/10 *Management of Priority Technical Issues* (at paragraph 27).

13 At the SES Band 2 level.

14 PS LA 2003/10 (at paragraph 28).

9.59 The second key change has been the introduction of quarterly ‘call overs’ enabling the SES executive in charge of a business line (BSL) to review the progress of a PTI case and to be updated regarding any difficulties. Reports from these call overs are referred to the ATO’s PTIPRB. The information contained in these reports is then included in the report used by the ATO’s Priority Technical Issues Committee (PTIC).<sup>15</sup>

9.60 The third change to improve top management awareness has been the introduction of a briefing now provided to the ATO’s Chief Tax Counsel (CTC) prior to each PTIC meeting by the committee’s convenor. This briefing outlines the PTI cases to be reviewed in an upcoming PTIC meeting and provides the CTC with early awareness of cases experiencing difficulties. The CTC then initiates follow up action prior to the PTIC meeting.

9.61 A further change introduced involves PTIPRB staff contacting case officers ten days prior to a PTIC meeting for an update on any PTI they are working on ‘without an ATO view’.<sup>16</sup> This enables a further update to be provided to the CTC prior to the PTIC meeting. In addition, PTIPRB also runs a final report<sup>17</sup> a few days before the PTIC meeting as a final check and update for the CTC.

9.62 Where there is disagreement amongst PTIC members during a meeting over a proposed strategy for the handling of a delayed PTI, the matter is now assigned for follow up by a member and a report is subsequently provided to the committee. This procedure has been introduced following IGT’s fourth report as an additional action point to address delayed PTIs.

9.63 A strategic ‘call over’ is now also held twice a year to review the progress of PTIs and to oversee a re-evaluation of the priorities of the PTI process in consideration of changing BSL risk management strategies. These sessions are chaired by the Second Commissioner (Law).

9.64 For ‘advice PTIs’<sup>18</sup>, a new circuit-breaker process has been introduced whereby a PTI case officer (and his or her manager) is contacted by the PTIPRB two months before the due date for finalisation of the ATO view. Where the case officer is unable to confirm that it will be finalised on time, the officer must escalate the matter, together with recommended strategies, to an SES Band 2 officer to review. If an extension is granted, the SES Band 2 officer is required to set review points within the revised time schedule and these are to be monitored by both the case officer’s manager and by the PTIPRB.

9.65 As indicated in the ATO’s response, the ATO’s procedural guide and practice statement<sup>19</sup> relating to PTIs have been updated to refer to the changes identified in recommendation B and to emphasise for staff the importance of actively managing to effect

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15 As outlined in the ATO’s response to recommendation A, PTIC meets every six to eight weeks and is a committee attended by the Second Commissioner (Law), the Chief Tax Counsel and other senior ATO executives to review all issues aged over 4 months without an ATO view, giving particular attention to those issues that appear to have stalled and require intervention.

16 ATO view is discussed in paragraph 9.23 of recommendation A.

17 Using the ATO’s Siebel case recording system.

18 See paragraph 9.30. The two new processes for ‘advice PTIs’ have been included in the ATO’s internal PTI procedural guide (paragraphs 7.1.1 and 7.1.3 of the *PTI Process Guide*) and also in the ATO’s practice statement relating to the management of PTIs (paragraph 28 of PS LA 2003/10).

19 PS LA 2003/10.

the timely resolution of PTI cases.<sup>20</sup> Enhancements to ATO systems have also been made enabling more detailed recording of updates for each PTI case. This in turn has provided tax officers with more readily available information regarding a PTI case.

9.66 For PTIs involving litigation, the ATO considers that the strategic internal litigation committee (SILC) process<sup>21</sup> (discussed in recommendation F) provides sufficient senior management awareness. Timeframes for these types of PTIs are not always within the control of the ATO and are dependant on the Court and Tribunal process.

9.67 ATO executives are kept aware of the status of PTIs over four months without an ATO view by reference to the report used for PTIC meetings. Detail regarding these cases, including the numbers of cases involved, are reported monthly to the Law and Practice Executive and on a twice-yearly basis to the ATO's executive committee<sup>22</sup> responsible for monitoring office-wide performance.

9.68 The ATO's annual report specifies the numbers of PTIs finalised during the year and also the proportion of aged PTIs (i.e. past the six-month timeframe) without an ATO view compared with the total number of PTIs. The following figures indicate a steady reduction in the number of aged PTI cases 'without an ATO view'<sup>23</sup>:

- 50 of 236 PTIs on hand (21 per cent) at 30 June 2007;
- 26 of 192 (14 per cent) at 30 June 2008; and
- 20 of 172 (12 per cent) at 30 June 2009.

## Summary

9.69 The above results suggest that the changes in ATO process and procedure have brought additional urgency to the resolution of PTIs. As outlined above, the ATO has employed significant effort to bring about change to the PTI process as it agreed to do for this recommendation.

9.70 The IGT concludes that the ATO's agreed changes are implemented. However, as demonstrated by the extended timeframes involved with the resolution of complex issues in the case studies that lead to the fourth report, the IGT remains of the view that change should also be introduced to increase top-down management and intervention for activities involved with the resolution of complex issues outside of the PTI process.

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20 Staff were also made aware of these changes via ATO Minute *PTIs and practice management* (28 July 2008)

21 The SILC process involves a number of strategic litigation meetings held between ATO staff involved with the litigation.

22 The ATO's Plenary Governance Forum.

23 These figures are reported in the ATO's 2008 and 2009 annual reports. The charts provided by the ATO in response to this recommendation cover all PTIs without an ATO view in the 2008 and 2009 financial years. In respect of these charts, it is noted that although the proportion of aged PTIs without an ATO view has slightly decreased between these two periods, the proportion of aged 'advice' PTIs without an ATO view has slightly increased. However, care must be taken with this last point as aged 'advice' PTIs without an ATO view represent less than half of all PTIs without an ATO view.

## RECOMMENDATION C

*To assist management of the events that are critical to timely resolution of complex issues, the Tax Office should improve project management capability for large complex issues, and introduce initiatives to ensure that compliance actions are fair and based on a contemporary appraisal of the factors that have led to the issue.*

*Improving project management capability is important to the Tax Office. Project plans are required for the resolution of all PTIs. In addition to the PTI Committee process mentioned under 'Area B' above, there are regular call-overs to monitor progress of resolution of PTIs against project plans.*

*In addition to improvements to assist officers in their planning for the development and delivery of public rulings and LAPS, the Tax Office is developing further assistance for officers in both the Law Sub-plan and the relevant Risk areas to improve the management and timeliness of resolution of PTIs. The main assistance is aimed at improving their project management capability by providing assistance with project plans that must be completed on registration of a PTI. Achievements against these plans are subsequently monitored through the PTIC and related call over processes to ensure milestones are met. Where there is risk that a significant milestone will not be met, the SES Band 2 officers will intervene as outlined above.*

*Risk owners for major compliance activities will ensure that:*

- adequate field work is undertaken to identify the issue and differentiate categories of taxpayers' circumstances;*
- direct communication takes place with affected taxpayers and/or their advisers;*
- regular reappraisal is made of compliance and revenue risk and costs, and*
- the quality of information provided to taxpayers to help them meet their obligations is tested before a compliance strategy is designed and commenced.*

### ATO position

Implemented

### ATO response

#### ***(1) Improving project management capability for PTIs***

9.71 Following the issue of the Tax Office Minute on 28 July 2008 referred to above, PS LA 2003/10 and the Priority Technical Issues Process Guide was also updated to set out the new policy and processes including:

- Emphasising the need for better project management of priority technical issues, including the need for clear and agreed timeframes; and

- Specifying escalation processes so that where there is a risk that a significant milestone will not be met, the relevant SES Band 2 officers will intervene.

9.72 See in particular, paragraphs 10, 26 to 28, 35 and 40 of PS LA 2003/10 and the Priority Technical Issues Process Guide (paragraphs 4, 6.3.2 to 6.3.4, 7.1 to 7.1.4).

9.73 To further assist staff in planning and managing the work involved in resolving a priority technical issue, the Tax Office developed a suite of proforma project plans (or 'resolution strategies'). These set out the key steps and milestones involved in each resolution strategy, with indicative timeframes where appropriate. A resolution strategy, with key milestones, including a completion date, must be agreed before the priority technical issue is registered. Staff are required to consider any additional activities they will need to undertake and the amount of time that will be needed to complete each activity.

9.74 These proforma resolution strategies are available to staff via the priority technical issues intranet site. Staff were made aware of these via the Priorities in Focus newsletter (for September 2008 and December 2008). Links to these schedules are also included in the PTI proposal form and on the public rulings and practice statement web pages; the Public Rulings Manual; the PTI Process Guide; and in the Information Kit for authors and sponsors of practice statements.

