Australian Government

Inspector-General of Taxation

Review into delayed or changed Australian Taxation Office views on significant issues

A report to the Assistant Treasurer

Inspector-General of Taxation

March 2010

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Reviewer:

David Pengilley, Senior Adviser

Telephone: (02) 8239 2111
Facsimile: (02) 8239 2100

Australian Government
Inspector-General of Taxation

Level 19, 50 Bridge Street
Sydney NSW 2000
GPO Box 551
Sydney NSW 2001

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Senator the Hon Nick Sherry
Assistant Treasurer
Parliament House
CANBERRA ACT 2600

Dear Minister,

On 10 March 2009, the former Assistant Treasurer directed me to review and report on concerns in relation to any perceived ATO delayed or changed approaches — so called 'U-turns' — on significant interpretative matters or on past administrative practices. I am now pleased to provide you with my report on this review which contains my findings as well as recommendations which when implemented should result in significant improvement to tax administration in Australia.

Overall, I found that, in certain circumstances, taxpayers' perception of changes in ATO views or practices are justified. The main problem is not one binding ATO advice clearly changing another, but it is disagreement over whether a previous view or practice existed and if it did exist whether the subsequent view constituted a change. The situation is further compounded by ATO delays in firstly identifying its compliance concerns (which are usually the reasons for developing the subsequent view) and, secondly, finalising its position in relation to those concerns.

Taxpayers are not as concerned with the perceived change as they are with its retrospective effect. To overcome these concerns, I have suggested that the Government consider whether some legislative changes are necessary. In the meantime and in the absence of such legislative change, I have worked with the ATO, with input from business and tax practitioners, to develop mechanisms to reduce the adverse impacts of perceived changed and delayed ATO advice. These mechanisms are contained in recommendations two to five and whilst they may not eliminate the problem, when appropriately implemented, they should improve the level of transparency and due process and thereby significantly alleviate the current concerns.

The direct involvement of key industry representatives, key tax practitioners, the ATO's Acting Second Commissioner – Law, Acting Chief Tax Counsel and particularly the Commissioner of Taxation on key points has greatly enhanced the outcomes of this review. I consider that this direct involvement is a good example of how the ATO, external practitioners, industry and my office can work together to improve Australia's tax administration system.

Ali Noroozi
Inspector-General of Taxation

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EXECUTIVE SUMMARY

On 10 March 2009, the Assistant Treasurer directed the Inspector-General of Taxation (IGT) to review and report on concerns in relation to any perceived Australian Taxation Office (ATO) delayed or changed approaches — so called 'U-turns' — on significant interpretative matters or on past administrative practices. In accordance with this direction and in response to submissions from concerned taxpayers and their representatives, the IGT conducted this review.

Perceived delayed or changed ATO views or practices on significant interpretative matters are one of the main reasons for some private sector dissatisfaction with ATO governance arrangements. Where the ATO is perceived to be changing or clarifying its existing views with retrospective effect, taxpayers can incur significants costs. In some quarters, this has resulted in substantial erosion of confidence in the ATO as a fair administrator and driven a reluctance to work with the ATO on technical issues.

In the absence of binding advice, the law as currently applied, allows the ATO to apply its views retrospectively without protection against primary tax for taxpayers. The examples that were raised in submissions to the Inspector-General of Taxation (IGT) show that the main problem is not that one binding ATO advice clearly changes another binding advice, but that there are disagreements over whether a previous ATO view or practice existed or the ATO rejects having accepted an industry view of which taxpayers and their representatives believe the ATO to have been aware and which they believe the ATO had accepted. The situation is further compounded by ATO delays in firstly identifying its compliance concerns and, secondly, finalising its position in relation to those concerns. On this basis, the IGT has concluded that taxpayers' perceptions of ATO changes in views or practices are justified in certain circumstances.

In relation to binding ATO advice, legislative protection exists to protect the taxpayer against primary tax, penalties and interest if that binding advice is subsequently changed. However, if the Government's intention was to provide similar certainty in relation to the ATO's General Administrative Practices (unless involving tax avoidance, fraud or evasion), then it should consider whether the current arrangements clearly achieve this aim and, if not, what legislative changes should be made.