9.75 In addition, enhancements to the Priority Technical Issues Proposal (which initiates work on a technical issue) have been made, together with system enhancements to the priority technical issues register. Enhancements to the Register include the ability to input additional key milestone dates and to attach project plans and other relevant documentation. This allows for better work management and monitoring of progress against milestones. Reports, including those of aged priority technical issues provided to the PTIC, have been enhanced to include data from these additional fields.

9.76 These improvements have been embedded into the design for priority technical issues, public rulings and practice statements in the new Siebel environment.

***(2) Initiatives to ensure that compliance actions are fair and based on a contemporary appraisal – context and initiatives***

9.77 The elements of this accepted IGoT recommendation are now embedded as published policy within Tax Office work processes and that policy duly states the risk owner expectations as agreed. It is available to staff through the Tax Office intranet.

9.78 Furthermore, the Tax Office plan is to also publish these risk owner expectations (and others) by 30 June 2010. This information to be published as Tax Office-wide Risk Management Instructions for Enterprise Risk Owners will be available to staff through the intranet.

9.79 They are issued under the Risk & Issues Management Corporate Management Practice Statement PS CM 2003/02 which has been refreshed this year.

9.80 Assurance of conformance with this practice statement for risk management will be provided through an annual Certificate of Assurance by the Chief Knowledge Officer (Corporate Governance – Risk Management).

9.81 The Chief Knowledge Officer may include sub-assurance questionnaires specifying criteria compliance with this practice statement to be completed by Business Service Lines in respect of risk management.

*Other implementation activities and context:*

9.82 The Tax Office has undertaken a stock take of risk management activities undertaken within key external forums such as National Tax Liaison Group (NTLG)<sup>24</sup> sub-committees and practitioner forums.

9.83 This was a focus because the Tax Office needed assurance that the most significant risk activities were being discussed with relevant external stakeholders for their feedback, input and awareness.

9.84 In particular, this check was felt necessary for the Tax Office to identify risk issues and differentiate categories of taxpayer circumstances through discussion with key external stakeholders. Furthermore, these forums are used to ensure the Tax Office can help taxpayers to meet their obligations through providing the right level of information.

9.85 These forum discussions are important because direct communication and community input from taxpayers and key advisers informs broader ATO compliance strategies which assists in achieving high levels of voluntary compliance. Taxpayer audits are only one element of ATO strategies.

9.86 Where this stock take noted that there were gaps, they were not significant.

9.87 Significant complex product risks across the Tax Office are managed by the product committees such as the Income Tax Steering Committee which endorse risks and compliance strategies with input from risk owners as part of an annual HOTSA (Health of the System Analysis) process. These product committees have membership across the ATO including senior executive officers from Compliance, Law and Operations.

9.88 Within Compliance sub-plan, the detailed strategies are developed and managed at a product, market and special focus area (e.g. ATP, SNC) level. The governance and management arrangements require regular reassessment and monitoring of risks to test assumptions, evaluate effectiveness of treatment strategies and to identify where risks have changed. The outcomes of these reviews and the deliberations of these committees are reflected in the relevant risk registers, the formulation of our Compliance Program and specific treatment strategies.

9.89 Many significant risks are mature and are not new such as non-disclosure of capital gains. This means that our risk management processes for many of our on-going risks would not require anything new as a result of this IGoT recommendation. This is because we continue to work with key external stakeholders and re-appraise our risk strategies.

9.90 The development of new strategies is undertaken in collaboration with businesses and their intermediaries and is guided by the recently published "Developing effective compliance strategies" [NAT 72788-11.2009]. In particular, there is a section in that

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24 The NTLG is the peak consultative forum dealing with complex technical and policy issues between the tax, accounting and legal professions and the Tax Office, and its sub-committees.

publication on “Engagement – consultation, collaboration and co-design”. The forums mentioned later in this response are utilised extensively for this purpose.

9.91 Furthermore, at a detailed level, SES risk owners manage a technical risk by reference to the PTI practice statement, PSLA 2003/10, which states a number of risk owner responsibilities, including the regular review of risk levels. These responsibilities are:

*Responsibilities of SES risk owners and risk contact*

The SES Risk Owner, together with the nominated Risk Contact who reports to them, is responsible for:

- managing the overall mitigation strategy (or project, should one exist, of which resolution of the PTI is a part) for the relevant risk including, for example, Taxpayer Alerts, call centre scripts, communication strategies, systems requirements, follow up compliance strategies, advice to Government
- ensuring that the risk associated with the PTI is recorded and maintained on the ATO or business line Risk Register where relevant
- together with the PTI Owner regularly reviewing the level of risk and the importance of resolving the PTI, and therefore the priority level of the PTI
- advising the PTI Owner of any new intelligence, changes to the importance of resolution of the technical issue to the risk mitigation strategy or changes to the rating of the associated risk
- ensuring that the PTI Owner is given every assistance in resolving the technical issue
- liaising with the PTI Owner and stakeholders in articulating the technical issue and ensuring the resolution strategy deals appropriately with the business risks
- together with the PTI Owner and PTI SES, developing a plan for resolving the PTI, including the establishment of milestones and deadlines and the conduct of a consultative process
- in consultation with the PTI Owner, engaging as early as possible all relevant stakeholders including other business lines and areas such as Aggressive Tax Planning, International Strategy & Operations, Governance and Government Relations, Law & Practice, Goods and Services Tax or parties external to the Tax Office (including consultative processes as necessary)
- regularly reviewing progress of resolution of the technical issue (with the PTI Owner, PTI SES and stakeholders) to ensure that milestones and deadlines are being met and/or updated
- together with the PTI Owner, escalating changes to key milestone dates and completion dates to relevant DCTC or DC of the owning business line for approval
- ensuring that any related cases are maintained and managed in the appropriate case management systems and finalised once the technical issue is resolved, and



- determining any residual risk and evaluating the risk mitigation strategy on completion.

9.92 When a new risk emerges, the first response from the Tax Office is not to undertake extensive audit activity. Where appropriate, it may undertake limited review fieldwork with a number of taxpayers to understand if a risk exists and to assist with assessing the prevalence and size of the risk.

9.93 If a risk does exist the ATO assigns a risk owner and develop a comprehensive risk management strategy for complex risks. Necessarily, this work involves an appraisal of the risk drivers and the basis of the technical positions adopted which may be confirmed through our liaison with key stakeholders in the external forums mentioned above.

9.94 In some cases, the ATO risk management strategy has been to simply clarify the law through a tax ruling or determination. The strategy may take other paths.

9.95 For example, when new aggressive tax planning arrangements emerge, the Tax Office issues tax alerts and as possible, it then follow up the relevant taxpayers with correspondence explaining its views and giving those taxpayers and opportunity to make a voluntary disclosure. In particular, this activity demonstrates direct communication by the ATO with taxpayers and/or their advisers as required by the recommendation.

9.96 Division 7A is another risk topic where the Tax Office adopted an enquiring approach [instead of an intensive audit program], followed by law changes and clarification of the law. Throughout this process the ATO worked with the relevant tax professionals through key ATO external forums with the impact not being an audit program but a measured improvement in voluntary compliance which is now evident through ATO Compliance Effectiveness work.

9.97 ATO risk activities on Division 7A illustrates implementation of this agreed recommendation. In particular, the ATO has re-appraised the risk through our Compliance Effectiveness framework. That framework is the ATO process for appraising risk assumptions and risk ratings. ATO work on this risk also demonstrates the testing of the quality of information provided to taxpayers to help meet their obligations.

9.98 Another significant example of this recommendation in action is in GST where through the ATO's refund integrity work, a significant Section 13 risk emerged where some taxpayers took a view of the GST rules which became a risk and required clarification. The Tax Office communicated early and consistently with all relevant taxpayers and their advisers on this GST risk and as a result, fully appraised the risk. This action resulted in an efficient and effective way of managing the risk early preventing significant audit activity.

9.99 Importantly, all activities required by this recommendation are evidenced by our work on this GST risk. Our work on this risk particular demonstrates our testing of the quality of information provided to taxpayers to help meet their obligations.

9.100 Our approach to the management of risk associated with trusts is consistent with this recommendation. The ATO had long been concerned about the significant interpretational and administrative difficulties relating to the taxation of trusts. Rather than conduct a program of audits enforcing our views, the ATO committed to funding various issues before the Courts.

9.101 In the most recent example, we funded the Bamford test case to the High Court. Pending resolution we issued Practice Statement PS LA 2009/7 centralising the coordination of all trust case work involving the assessment of the net income of a trust, to ensure a consistent approach. The Practice Statement instructed staff to only take active compliance action to apply the Commissioner's (then) view in any particular case where there had been a deliberate attempt to exploit the operation of the trust assessing provisions or where there was a dispute involving the trust for some other reason. The tax profession were consulted regularly through this process.

9.102 In relation to the wider management of the trust risk, the ATO has established a Trusts Steering Committee (TSC) to ensure that we deliver co-ordinated whole-of-ATO responses.

9.103 The Tax Office position is that any noting of agreed risk owner expectations in the Siebel work processes is only there to prompt tax officers and has not been held out to give complete assurances that risks will be managed as agreed with IGoT. Assurances come from amongst other things: continuing to work with key external stakeholders, complying with the PTI PSLA risk owner requirements, case appraisal and quality assurance processes, ongoing effectiveness reviews and management of our complex risks through accountable Tax Office committees which oversight the work of risk owners.

## **IGT Conclusion**

### ***Part i) - Implemented***

9.104 The IGT's fourth report stated that changes to reduce the risk of delayed resolution were needed to assist the management of the critical path events generic to complex issues. Generic events were said to include early identification; establishing and communicating robust technical views; and sound approaches to confirming risks and behaviours. Others might involve selecting a number of test cases and going through the objection, review and appeal processes, or it may be by seeking declaratory proceedings while the matters are still at the audit stage. These critical path events might also provide a good framework for considering ways of achieving improvements in other agreed areas including communication.

9.105 In responding to the IGT's report, the ATO referred to measures aimed at improving timely consideration and resolution of complex issues. These measures included case management leadership, aged case management, the PTI process and alternative processes to the statutory dispute resolution Part IVC process. However, the case studies showed that despite the introduced measures, prolonged delays were still experienced, indicating that further change was needed. The first part of recommendation C was directed at this by seeking improvement to the ATO's project management of complex issues.

9.106 As in recommendations A and B, the ATO's response to the first part of recommendation C has been directed towards the changes it agreed to implement in the management of PTIs.

9.107 Firstly, the ATO has introduced a suite of project plan templates<sup>25</sup> to assist staff meet key milestones and to manage the various types of PTIs. These plans are submitted with the

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25 Referred to by the ATO as 'resolution schedules'. No update was made to the project management approach of the ATO for litigation matters.

initial PTI proposal and are therefore considered for approval by at least two senior ATO executives.<sup>26</sup> The project plans specify the proposed activities and target dates for the PTI. The plans must be regularly<sup>27</sup> reviewed by the PTIPRB (and also reviewed on a monthly basis by PTI case officers). Where at any review point it is apparent that a milestone will be missed, requiring a change to the expected completion date, the relevant ATO executive<sup>28</sup> must be provided with an explanation and a revised resolution schedule. Their approval is required before any extension of key milestone or completion dates is allowed.<sup>29</sup>

9.108 A number of the changes discussed in recommendation B, including the introduction of quarterly 'call overs' enabling BSL SES officers to review the progress of PTIs and to address issues causing delay, also contribute to the more effective project management of PTIs.

9.109 The IGT observed the appropriate application of the above mentioned changes in the PTI cases reviewed during fieldwork.

9.110 As indicated in the ATO response, the procedural guide and practice statement<sup>30</sup> relating to PTIs have been updated to refer to the changes identified in recommendation C and to in turn emphasise to ATO staff the importance of actively managing to effect the timely resolution of PTI cases.<sup>31</sup> To assist the introduction and operation of the project plans, the ATO also made a number of enhancements<sup>32</sup> to the PTI proposal, the PTI register and to associated systems.

9.111 In summary, the ATO's agreement to the IGT's recommendation was limited to PTIs.

9.112 The ATO has introduced changes to assist in the project management of PTIs which is in line with what it had agreed to implement. For example, the introduction of new project plans that are submitted for approval by senior ATO executives at the start of the PTI process.

9.113 The IGT concludes that the ATO's agreed changes are implemented. However, as evident with the extended timeframes involved with the resolution of complex issues in the case studies that lead to the fourth report, the IGT remains of the view that change should be introduced outside of the PTI process.<sup>33</sup>

### *Part ii) - Implemented*

9.114 The IGT's 2008 report stated that there was a danger that leveraged compliance approaches used by the ATO may inadequately differentiate between the types of taxpayers involved or may be based on inadequate fieldwork to confirm and distinguish taxpayer

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26 At the SES Band 2 officer level.

27 PS LA 2003/10 *Management of Priority Technical Issues* (at paragraph 27).

28 At the SES Band 2 level.

29 PS LA 2003/10 *Management of Priority Technical Issues* (paragraphs 27 and 28).

30 PS LA 2003/10 *Management of Priority Technical Issues*.

31 Staff were also made aware of these changes via ATO Minute *PTIs and practice management* (28 July 2008).

32 For example, enabling the project plans to be attached as a link to PTI proposals.

33 As discussed in recommendation A, the resolution of complex issues involves a number of stages and corresponding activities and the case studies that lead to the IGT's fourth report revealed extended delays in the completion of these stages.

behaviours. Lead cases may be selected initially for examination by the ATO to understand potential tax risks and their scope and can aid in understanding the relevant technical issues. This initial activity can inform and strengthen ATO compliance risk mitigation strategies and views of the law, without being representative of the full range of cases where different circumstances or legal interpretations may exist.

9.115 The IGT found that risk assessments of emerging major issues may not be borne out by field appraisals and subsequent experience. The IGT also found that the risk of this type of approach was at its highest where the scale of a compliance issue, and the potential effort required to address it, causes the ATO to look for a highly leveraged 'silver bullet' strategy, including the potential for applying anti-avoidance provisions.

9.116 The IGT's fourth report stated that there was a need for the ATO to introduce initiatives to ensure that an appropriate balance is struck between administrative efficiency and the need to recognise individual circumstances. There was also a need that risk assessments of major compliance issues be regularly updated to ensure that compliance action is in proportion to the monetary and non-monetary costs and benefits, and relative to other compliance risks.

9.117 The IGT also recommended that the quality of information provided to taxpayers to help meet their obligations be tested before the design of a compliance strategy. This was considered necessary to ensure that appropriate information be made available to taxpayers operating in a self assessment environment *before* the launching of a compliance strategy.

9.118 A further point arising from the case studies leading to the IGT's fourth report was the need for the ATO compliance strategies to feature direct and early communication with taxpayers potentially affected by a compliance concern.

9.119 The IGT notes that the ATO communicates with taxpayers directly through a variety of methods, including through the issue of taxpayer alerts. Furthermore, the IGT notes that the ATO discusses its compliance tax risks and strategies with tax agents and tax professionals at a myriad of ATO forums including NTLG sub-committee meetings.

9.120 During fieldwork conducted for the follow up review, the IGT identified circumstances where tailored communication has been provided to groups of taxpayers involved in arrangements. In addition, during the course of this review the ATO provided IGT with examples demonstrating its efforts to communicate early and directly with taxpayers and tax agents regarding complex tax risks where those taxpayers with tax risks could be identified. The issue of alerting taxpayers to compliance concerns as and when they arise is considered more fully in the IGT's *Review into delayed or changed ATO views on significant issues*.

9.121 In August 2009, the ATO issued guidelines to staff through its intranet setting out the additional agreed requirements arising from this IGT recommendation, including the need for improved project management capability for the handling of large complex issues. In March 2010, this internal guideline was updated to reflect a similar recommendation contained in the IGT's *Review into aspects of the Tax Office's settlement of active compliance activities* (namely recommendation 13).

9.122 The ATO guidelines apply to risk owners managing major compliance activities and major complex issues including those with multiple taxpayer or 'leveraged' active compliance cases.

9.123 The ATO has advised IGT that the oversight of major complex issues rests with product committees for income tax, GST, Excise, Superannuation and has been in place for some time (led by SES Band 2 officers). The ATO advised IGT that these committees conduct on-going reviews of the risks with risk owners, review strategies to manage risks and also assess compliance effectiveness.

9.124 The ATO is now in the final stages of publishing<sup>34</sup> its newly approved Risk Management Instruction to ensure that the agreed requirements set out in the above mentioned guidelines<sup>35</sup> are met. Assurance is to be achieved by assigning SES Band 2 level officers with accountability and sign-off that the minimum requirements relating to the effective management of risk categories, including the handling of complex issues, is complete.

9.125 The ATO's *Risk and Issues Management* corporate practice statement<sup>36</sup> has been updated to incorporate the introduction of the above mentioned corporate instruction. In particular, reference is made to the new responsibilities held by SES Band 2 officers and to the requirement that they provide evidence to the ATO's Chief Knowledge Office (CKO) regarding their adherence to the corporate instruction. The practice statement notes that the CKO is responsible for providing assurance of conformance and also for actioning non-conformance. The CKO is also required to provide an annual Risk Management Certificate of Assurance. The practice statement states that ongoing monitoring and analysis to ensure that issues are being effectively identified, recorded, managed and escalated in the ATO is to be undertaken by a First Assistant Commissioner.