In the meantime, working within the existing legislative framework, the IGT has worked with the ATO, with input from industry and tax practitioners, to develop a mechanism that should reduce the adverse impacts of changed and delayed ATO advice. This mechanism should strike a balance between:

- protection for taxpayers where the ATO has facilitated or contributed to formation of taxpayer views which are inconsistent with subsequent ATO views; and

- preventing a laissez-faire situation where any position could be arguably justified on a particular area of uncertainty before the ATO releases its formal view.

The mechanism ensures that in determining the date of effect of its advice products, the ATO is guided by a clearly stated set of principles and criteria and that the decision-making process is transparent and instils public confidence.

The IGT also found that underlying some of the above concerns is the manner in which the ATO engages with the taxpaying community while developing its views on technical issues. Whilst there are many positive aspects of the ATO consultation processes, there is significant scope for improvement in certain areas, including:

- reducing ATO delays in identifying its compliance concerns and finalising its position in relation to those concerns;
- improving the tone and manner of technical discussion papers on issues of compliance concern; and
- providing interim guidance (to both taxpayers and ATO compliance officers), to the extent it can, for those issues that will not be resolved quickly.

The IGT believes that the recommendations contained in this report will deliver significant improvements to the tax administration system in this country when they are appropriately implemented. Accordingly, the IGT will maintain a watching brief over the implementation of these recommendations.

CHAPTER 1 — STRUCTURE OF THIS REPORT

1.1 This report, on the Inspector-General of Taxation's (IGT) review into delayed or changed Australian Taxation Office (ATO) views on significant issues, is produced pursuant to section 10 of the *Inspector-General of Taxation Act 2003* (IGT Act 2003). In accordance with section 25 of the IGT Act 2003, the Commissioner of Taxation was provided with an opportunity to give submissions on any implied or actual criticisms contained in this report.

1.2 This report documents the findings and conclusions of the review. It is divided into six chapters.

1.3 An overview of the review process and its general findings is given in Chapter 2. It directs readers to where further detail of the general findings is located in this report.

1.4 The chain of events giving rise to taxpayer perceptions of 'U-turns' is discussed in Chapter 3. The chapter also refers to the following chapters for more detailed discussion of specific systemic issues that were identified in the review.

1.5 The relevant legislative protections against retrospectively applied ATO views are discussed in Chapter 4. The chapter discusses binding advice, the scope of the general administrative practice (GAP) provisions and the Commissioner's power of general administration not to undertake compliance action for prior periods on particular issues.

1.6 The ATO administrative changes that would help to reduce the adverse effects of perceived 'U-turns' are discussed in Chapter 5. The chapter also discusses the process and criteria in determining whether the ATO should apply views retrospectively.

1.7 The ATO's engagement with the taxpayer community on technical matters, including delays in identifying significant risks to revenue and the delays in finalising ATO views, is discussed in Chapter 6. The chapter also discusses the role of technical discussion papers in some detail.

CHAPTER 2 — OVERVIEW

2.1 On 10 March 2009, the Assistant Treasurer directed the IGT to review and report on concerns in relation to any perceived ATO delayed or changed approaches — so called 'U-turns' — on significant interpretative matters or on past administrative practices. At the direction of the Assistant Treasurer and in response to submissions from concerned taxpayers, the IGT started this review pursuant to subsections 8(2) and 8(1) of the IGT Act 2003 respectively.

2.2 Perceived delayed or changed ATO approaches on significant interpretative matters are one of the main reasons for private sector dissatisfaction with ATO governance arrangements. Where the ATO is perceived to be changing or clarifying its existing views with retrospective effect, taxpayers can incur significants costs. The action can also reduce the level of prospective certainty in the administration of the tax laws. In some quarters, this has resulted in substantial erosion of confidence in the ATO as a fair administrator and driven a reluctance to work with the ATO on technical issues.