9.126 At a higher level, the ATO Audit Committee oversees internal governance and assurance policy to monitor and evaluate internal controls (such as risk management) to support the ATO's Integrity Framework.

9.127 Given that these changes are yet to be finalised, IGT is currently unable to test their application and effect in terms of the recommendation. However, the IGT recognises the changes being made by the ATO and the work it has undertaken in response to the recommendation. For example, the introduction of guidelines for staff in August 2009 which has now been reinforced through the Risk Management Certificate of Assurance process. The IGT considers that for the purposes of this review this part of the recommendation is implemented providing the process is effected in the manner envisaged above.

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34 To be published by 30 June 2010.

35 Issued in August 2009.

36 PS CM 2003/2.

## RECOMMENDATION D

*More needs to be done to reduce the time taken to identify and progress test or lead cases including increasing Tax Office efforts to identify a suitable lead case on an issue, and offering inducements encouraging taxpayers to come forward.*

*The Tax office is committed to clarifying the law through litigation of contentious areas of the law. Our test case litigation program is designed to do this. As well as considering applications for test case funding from taxpayers, we will continue to proactively seek significant or contentious lead cases and, because of the public interest in having the law clarified, fund them as part of our test case program. This will include:*

- generally offering test case funding where the Commissioner appeals against an AAT decision or seeks special leave to appeal to the High Court;*
- given the nature of the issues covered by the test case program, funding will generally be extended to appeals against funded decisions, at least to the Full Federal Court. Where cases are approved for funding in state or territory courts, funding will generally extend to the Court of Appeal or equivalent in the relevant Supreme Court. In contrast to the current test case funding arrangements, a fresh application for funding will not usually be needed but a decision on funding will be made by taking into account the nature of the issue being tested on appeal.*
- contacting all taxpayers that we have identified as having objections lodged on a legal issue and seeking their willingness to be part of the test/lead case process and including the likely factual matrix needed to test the legal issue;*
- resolving objections from taxpayers who have suitable cases and encouraging them to come forward as a test case*
- publicly announcing that a test case is being sought describing the issue to be clarified and why; and*
- seeking NTLG/professional body assistance to publicise the fact that a test case is being sought. An ongoing challenge is to identify, and obtain agreement from, taxpayers to be test cases where there is no application from a taxpayer for test case funding.*

*The Inspector-General has raised concerns in relation to the need for new procedures to accelerate and encourage the identification and progression of test cases. In response to those concerns the Tax Office will increase the existing 50 per cent GIC remission concession (currently available for disputed tax debts where taxpayers enter into a 50/50 arrangement by paying a minimum of 50 per cent of the tax in dispute) from 50 per cent to 75 per cent where a test or lead case funded as part of the test case program is involved.*

*It would not be expected that penalties would generally be imposed in test cases. Penalties may, however, be imposed in certain lead cases for widely marketed schemes. It would not be appropriate to remit penalties in such cases merely because a case is the first case to be litigated.*

## RECOMMENDATION D CONTINUED

*It is generally easier to get agreement from taxpayers to be test cases where there is agreement on the facts of the case. We will continue to seek agreement on facts where possible in those cases which we believe would be suitable to test a contentious area of the law.*

*Once identified we seek to fast track test cases through the court. This involves the necessary cooperation of taxpayers and the court. New Federal Court directions for tax litigation should enable more timely progress of cases, particularly test or lead cases.*

*We are currently revising our test case funding guidelines which explain our approaches to law clarification through litigation of contentious issues. The revised guidelines will include the relevant approaches agreed in this report.*

### ATO position

Implemented

### ATO response

9.128 The Test Case Litigation Program, continues to be an effective means of identifying contentious areas of the law that need to be clarified, and has revised its published guidelines to incorporate and explain the approaches to law clarification as agreed with the Inspector-General. The revised test case litigation guide was launched on 9 June 2009. Hard copies of the guide are available on request and an electronic copy is available online on the Tax Office website:

<http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/57395.htm>.

This guide was revised to clarify the funding process for applicants and to clarify the types of funding the Tax Office offers.

9.129 The deputy chair of the Test Case Litigation Panel recently completed a series of discussions with the Legal Services Branch teams encouraging staff to identify potential test case issues amongst their cases. Staff were asked to consider as a matter of practice, whether test case funding would suit any new matters, and to constantly revisit the possibility of test case funding during Strategic Internal Litigation Committee (SILC) conferences with the litigation team as the litigation progresses. Staff were invited to advise the strategic litigation unit of any such cases for the test case secretariat and the deputy chair to consider.

9.130 Steps continue to be taken to identify issues at the audit and objection stages, and also from private ruling requests. The deputy chair of the panel and the test case secretariat continue to conduct discussions with the BSL SES officers responsible for litigation and the BSL litigation co-ordinators to identify emerging issues, at audit or objection, where litigation would be a means of resolving the issue.

9.131 As such, more has been done to reduce the time taken to identify and progress test or lead cases and offering inducements encouraging taxpayers to come forward. The identification and progress of test cases is a continuing process in a business as usual environment.



9.132 Continuing in a business as usual manner:

- The test case program has recently approved funding for a number of further appeals. This kind of funding assures that test case issues are litigated at least to the Full Federal Court to achieve greater certainty and clarification of the relevant issues.
- The test case program has recently approved funding to a taxpayer for the Commissioner's appeal to the Federal Court against a decision of the AAT. This kind of funding allows the Commissioner to seek judicial clarification concerning issues decided by the Tribunal without placing taxpayer's at a financial disadvantage.
- The test case program is closely monitoring the progress of a number of litigation matters, brought to the attention of the program by LSB staff in relation to legal expenses. For example, the program identified the deduction of legal expenses as an issue it sought to test further after the *Shane Day* decision of the High Court.

9.133 We have now amended Chapter 28 of the ATO Receivables Policy, 'Recovering disputed debts', at paragraphs 16-19 and 22 to give effect to the agreed area for improvement. These paragraphs outline our commitment to increase the GIC concession available for funded test cases from 50 per cent to 75 per cent.

### **IGT Conclusion — Partly Implemented**

9.134 The case studies, upon which the IGT's fourth report was based, had showed that where resolution of complex issues appropriately involved testing a technical position through litigation the lead times to identify and progress test cases could be protracted and result in major delays. As a result, taxpayers were faced with making decisions during extended periods of uncertainty surrounding the ATO's technical and compliance position. The IGT therefore raised a number of possible courses of action to address this issue and called for the ATO to do more to reduce the timeframes in identifying and progressing test or lead cases. This included processes to demonstrate ATO openness to have matters tested in court, and for actions to get matters into the courts to be publicly demonstrated. Additionally, more was needed to be done to manage critical path events such as selecting a number of test cases and going through the objection, review and appeal processes, or it may be by seeking declaratory proceedings while the matters are still at the audit stage. Furthermore, the IGT suggested that procedures and positive inducements be introduced to encourage taxpayers to come forward with cases requiring judicial clarification and for the ATO to proceed these matters to hearing without impediment or delay.

9.135 In responding to the IGT's fourth report, the ATO committed to demonstrate to the public through the test case program its openness to have matters tested and to proactively seek cases using particular approaches. A key change to address this has been a re-write of the ATO's test case booklet which was released in 2009. In undertaking this re-write, the ATO sought input from relevant stakeholders including the NTLG. Feedback from one leading professional association lead directly to the ATO developing and including in the booklet an 'overview' flowchart to provide taxpayers with a clearer understanding of what is involved with applying for a test case and the stages of the process. Positive feedback from stakeholders regarding the clarification provided by the revised booklet was received by the ATO following the booklet's release.

9.136 The ATO has also developed new processes leading to more continual dialogue internally regarding issues that could be the subject of a test or lead case. For example, senior



ATO law and business line litigation executives now meet on a quarterly basis to discuss current test cases and to also present the top five emerging issues within their own groups. Also on a six-weekly basis, the ATO's team who manages the test case program (the Strategic Litigation Unit – SLU) conducts a call over for current test cases with executives from the ATO's Legal Services Branch (LSB), as well as with Senior Tax Counsels (STCs) which includes discussion of potential issues for test case program funding.

9.137 The ATO also points to improved dialogue with externals to identify issues requiring clarification. For example, publicly announcing that a test or lead case is being sought by the ATO as well as outlining the issue(s) involved. This has been completed through the use of media releases and through the inclusion of agenda items at stakeholder consultation forums such as the NTLG. Also during the course of this review, the IGT examined cases where the ATO identified and approached a particular class of taxpayer (and their professional association) and asked them to apply for test case funding.

9.138 Fieldwork undertaken by the IGT, including a review of nine completed cases, demonstrated the ATO's efforts to identify and progress test and lead cases, including the particular methods agreed to (by the ATO) in response to the IGT's recommendation. For example, offering a range of inducements to come forward with a potential case such as by funding reasonable pre-litigation costs to develop a case and also providing funding without the need for application to the Test Case Panel.<sup>37</sup> This fieldwork also demonstrated the ATO fast-tracking the resolution of taxpayer's objections and encouraging taxpayers to participate as a test or lead case.

9.139 The IGT notes that the ATO's above response also refers to an increase in the level of GIC remission concession for funded cases from 50 per cent to 75 per cent. Fieldwork undertaken by the IGT determined that this new inducement has not yet been applied in any case, however, the IGT notes that this only applies to cases where the taxpayer has entered into a 50/50 arrangement by paying a minimum of 50 per cent of the tax in dispute. The ATO has advised the IGT during the course of this review that it will investigate whether there are any gaps in the process behind this concession.

9.140 Despite the ATO's efforts, there is a significant limitation in terms of measuring and monitoring from the time that an issue has been identified as requiring law clarification to the time a test or lead case enters the judicial system. During fieldwork for this follow-up review, the IGT sought to sample test the timeframes involved, however the ATO was unable to point to any system capability that would enable the IGT, or the ATO themselves, to do so. This is a key shortfall in terms of the IGT's recommendation as this type of analysis is required before any determination can be made whether the ATO's efforts are working.

9.141 Discussions during the course of the review between the IGT and SLU executives noted that an internal review is required to address this and that this would be an aspirational target for the ATO. The ATO advised the IGT that it is in the initial stages of discussions between the business lines (BSL) about how to effectively track timeframes and what needs to be done. There are number of options to consider that will improve things including, for example, appropriate sign-off (and tracking) by BSL Deputy Commissioners when escalating an issue for test or lead case consideration.

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37 Also, the administrative-side of the test case process has now been simplified through the removal of the need to make a separate funding request for most appeals.

9.142 In conclusion, the IGT has observed the efforts of the ATO to identify and progress test or lead cases. However, as outlined above, there is more to be done in terms of the IGT's recommendation, beginning with an appropriate system to track the progression of matters.

## RECOMMENDATION E

*Transparency and communication would be greatly enhanced if the Tax Office's full agenda of significant technical issues under consideration was made publicly available and easily accessible. A consolidated listing of all significant technical issues that it has under consideration on a 'Technical Issues Agenda' area within the Tax Office website would be a suitable way of making this improvement.*

*The Tax Office website currently has information on significant technical issues through the publicly available rulings and LAPS programs. The ATO also provides a list of Strategic Litigation issues to the NTLG on a regular basis.*

*Within the next two years (in recognition of current major Tax Office IT commitments) the Tax Office will work towards consolidating its information on significant technical issues (generally all PTIs) into one reference area on the Tax Office's web site with links to other relevant areas such as the Public Rulings and LAPS Programs. Some issues may not be included due to confidentiality considerations.*

## ATO position

Not implemented

## ATO response

9.143 The Tax Office has recently moved the management of interpretative assistance work, such as priority technical issues, private and public rulings and practice statements, to a new information technology platform, known as 'Siebel'. In recognition of this, it was agreed that the Tax Office would work towards implementing this recommendation over 2 years from the date of the finalisation of the report [which was 6 August 2008].

9.144 From September 2009, all work in relation to priority technical issues, public rulings and practice statements are completed using the Siebel system.

9.145 Issues around reporting are yet to be fully resolved and detailed management reports (such as the public rulings and practice statement programs) are still to be 'built'. Until that time, these reports will continue to be generated from existing systems, such as the PTI Register, requiring considerable manual intervention to both capture data and produce such reports. This work has had priority over implementation of this recommendation, to ensure we can continue to effectively manage our priority technical issues and public advice products through to resolution.

9.146 We are continuing to work on better automating our enterprise reporting processes for PTIs, Public Ruling and related work, and are confident that as we develop more effective reporting from our enterprise systems, we will be better placed to understand how the Tax Office website can be enhanced so that information relating to these issues can be captured in

the one reference area. This recommendation is being taken into consideration in determining the reports that are needed and how they are designed.

9.147 As our reporting capability improves and once we have developed a prototype design for the Tax Office website, we will consult with the National Tax Liaison Group and other stakeholders as appropriate.

9.148 Taking these factors into account, an implementation date towards the end of 2010 is forecast.

### **IGT Conclusion — Not Implemented**

9.149 The IGT's fourth report found that the case studies indicated some variance in respect of the ATO's directness and timeliness of communication with taxpayers. It stated that at the level of principle, all ATO compliance strategies need to feature direct and early communication with taxpayers potentially affected by a compliance concern (an exception may be some serious non-compliance criminal matters). A reliance on exposing issues to professional bodies through consultation forums or on indirect communication, such as speeches and seminars, is no substitute for a default approach of direct communication and guidance to both taxpayers and their advisers. As noted in the IGT's fourth report, a consolidated listing of all significant technical issues that the ATO has under consideration in a 'Technical Issues Agenda' area on the ATO website would be a suitable way of making this improvement.

9.150 The ATO's above response states that it is now working towards implementation of the recommendation by the end of 2010.<sup>38</sup> This includes the development of reporting capability that is to be generated from its new Siebel technology platform. Upon completion of this work, the ATO considers that it will be better placed to capture the information relating to this recommendation in one reference area on the ATO website. However, it remains unclear why the implementation of this recommendation is dependent on this new technology platform. An interim measure to address the recommendation should be possible given that a significant amount of relevant information is already available<sup>39</sup> on the ATO website.

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38 It is noted that this is a few months more than the timeframe agreed to by the ATO in the IGT's 2008 report.

39 The IGT's 2008 report highlighted the level of information already in place on the ATO website including, for example, information on around 70 per cent of the Tax Office's list of PTIs (albeit in a disparate form).

## RECOMMENDATION F

*To avoid uncertainty, draft or all final public advice products (including taxation rulings, determinations, interpretive decisions, Practice Statements, Fact Sheets and publications), should be promptly withdrawn or appropriately flagged as soon as the Tax Office has changed its view of the law, or where a court decision has raised the need for review. This should occur as soon as the change or need for review is identified, even if a replacement or fully updated product is not immediately available.*

*The Tax Office recognises the need to ensure the public advice and guidance it provides represents the current Tax Office view. It recognises the importance in a self-assessment system of taxpayers having access to advice and guidance about the application of the laws administered by the Commissioner.*

*The Tax Office agrees that once it concludes that its view has changed, the existing public advice or guidance should be withdrawn immediately and the Tax Office should clearly indicate whether replacement advice or guidance is required.*

*Where the existing view is merely being reconsidered due to possible uncertainty, the existing advice or guidance would not normally be withdrawn. Where there is a change to a general administrative practice that is less favourable for taxpayers and that change is not communicated by way of a public ruling, the Tax Office will not necessarily amend assessments that were raised consistently with a practice in place at the time of the assessments. As a general rule the Tax Office will amend assessments only where tax avoidance is involved or the practice has been exploited in an unintended way. (See para 32 of PS LA 2008/3.)*

*The Tax Office's views about the provision of advice and guidance are now comprehensively explained in PS LA 2008/3 – Provision of advice and guidance by the Tax Office.*

### ATO position

Implemented

### ATO response

9.151 As stated in the response to this agreed area, the Tax Office agrees that once it concludes that its view has changed, the existing public advice or guidance should be withdrawn and the Tax Office should clearly indicate whether replacement advice or guidance is required.

9.152 This is current Tax Office policy and the Tax Office's views about the provision of advice and guidance are now comprehensively explained in PS LA 2008/3 (about the provision of advice and guidance by the Tax Office). Additional guidance on this policy in specific circumstances, such as public rulings, practice statements, ATO Interpretative Decisions and court decisions is set out in the Public Rulings Manual (rulings) ; the Information Kit for Authors and Sponsors (practice statements), PS LA 2001/8 (ATO Interpretative Decisions) and PS LA 2007/2 (court decisions and decision impact statements).

9.153 Additional guidance about the selection, development, publication and review (including withdrawal) processes for public advice and guidance products is contained in PS LA 2008/12 (see in particular paragraphs 69, 74 to 77, and 81 to 92). Further, PS LA 2003/3 (Precedential ATO view) sets out processes and responsibilities for maintaining the currency, accuracy and consistency of precedential ATO view documents, including public rulings (see in particular paragraphs 35 to 40).