2.3 The IGT announced submission guidelines and terms of reference for this review on 21 April 2009. The terms of reference are reproduced in appendix 1. The IGT received 57 submissions from taxpayers and their representatives, raising more than 60 potential examples of delayed or changed ATO views on significant issues. A list of these examples is provided in appendix 2. The IGT also met with interested taxpayers, their representatives and selected industry and tax practitioner bodies to understand their experiences.

2.4 Fifteen of these examples were reviewed in more detail by looking at the related ATO files and discussing the issues with key ATO staff. They involved differing industry groups, tax issues and types of internal ATO processes. These 15 examples are shown on the list in appendix 2.

2.5 Generally, the examples involved the ATO releasing new advice or guidance which allegedly differed from one of the following previous categories of views or practices:

- an ATO binding view — for example, a public ruling;
- an ATO non-binding view or practice — for example, a view set out in a number of published edited versions of private rulings (which are binding only in relation to the rulees);
- an industry practice developed in the absence of ATO guidance and/or unchallenged by the ATO for a significant period of time despite the ATO being well aware of the practice; or
- a view adopted by taxpayers on new law and in relation to which there was no ATO view for a significant period of time.

2.6 The IGT found that the perceptions of 'U-turns' were generally based on a chain of events that mainly involved previous non-binding ATO views or industry practices of which the ATO was understood to be aware. The following chain of events are illustrative of what took place in many of the examples that were cited in submissions to us:

1. Taxpayers and their representatives perceived that the ATO accepted a practice or view and relied on that perception when entering into arrangements. In some cases, taxpayers and their representatives may have considered that there was no ATO practice or view, however, they self-assessed within the limited timeframes allowed and in the absence of ATO views.

2. The ATO later became aware of compliance concerns (concerns with practices or views that the ATO perceived to be of sufficient risk to revenue) in relation to particular arrangements. Commonly, the ATO became aware through audits, and to a lesser degree through advice requests.

3. The ATO rejected that it accepted the view which taxpayers believed the ATO held and/or considered that existing binding advice did not cover the arrangements which were the subject of the concern. It then commenced a process (which may have included issuing a technical discussion paper and engaging in consultation with taxpayers and their representatives) to develop, finalise and apply a view to those arrangements.

4. Because the ATO considers that it cannot estop the operation of the law, it considers that it must therefore apply its view retrospectively to applicable arrangements where it becomes aware of them.

5. Taxpayers and their representatives thought it unfair to be adversely affected at a later point in time when it could do nothing to predict changed or new ATO views or to minimise their adverse effects. They considered that the ATO's retrospective application of views in these circumstances did not sufficiently consider:

    - reasonable taxpayer reliance on what taxpayers believed to be ATO practice, views or conduct, in light of the taxpayer community's expectation that the ATO will administer the law as it sets out in its public statements; and

    - ATO delays in light of the onus that the self-assessment system places on taxpayers to apply the tax law in real time.

2.7 The IGT established a working group comprising key tax practitioners and representatives. The participants were: Michael Barbour, Westpac; Michael Bersten, PricewaterhouseCoopers; Alf Capito, Ernst & Young; Frank Drenth and David Kuhne, Corporate Tax Association; Matt Hayes, KPMG; Andrew Mills, Greenwoods & Freehills; and senior ATO officials, such as Kevin Fitzpatrick, Acting Second Commissioner—Law; Andrew England, Acting Chief Tax Counsel; and Peter Walmsley, Deputy Chief Tax Counsel.

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

2.9 The working group met several times to discuss the potential solutions to the systemic issues identified in this review. It should be noted, however, that the views and recommendations expressed in this report are not necessarily those of individual members of the working group. The views and recommendations were finalised by the IGT after much deliberation, and based on input received and discussions with private sector representatives and the ATO.

2.10 The IGT also worked progressively with ATO senior management to distil the scope for improvement and to agree on specific actions. The IGT also discussed these matters with interested external stakeholders and working group members.

2.11 Overall, the IGT considers that, whilst the ATO may have acted within the law, there are circumstances where taxpayer perceptions of ATO changes in views or practices and their related delays may be justified. This is discussed in more detail in Chapter 3.