9.154 Additional guidance on Tax Office policy in specific circumstances, such as public rulings, practice statements, ATO Interpretative Decisions and court decisions is set out in the Public Rulings Manual (rulings) ; the Information Kit for Authors and Sponsors (practice statements), PS LA 2001/8 (ATO Interpretative Decisions) and PS LA 2007/2 (court decisions and decision impact statements).

9.155 As an example and in the context of public rulings, part of the approval process for a withdrawal includes giving a reason for the withdrawal. Where there is no replacement product, the area initiating the withdrawal must give reasons for that which might include factors such that the law is obsolete or that there is new law which is clear and no additional guidance is needed.

9.156 It should also be noted that, as stated in the response to this agreed area that where the existing view is merely being reconsidered due to possible uncertainty, the existing advice or guidance would not normally be withdrawn. Where there is a change to a general administrative practice that is less favourable for taxpayers and that change is not communicated by way of a public ruling, the Tax Office will not necessarily amend assessments that were raised consistently with a practice in place at the time of the assessments. As a general rule the Tax Office will amend assessments only where tax avoidance is involved or the practice has been exploited in an unintended way. (See paragraph 32 of PS LA 2008/3 Provision of Advice and Guidance by the Tax Office.)

## **IGT Conclusion — Partly Implemented**

9.157 As discussed in IGT's fourth report, the reason for this recommendation was to ensure that taxpayers are clear about their situation and that ATO advice is up-to-date. To achieve this end, the IGT stated that taxpayer uncertainty would be reduced if the ATO promptly withdraw or flag draft or final public advice products as soon as it has changed or is uncertain with its view of the law, or where a court decision has raised the need for review. Although the ATO's above response refers to processes and practices already in place, fieldwork by the IGT has demonstrated that there are still examples occurring where the ATO must improve its efforts to promptly flag or remove items to avoid uncertainty for taxpayers in accordance with the IGT recommendation.

9.158 One example involves the timeliness of the publication of decision impact statements. These are documents developed by the ATO in response to recommendations in the IGT's 2006 report *Review of Tax Office management of Part IVC litigation*. The purpose of the IGT's recommendations was for the ATO to provide a timely and succinct statement of intent as to the ATO's interim administrative approach following the handing down of a decision by a court or tribunal. This form of guidance was intended to inform taxpayers of the way forward and to enable them to operate in a self-assessment environment.

9.159 The IGT's recommendations envisaged that the statements of intent would be based on existing internal ATO documents, in the form of finalised case reports, which set out the implications of decisions on current rulings and determinations, and flag matters that could be potentially impacted following more detailed analysis by the ATO. The ATO's own internal practice requires that the aforementioned case reports must be prepared within one week of the relevant court or tribunal decision.

9.160 Statements of intent provided immediately following the handing down of a decision, would assist taxpayers in charting their way forward and to enable them to operate in a self-assessment environment. Detailed 'technical' interpretation or analysis, if this was required, could be provided later following appropriate review and analysis by the ATO's technical staff.

9.161 The IGT recommended an eight-week timeframe for the publication of this guidance to taxpayers to take into account the normal periods of appeal that may apply to court or tribunal decisions. In agreeing to this recommendation in principle, the ATO noted that it may not be logistically possible to do so within eight weeks in all cases (such as where the possible application to other cases is unclear).

9.162 Although the ATO has directed its officers regarding this eight-week timeframe<sup>40</sup>, the average timeframe for finalisation of a decision impact statement is currently seven weeks more than the set timeframe. Fieldwork conducted during the course of this review evidenced that the ATO can in fact meet the eight-week timeframe. In one matter<sup>41</sup>, publication occurred within just ten days of the decision being handed down.

9.163 In making the above comments, the IGT recognises that there are some cases that may take longer than the set timeframe given the complexity of the law surrounding a court or tribunal's decision. Furthermore, the IGT notes that the ATO has reduced the backlog of outstanding cases and continues to employ efforts to reduce average timeframes.

9.164 A second example indicating the need for the ATO to improve its efforts to promptly ensure that taxpayers are clear about their situation involves the ATO's denial of GST input tax credits (ITCs) in relation to charter boat expenses. In 2003, the ATO had openly set its approach by directing relevant charter boat taxpayers to a new public ruling on income tax issues (TR 2003/4 *Income tax: boat hire arrangements*) and to a fact sheet on GST issues (*GST and boat hire arrangements*).

9.165 In December 2006, the Administrative Appeals Tribunal (AAT)<sup>42</sup> identified an apparent anomaly in the tax law which reversed the ATO's approach of denying ITCs for charter boat acquisitions. In February 2007, the ATO obtained external legal advice which agreed with the Administrative Appeals Tribunal (AAT) view and in April 2007, the ATO's Tax Counsel Network (TCN) instructed tax officers to resolve objections in view of this adjusted approach. Despite this change in approach, the ATO did not take any steps to announce to the public on its Charter Boat industry webpage the change in approach or to inform previously affected taxpayers. The ATO's public advice was not updated.

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40 Annexure F, paragraph 68, PS LA 2009/9 *Conduct of Tax Office litigation*.

41 *South Steyne Hotel Pty Ltd & Ors v Commissioner of Taxation* [2009] FCAFC 155.

42 *VCK and Commissioner of Taxation* [2006] AATA 1073.

9.166 On 21 June 2007, new law<sup>43</sup> was enacted which corrected the anomaly referred to by the AAT (with effect from 1 July 2007).<sup>44</sup> Also on June 21, despite removing the above GST fact sheet from the above mentioned webpage, the link to the fact sheet was merely deactivated – no explanation was provided and therefore one could have assumed that the fact sheet was still current.

9.167 An addendum to TR 2003/4 in response to the June 2007 legislation was not issued until 29 October 2008. The ATO's Charter Boat industry webpage still has no indication of this addendum.

9.168 A review of the ATO webpage by the IGT in August 2009 revealed that the inactive GST fact sheet link remained. However, a further review one month later revealed that the link was finally removed (although still no acknowledgement to taxpayers that anything had changed). Apart from this, the webpage remains unchanged.

9.169 The ATO original response to this recommendation stated:

‘The Tax Office agrees that once it concludes that its view has changed, the existing public advice or guidance should be **withdrawn immediately** and the Tax Office should **clearly indicate** whether replacement advice or guidance is required.’<sup>45</sup> [emphasis added]

9.170 The ATO could have indicated on the Charter Boat industry webpage whether replacement advice or guidance was required. Instead, an inactive link to the fact sheet containing its prior view was left on the ATO webpage for more than two years, leaving taxpayers to think that the reason for the inactive link was a technology problem rather than the ATO distancing itself from the content of the fact sheet.

9.171 As identified during this follow up review, the ATO continues in its efforts to effect timely communication. The IGT recognises the challenges posed by this recommendation but maintains its view that ATO advice or guidance should be promptly withdrawn or flagged as soon as it is identified that there is a change in, or need for review of, the ATO view.

9.172 The above examples highlight that despite the efforts to date, further improvement in terms of the recommendation is required. The IGT will maintain a watching brief over the ATO's efficiency in carrying out these practices.

9.173 The IGT concludes that the recommendation is partly implemented.

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43 *Tax Laws Amendment (2007 Measures No 2 ) Act 2007.*

44 Although a separate page was included on the ATO website containing links to the legislation and supporting materials, the IGT considers this should have been clearly identified on the ATO's Charter Boat industry webpage.

45 *Report on improvements to tax administration arising from the Inspector-General's case study reviews of the Tax Office's management of major, complex issues* (October 2008) at page 13.





## 10. OTHER MATTERS

### MONITORING AND REPORTING OF IMPLEMENTATION OF RECOMMENDATIONS TO SENIOR TAX OFFICE MANAGEMENT

10.1 Monitoring of the progress of recommendations from all external scrutineers, including those of the IGT, is undertaken by the ATO's Audit Committee. Reports to this Committee are co-ordinated by the ATO's Internal Audit group (Internal Audit) via the following steps:

1. On a quarterly basis, all business lines with active recommendations are required to provide Internal Audit with a written report detailing:
  - responsibility for a recommendation;
  - description of the progress made during the quarter;
  - a target completion date; and
  - a likely implementation date (if the recommendation is overdue).
2. The responses are then entered into a database and Internal Audit undertakes a quality review of the information.<sup>1</sup>
3. Based on the above information, Internal Audit determines the issues or reasons for the incomplete implementation and prepares a final report for the quarterly Audit Committee meeting.<sup>2</sup>

10.2 The ATO Audit Committee meeting is held and recommendations requiring attention are then referred to either the ATO's Chief Internal Auditor (attached to Internal Audit) or other senior ATO staff for action.

10.3 A review by the IGT of copies of the above mentioned quarterly Audit Committee reports for 2009 revealed some inaccuracy, incompleteness and a need for further detail to better equip the Audit Committee to determine the status of recommendations. A clear example demonstrating the IGT's concerns involves the lack of reference in the September or December 2009 quarterly reports regarding the status of recommendation 1 from the LAFHA case study review<sup>3</sup> or recommendation E from the fourth report<sup>4</sup> – with both recommendations still not implemented.

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1 Business Lines are reminded each quarter that adequate records must be kept to substantiate all status updates.

2 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).

3 *Review of Tax Office's management of complex issues - Case study on living-away-from-home allowances* (April 2007).

10.4 In October 2009, the ATO's Internal Audit group completed a review of the timeliness of the implementation of recommendations issued by external scrutineers. The report also identified some points for consideration relating to both initial ATO responses to issued recommendations and subsequent status updates provided by ATO business lines to the ATO's Internal Audit group. The review sample focussed on eleven recommendations from external scrutineers<sup>5</sup> with just one was from the IGT. It was found that although processes were managed appropriately, there was a need for incremental improvements in the way business lines manage their responses to Internal Audit. The review noted that 50% of initial responses to Internal Audit lacked sufficient information and returned to business lines for further detail and clarification.<sup>6</sup> It was also found that status updates for a number of recommendations were reiterated the following quarter thereby not allowing the Audit Committee to accurately and appropriately assess progress against the recommendations.<sup>7</sup>

10.5 The final report from the review was tabled before the ATO Audit Committee in February 2010 and suggested a number of areas for improvement including:

- the creation of a centralised database to aid the effective implementation of recommendations
- a requirement that business lines provide Internal Audit with an implementation plan for each recommendation<sup>8</sup>
- each individual point forming a recommendation is to be separately acknowledged and addressed.

10.6 The report concluded that implementation of improvements to the way management responses are developed, should assist in the provision of more comprehensive responses to recommendations which in turn would better equip the ATO's Audit Committee and external scrutineers to make an assessment against progress.<sup>9</sup>

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4 *Improvement to tax administration arising from the Inspector-General's case study reviews of the Tax Office's management of major, complex issues* (October 2008).

5 In respect of reviews between 30 June 2006 and 30 June 2008.

6 *Follow-up: External Scrutineer Recommendations* (Final Report, page 5).

7 *Ibid*, page 15.

8 Also, to incorporate this requirement into the corporate practice management statement between the ATO and IGT – namely PS CM 2005/1.

9 *Follow-up: External Scrutineer Recommendations* (Final Report, page 10). A further report regarding these processes has been prepared just prior to the conclusion of this review by the ATO's Chief Internal Auditor

## Conclusion

10.7 The sampling of quarterly ATO Audit Committee reports undertaken by the IGT indicated some inaccuracy, incompleteness and a need for further detail. It is hoped that suggestions arising from an internal ATO review, which is currently before the Audit Committee, will increase both the level and accuracy of information provided.

## COMMUNICATION TO TAXPAYERS OF THE CHANGES BROUGHT ABOUT BY THE IMPLEMENTATION OF RECOMMENDATIONS

10.8 The level of change associated with the recommendations that have been implemented by the ATO has necessitated a pro-active approach in communicating with taxpayers. A number of methods have been used to complete this which reflects the ATO's continuing efforts to improve its interactions with the tax community. A few examples of how the ATO has undertaken this for the purposes of this review are outlined below.

### i) GST audits for large taxpayers

10.9 This was particularly the case in the area of the ATO's management of GST audits for large taxpayers. For example, the ATO has provided taxpayers with a consolidated guide on the manner in which voluntary disclosures can be made, the type of information to be provided by a taxpayer and the resultant effect on tax, penalties and interest charges. Also, the ATO has clarified via a law administration practice statement<sup>10</sup> its position on when a GST audit has started and the circumstances in which this will occur orally or by letter.

### ii) Entering litigation with the ATO through the test case program

10.10 The ATO has also been proactive in updating taxpayers about the availability of test case funding with the release in 2009 of a revised booklet on the ATO's test case litigation program. A dedicated webpage on the ATO website was established for booklet. A number of changes were incorporated into the booklet to provide further clarity for taxpayers about the criteria of cases eligible for funding and included more comprehensive guidance on the process involved with cases taken to the High Court. A flow chart describing the test case funding process was also included following representations from a leading professional association to provide further clarity for taxpayers.

## Conclusion

10.11 The IGT recognises the efforts undertaken by the ATO in advising taxpayers of the 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 range of approaches. It is important for these efforts to continue as further changes arise in connection with the recommendations.

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10 Although practice statements are designed for use by ATO staff, they are publicly available and provide a considerable level of information about the Tax Office approach.



## APPENDIX 1 TERMS OF REFERENCE OF THE REVIEW

A1.1 As of October 2008, 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 complex issues – Case study on service entity arrangements* (publicly released 24 April 2007);
- *Review of Tax Office Management of complex issues – Case study on living-away-from-home allowances* (publicly released 10 May 2007);
- *Review of Tax Office's management of complex issues – Case study on research and development syndicates* (publicly released 16 August 2007);
- *Review of the potential revenue bias in private binding rulings involving large complex matters* (publicly released 25 February 2008);
- *Review of the Tax Office's administration of GST audits for large taxpayers* (publicly released 11 June 2008); and
- *Improvement to tax administration arising from the Inspector-General's case study reviews of the Tax Office's management of major, complex issues* (publicly released 29 October 2008).

A1.2 On 29 June 2006 the Inspector-General announced that he would undertake a follow up review into the Tax Office's implementation of agreed recommendations included in these reports. The terms of reference for this review were as follows:

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 timely implementation;
- Tax Office 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
- determine whether the Tax Office has addressed systemic issues identified in the reports.

The Inspector-General will also review the timeliness of publication of Decision Impact Statements by the Tax Office following on from his recommendations in the 2006 report *Review of Tax Office management of Part IVC litigation*.

Furthermore, the Inspector-General's findings regarding the implementation of recommendations from the 2008 report *Review of the potential revenue bias in private binding rulings involving large complex matters* will also form part of his current review into the Tax Office's administration of private rulings.



## **APPENDIX 2      FORMAL TAX OFFICE RESPONSE**

A2.1      The Second Commissioner's letter in response to the IGT's review is reproduced below on page 128.



**Australian Government**  
**Australian Taxation Office**

**SECOND COMMISSIONER OF TAXATION**

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

29 June 2010

Dear Ali

Thank you for your final report "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 June 2006 and October 2008".

The ATO and Inspector-General share a common goal of improving the administration of the tax system. The ATO is committed to implementing the agreed recommendations of scrutineers. As noted in your report, the Audit Committee recently endorsed a number of initiatives to improve the monitoring of agreed recommendations.

We are pleased that you found that 38 of the 41 agreed recommendations have either been fully implemented (30) or partly implemented (8) (i.e. that substantial progress has been made and the ATO is actively pursuing completion).

In relation to 3 of the 30 fully implemented recommendations you have also indicated that you may wish to undertake future testing of the application of changes the ATO has put in place (recommendations 5 and 7 of the Review of Tax Office Management of Complex Issues – Case study on Service entities report and recommendation c(ii) of the Report on improvements to tax administration arising from the Inspector-General's case study reviews of the Tax Office's management of major, complex issues).

Your report also concludes that 3 agreed recommendations have not been implemented. They are:

- Recommendation 8 from the *Review of Tax Office Management of Complex Issues – Case study on Service entities report*,
- Key recommendation 2 from the *Review of Tax Office Management of Complex Issues – Case study on Living Away from Home Allowance*, and
- Agreed Area E from the *Report on improvements to tax administration arising from the Inspector-General's case study reviews of the Tax Office's management of major, complex issues*.

Below are our comments relating to each of those conclusions.



## **Review of Tax Office Management of Complex Issues – Case study on Service entities**

Key Recommendation 8 of this review recommended that all guidance of a significant nature and applying to a substantial segment of the taxpayer population is, to the maximum extent possible, embodied in a form which is legally binding. The ATO agreed with the broad principle underlying the recommendation.

The ATO has issued three practice statements to provide guidance for our staff on the ATO's advice and guidance framework.

We are satisfied that the current advice and guidance framework strikes the right balance between appropriate levels of guidance and appropriate levels of protection for taxpayers. In particular, we use the class, product and public rulings regimes to ensure that guidance which is of a significant nature and which applies to a substantial segment of the taxpayer population is embodied in a form of advice which is legally binding on the ATO. Individual taxpayers can also continue to seek a private binding ruling where they feel the need for specific protection.