2.12 In this context, the IGT found that the examples highlighted scope for further improvement in the following areas:

- Improving certainty of legislative protection for taxpayers where the ATO retrospectively applies a newly developed ATO view (this issue is discussed in Chapter 4);

- refining the ATO's process and criteria for deciding whether to apply new, changed or clarified ATO views retrospectively, to better ensure that an appropriate balance is struck between:

  - protection for taxpayers where the ATO has facilitated or contributed to the formation of taxpayer views which are inconsistent with subsequent ATO views; and

  - preventing a laissez-faire situation where any position could be arguably justified on a particular area of uncertainty before the ATO releases its formal view (this issue is discussed in Chapter 5); and

- improving the ATO's engagement with the community while it develops its technical views (this issue is discussed in Chapter 6); and

- minimising the time periods occurring before the ATO identifies its compliance concerns and the time taken in finalising ATO views without compromising its reliability (this issue is discussed in Chapter 5).

CHAPTER 3 — THE CHAIN OF EVENTS GIVING RISE TO PERCEPTIONS OF U-TURNS

Taxpayer perceptions of ATO acceptance

3.1 At the outset, it is important to acknowledge the onus that the self assessment system places on taxpayers to apply the tax law in real time. Taxpayers must decide how the tax laws apply to their affairs as best they can in the available time. This time is often limited due to, for example, a transaction needing to take place immediately. Also, taxpayers are not able to delay in deciding how the tax laws apply because of deadlines for lodgement or reporting. Taxpayers also have limited resources in undertaking these activities.

3.2 It is also important to acknowledge that ATO views do not create or extinguish legal rights. They are only statements of administrative intent. Whilst there is no legal obligation on the ATO to provide guidance, views or advice, the ATO has committed itself to giving advice and information on which taxpayers can rely. This reflects the community's expectation of a tax administrator in a self assessment environment.

3.3 Taxpayers may seek to obtain the protection of binding ATO advice (advice that protects taxpayers against additional primary tax, interest and penalties in the event that the advice is wrong — for example, a public ruling). However, the delays and costs in obtaining this level of certainty can be commercially prohibitive. Delays in finalising or clarifying views or changing views may limit taxpayers' commercial opportunities and significantly increase their costs. Also, there is widespread perception amongst large corporates and external tax advisers that there is a revenue bias in the ATO's private rulings.[1]

3.4 Taxpayers may also seek specialist tax advice from advisers. However, taxpayers' costs would be prohibitive if they were expected to obtain specialised technical advice on every issue. Therefore, they generally assess the need to obtain more specialised (and costly) advice on the basis of perceived risk, as does the ATO. In this respect, taxpayers generally seek to use the ATO's guidance and non-binding advice as a means to test whether there is such a need.

3.5 To a large extent, taxpayers also seek to reduce uncertainty by assessing their liabilities in line with the ATO's interpretation of the law. For example, many

1 See the IGT's report on the potential revenue bias in private binding rulings. In that review, the IGT found that, within the scope of the IGT's powers, there was no evidence of undue revenue bias and no submissions to the review brought forward examples of undue revenue bias. Almost all representations to the IGT acknowledged and accepted that there was an inherent revenue bias in the private binding ruling system arising from the ATO's dual role as impartial rulings administrator and revenue collector. However, the ATO disputed such an inherent bias existed. The IGT also found that perceptions of undue revenue bias were not limited to any particular industry group and not due to unfavourable rulings. The IGT recommended the ATO take action to increase transparency, more clearly demonstrate objectivity and reduce delays.

taxpayers, particularly small businesses and individuals, may prefer to follow ATO views to avoid costly litigation where they feel they cannot match the resources of the ATO. Taxpayers can resort to the courts if they wish to press their case for ultimate resolution, but this is a costly affair. Also, large companies may have become more reliant on ATO advice in recent years due to encouragement by the ATO to address tax risks as a part of their corporate governance.

3.6 Where new law is introduced, there may be no ATO guidance or advice. Generally, the ATO interacts with Treasury and taxpayers to facilitate a smooth introduction, often with great success. However, a difficulty arises where that interaction is incomplete and sufficient ATO advice or guidance is not provided. Some taxpayers expressed considerable frustration where years after new law had been introduced, the ATO had sought to adopt an interpretation (either in a compliance activity or in response to a request for advice) which was not consistent with prior taxpayer understanding of the application of the law. Taxpayers perceived that the ATO may apply the law with the benefit of hindsight without sufficient regard to the circumstances in which taxpayers felt they were doing their best to grapple with the application of the new law.

3.7 The examples that were raised in submissions to the IGT show that in light of the above, taxpayers and their representatives perceived that the ATO had accepted a practice or view and relied on that perception when entering into arrangements. ATO acceptance was seen as either positive action, such as the existence of a private binding ruling or other non-binding advice or statement, or, an absence of action in circumstances where the ATO was considered to have been aware of the practice, such as reviewing the practice in an audit or review but not challenging the practice or view.

ATO awareness of compliance concerns

3.8 It is also important to acknowledge that the ATO's compliance resources are limited. It allocates its resources on the basis of perceived risk to the revenue (its compliance concerns). Once the ATO becomes aware of a compliance concern, it may act to stop these practices. The examples show that commonly, the ATO became aware of compliance concerns through audits, and to a lesser degree through advice requests. Until the ATO is aware of the compliance concern it will not know whether to act or not.

3.9 The examples show that there is a spectrum of ATO awareness levels. For example, views expressed in public rulings generally receive the attention of high level technical officers and are commented on by private sector representatives before release. In some cases the ATO may not be aware that a particular approach to the application of the tax laws is being taken. In other cases, the ATO may become aware in an audit or private ruling application that a particular approach has been taken by a taxpayer, but the ATO has not diverted compliance resources to determine whether that approach is more widespread. There may also be cases where the ATO is aware that such a practice is widespread but considers that the approach is not of a comparatively high risk and takes no further action to divert compliance resources to alter that practice.

3.10 The examples also show that a significant period of time may have elapsed between the practice developing (for example, on the basis of perceived ATO acceptance in a non-binding view) and the ATO becoming aware of its compliance concern and communicating this to taxpayers. Delays in identifying compliance concerns can significantly increase the adverse impacts of retrospective application of new or changed ATO views. This issue is discussed further in Chapter 6.

3.11 Once the ATO becomes aware of a compliance concern, it may trigger its internal processes to consider the technical issues (such as the interpretation of the law, the application of the law to certain facts, etc.).

ATO technical view development

3.12 The ATO's technical view development operates on a precedential technical decision-making basis. Generally, this means that views are formulated by senior ATO technical officers which other officers are then required to apply when faced with materially similar circumstances, unless those other officers escalate the matter to the senior technical officer for reconsideration or reformulation). These precedential views are required to be published and kept up to date — for example, ATO Interpretative Decisions (ATOIDs) and practice statements.

3.13 Although these precedential views may be directions to ATO staff to apply that view when encountered in advice or compliance activities, under the law, these views will not provide taxpayers with protection from additional primary tax in the event that the ATO later changes its view and then retrospectively applies that changed view. Since 2005, the ATO has sought to provide a statement in relation to the level of protection afforded (usually against penalty and interest) by these guidance products in the product themselves. It should be noted that the law will only provide additional primary tax protection where the advice binds the ATO — that is, where the advice is contained within the binding part of a public ruling or a private ruling which is only binding with respect to the relevant taxpayer.

3.14 However, in light of the factors outlined above, taxpayers may consider that they have a certain degree of comfort in relying on precedential ATO views even though these ATO views are not binding on the ATO.

3.15 Where the ATO considers that existing binding advice does not cover the arrangements which were the subject of the compliance concern, it may commence a process to develop, finalise and apply a new technical view to those arrangements. These processes may take many months or years to finalise. These delays are discussed further in Chapter 6.

3.16 The ATO may also seek to engage with the taxpayer community to assist it to understand the arrangements and develop its view. This may be through a technical discussion paper. However, taxpayers are concerned with the tone of some technical discussion papers and that some ATO compliance officers may seek to use the views in these papers before the technical discussion process is finalised. The IGT identified opportunities to improve the framework for engagement — specifically in relation to the use of technical discussion papers. These opportunities are discussed in Chapter 6.