We therefore consider this recommendation is implemented.

While we note your observations about the 2009 changes to the TaxPack, we believe it is a good example of the above principles in operation. Those aspects of 2009 TaxPack that were of a significant nature carry the status of a Public Ruling. The remaining sections of TaxPack carry the appropriate levels of protection for what is more general and less significant guidance.

## ***Review of Tax Office Management of Complex Issues – Case study on Living Away from Home Allowance***

Recommendation 2 recommends, in the absence of the ATO providing formal advice to Treasury or any legislative change, issuing a new public ruling to replace Miscellaneous Taxation Ruling MT 2030. Your report notes that implementation of this recommendation was subject to the outcome of recommendation 1. Recommendation 1 relates to concluding a view on whether the ATO should formally advise the Treasury that legislative change is required or not. The ATO has worked closely with Treasury in relation to this matter by providing information, considering a Treasury discussion paper and providing research we commissioned concerning industry LAFHA practices. We also provided background briefing to Treasury on areas for consideration by the Australia's Future Tax System Review which included reference to LAFHA as an area of FBT requiring reform. We note that recommendation 9 of the 'Australia's Future Tax System Review' will impact on the issues and that further work in this area now awaits the Government's response to that recommendation.

## ***Report on improvements to tax administration arising from the Inspector-General's case study reviews of the Tax Office's management of major, complex issues***

Recommendation E of this report concerns making publicly available the ATO's full agenda of significant technical issues under consideration. We agreed to this recommendation and had planned to use developments in our technology capability to implement it by August 2010. During the period since your review the ATO has transitioned all work of this nature onto the Siebel system and reporting functionality is still being developed. The ATO has had to assign resources to higher priority issues to ensure

we can continue to effectively manage priority technical issues and public advice products through to resolution during this transitional phase.

There are also a number of other matters that we want to comment on:

***Review of Tax Office Management of Complex issues – Case study on research and development syndicates***

Key Recommendation 1 was that the ATO review whether settlements with taxpayers who were not fully informed should be unwound and remade. Your commentary concerning this recommendation considers the question of whether an investor was fully informed from the perspective of whether they had been told of the mediation. This was canvassed in the report when making the recommendation that the ATO review particular cases.

The ATO review was directed to the circumstances of each individual taxpayer. This focus is in keeping with the ATO guidelines which concern whether taxpayers know what they are doing when entering a settlement agreement.

The decision not to unwind the settlements in particular cases included a consideration of both their knowledge of the mediation and a wide range of matters including the degree of sophistication of the investors, their knowledge of the concurrent *Zoffanies* decision and whether they had access to specialist advisors. All taxpayers were considered to be sophisticated and had access to specialist advisers. It was also noted in the review that some cases in this group had in fact been settled on more favourable terms consistent with their specific individual circumstances.

The ATO individually notified the eight taxpayers of our decision not to reopen the settlements in late 2007. The ATO also posted information on its external website in December 2007 concerning the Inspector-General's recommendation, of the review and the ATO's decision.

The ATO considers that it has implemented this recommendation.

***Review of the Tax Office's administration of GST audits for large taxpayers***

In relation to Key Recommendation 4.4 part (iii) regarding GIC remission decisions for large taxpayer GST audits that are subject to adequate internal quality controls you concluded that the recommendation is not implemented because there remains the possibility that sizeable remissions of GIC could be occurring without appropriate senior scrutiny. The ATO has consistently maintained the view that the quantum of GIC in itself is not a factor taken into consideration for GIC remission purposes. We believe that we already have in place sufficient senior level scrutiny in such circumstances.

***Report on improvements to tax administration arising from the Inspector-General's case study reviews of the Tax Office's management of major, complex issues***

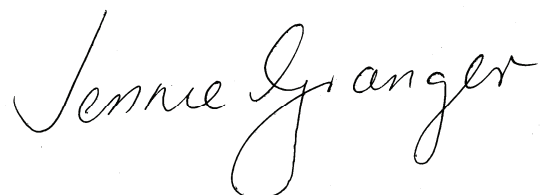
Recommendation F of this report relates to ensuring the prompt withdrawal of advice, if and when required. The ATO continues to strive to ensure this. While we do not agree with all of the Inspector-General's observations about the two examples cited, we acknowledge that we do not always manage this as well as we would like. Your report confirms for us that there continues to be room for improvement and provides some useful indicators as to the kinds of improvements on which we might focus.

We appreciate that your report acknowledges the assistance and cooperation of tax officers during the course of the review. Significant effort was applied by a large number of

senior Tax officers owing to the breadth and depth of your review. We would also like to take this opportunity to thank you and your team for their professionalism and cooperation during the course of this review.

Thank you for opportunity to comment on your final draft report.

Yours sincerely

A handwritten signature in cursive script that reads "Jennie Granger". The signature is fluid and elegant, with the first letters of each word being capitalized and prominent.

Jennie Granger  
Second Commissioner Law



## APPENDIX 3 RECOMMENDATIONS NOT AGREED TO BY THE TAX OFFICE

### Review of Tax Office's management of complex issues - Case study on service entity arrangements

#### KEY RECOMMENDATION 1

*Before it decides on an approach to any compliance issue, the Tax Office should test how well it has met its obligations, in a self assessment system, to provide adequate and contemporary guidance to taxpayers on the relevant issue. The Tax Office should introduce formal processes and procedures to ensure that it tests itself against this obligation before finalising the approaches that it will adopt to the relevant issue. It should not tolerate any internal culture which ignores the need to provide such adequate and contemporary guidance to taxpayers.*

#### KEY RECOMMENDATION 4

*The Tax Office should acknowledge, in a public statement, that it has changed its view on how to calculate the amount of a service entity fee that will be deductible with effect from the date of issue of TR 2006/2 and its accompanying booklet on 12 April 2006. It should confirm that this change will be applied prospectively from that date and that this prospective application will include a 12 months period of grace for taxpayers to adjust their service entity arrangements.*

*The Tax Office should, in this public statement, outline the consequences (including those relating to the remission of penalties, interest and prior year tax adjustments) that this change in view has for all taxpayers with service entities, including:*

- taxpayers who are currently subject to prior year audits of service entity arrangements;*
- taxpayers who have entered into prior settlement arrangements with the Tax Office in relation to their service entities; and*
- taxpayers whose service entity arrangements will be subject to audit after 30 April 2007.*

## Review of the Tax Office's administration of GST audits for large taxpayers

### KEY RECOMMENDATION 4.2

*The Inspector-General recommends:*

- *that the Tax Office's existing policy on wash transactions should be altered so that full remission of GIC on a one-off wash transaction error becomes the norm rather than the exception;*
- *that the Tax Office should issue a specific policy to reflect that it will generally fully remit GIC in cases where a wrong entity has accounted for the GST; and*
- *that the Tax Office addresses any undesirable behaviour on the part of the relevant taxpayer in relation to failing to account for GST on one-off wash transaction errors or other similar transactions which involve no revenue loss through the existing penalty regime rather than the GIC regime.*

### KEY RECOMMENDATION 4.3

*The Tax Office should review all large taxpayer GST audit adjustment cases which have involved unprompted voluntary disclosures where GIC has been charged at the full rate with a view to re-setting the GIC rate in these cases to the bank bill rate, being the rate which generally represents Tax Office policy.*

## 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
BSL	Tax Office Business Line
CAP	Compliance Assurance Practice
CoE	Centre of Excellence
Commissioner	Commissioner of Taxation
CPIT	Compliance Penalties & Interest Team
CTU	Complex Technical Unit
EIS	Executive Information System
FBT	Fringe Benefits Tax
FBTAA	<i>Fringe Benefits Tax Assessment Act 1986</i>
GAP	General Administrative Practice
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
IQF	Integrated Quality Framework
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
ITC	Input Tax Credits
JCPAA	Joint Committee of Public Accounts and Audit
LAC	Large Active Compliance
LAFHA	Living-Away-From-Home-Allowance
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
PTIC	Priority Technical Issues Committee
PTIPRB	Priority Technical Issues and Public Rulings Branch
ROSA	Report on Aspects of Income Tax Self Assessment
SB	Small Business
SES	Senior Executive Service
SIC	Shortfall Interest Charge
SILC	Significant Issues Litigation Committee
SME	Small to Medium Enterprise
SMSF	Self Managed Superannuation Fund
SNC	Serious Non Compliance
STC	Senior Tax Counsel
STCT	Small Taxation Claims Tribunal
TAA 1953	<i>Taxation Administration Act 1953</i>
Tax Office	Australian Taxation Office
TC	Test Case
TCN	Tax Counsel Network
TEP	Technical Excellence Practice
TQR	Technical Quality Review