Legislative taxpayer protection against retrospective ATO action

3.17 Once the ATO formulates its view, it applies that view. The ATO considers that it must apply its view retrospectively to applicable arrangements where it becomes aware of them because it considers that it cannot estop the operation of the law.

3.18 As previously stated, there are legislative provisions which effectively provide protection from additional primary tax liabilities, penalties and interest arising from delayed or changed ATO views in certain circumstances.

3.19 Taxpayers can seek certainty about their primary tax liabilities by either relying on a public ruling (where one covers the arrangement) and/or by obtaining a private binding ruling which is binding on the ATO with respect to their arrangements. This will prevent the ATO retrospectively applying a more adverse view to the arrangements. However, for the reasons set out above, taxpayers generally seek to minimise their costs and uncertainty by following existing ATO guidance that may not be binding on the ATO with respect to them.

3.20 There are also circumstances in which the Commissioner may exercise his power of general administration not to undertake compliance action for prior periods on particular issues where taxpayers assess themselves in accordance with a general administrative practice (GAP). This may also effectively provide protection against the ATO retrospectively applying a more adverse view to the arrangements.

3.21 However, there are concerns with the practical application of these protections. These are discussed in Chapter 4.

3.22 As a result of the issues raised above, the examples show that taxpayers and their representatives thought it unfair to be adversely affected at a later point in time when they could do nothing to predict new, changed or clarified ATO views or minimise their adverse effects. They considered that the ATO's retrospective application of views in these circumstances did not sufficiently consider:

- reasonable taxpayer reliance on what taxpayers believed to be ATO practice, view or conduct, in light of the taxpayer community's expectation that the ATO will administer the law as it sets out in its public statements; and
- ATO delays in light of the onus that the self assessment system places on taxpayers to apply the tax law in real time.

3.23 On the basis of this chain of events, described above, the IGT generally concludes that the ATO may act within law because it does not apply a view which is a strict clear 'change' from binding ATO advice that applies to the taxpayer in question. However, the IGT does consider that taxpayers perceptions of changes in views or practices are justified in light of the above chain of events in certain circumstances, particularly where there are extended delays. This is explored further in the next chapter.

CHAPTER 4 — PROSPECTIVE TAXPAYER CERTAINTY UNDER THE EXISTING LEGISLATIVE FRAMEWORK

4.1 The protections against the adverse effects of ATO delayed or changed views give a measure of certainty to the future treatment of taxpayers' affairs — a measure of taxpayer prospective certainty. However, the examples highlight concerns with the scope of protection afforded to taxpayers in light of the difficulties faced with their practical application. These are discussed below in relation to binding advice, the operation of the general administrative practice (GAP) provisions, and the Commissioner's power of general administration not to undertake compliance action for prior periods on particular issues.

Binding ATO advice

4.2 As a mechanism for prospective certainty, the law provides that the Commissioner is bound to assess a taxpayer's arrangements consistent with binding advice, such as public and private rulings where the advice applies to the taxpayer. Effectively, this provides protection from primary tax that might otherwise be imposed in the event that the ruling did not correctly reflect the law.

4.3 Generally, public rulings will provide protection to all taxpayers until they are withdrawn. Private rulings, however, need not be withdrawn as the general ATO practice is to limit their protection for the relevant taxpayer for a fixed period of time.

4.4 Notwithstanding the existence of binding ATO advice, there are disputes about whether subsequent ATO action changes previously issued binding advice or whether it is consistent with that advice. Reasonable people can differ in their opinions on the application and scope of binding advice. ATO rulings may also be narrow in scope or generally worded.

Non-binding advice

4.5 Non-binding advice refers to all forms of ATO advice that do not amount to 'binding ATO advice'. Non-binding advice will not stop the ATO from applying an inconsistent view when it assesses tax obligations. Non-binding advice may provide protection from interest and penalties, but not primary tax. The vast majority of ATO advice and practice falls within this category. The ATO provides an explanation of their advice and guidance framework in Practice Statement Law Administration (PSLA) 2008/3.

General administrative practice (GAP)

4.6 The term 'general administrative practice' (GAP) was first enacted into tax law in 1992 to give penalty and interest protection to taxpayers lodging returns consistent with a GAP (now sections 284-215 and 361-5 of the *Taxation Administration Act 1953* (TAA 1953)). The term 'GAP' was not defined.

4.7 The explanatory memorandum to the Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005 provides as follows:

> 3.130 General administrative practice will usually be established by the ATO having communicated consistently to a wide range of taxpayers on a particular issue. A general administrative practice is usually adopted for the efficient administration of the taxation system and will often be documented in a Law Administration Practice Statement, General Administration Law Administration Practice Statement, an ATO policy document (eg, the ATO Receivables Policy), or other precedential material (such as an ATO Interpretive Decision). An example is Law Administration Practice Statement PS LA 2003/8 which sets out the rules developed to lessen the cost of accounting for low cost assets for taxpayers carrying on a business. Where a draft public ruling represents the Commissioner's only public statement on an issue, the draft ruling will usually represent the Commissioner's general administrative practice.
>
> > 3.131 A general administrative practice is not established merely because there are several similar private rulings on a matter, although evidence of a significant number of uncontradicted private rulings on a matter over time will tend to support such a conclusion. Similarly, a bare failure by the Commissioner to take some action within his power does not establish a general administrative practice, but a repeated failure to exercise that power after the issue is drawn to the Commissioner's attention will tend to do so. Again, mere silence or failure to issue a public ruling on a matter does not constitute general administrative practice, but it will be established where, following identification of an issue, ATO officers have accepted it as the basis on which taxpayers should treat the issue in a range of situations.

4.8 In 2005, section 358-10 of the TAA 1953 was enacted to provide that a public ruling cannot apply detrimentally from a time before it is issued where that ruling changes a GAP. The ATO's position (which is confirmed by recent legal advice that the ATO obtained from the Australian Government Solicitor — the AGS legal advice) is that this does not mean that the ATO must assess the taxpayer's liabilities in accordance with the GAP. It only means that the ATO is not bound to apply the ruling and that the GAP will continue to operate only for the purpose of providing interest and penalty protection.

4.9 As set out below, it should also be noted that establishing whether a GAP exists can be extremely difficult for taxpayers.

4.10 Section 358-10 was introduced as part of a range of measures flowing from Treasury's Review of Aspects of Income Tax Self Assessment. That review considered the problem of retrospective application of changed ATO views, amongst other things. The review report[2] recommended:

> Recommendation 2.6
>
> Where the ATO changes a public interpretation or long standing practice to the detriment of taxpayers, that change should become effective prospectively and, where necessary, from a future date that allows affected taxpayers reasonable time to become aware of, and act upon, that new interpretation.

4.11 The Government acted on this recommendation by enacting section 358-10 and documenting its expectation in the explanatory memorandum that the Commissioner exercise his powers of general administration not to undertake compliance action for prior periods on a particular issue where he changed a GAP and the new practice was less favourable for taxpayers.

> Although the provisions referred to in paragraphs 3.128 and 3.129 [of the Explanatory memorandum to the Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005] refer to penalty and interest being foregone, the Commissioner's acceptance that there has been a general administrative practice can also result in no further primary tax being payable. Where the Commissioner changes a general administrative practice in a way that is less favourable for taxpayers, he is not obliged to amend assessments that were raised consistently with a practice in place at a particular time. The Bill needs no special provision to bring this about because it is an inherent part of the Commissioner's general power to administer the tax laws to make judgments about what returns to review and amend. Accordingly, the Commissioner would commonly decide to make a change in general practice prospective where the new practice is less favourable for taxpayers. Furthermore, in some cases it would be appropriate for the new practice to start at a future date (eg, because taxpayers need time to adjust their accounting systems). However, consistent with [Treasury's Report on Aspects of Income Tax Self Assessment, August 2004] at page 13, the Commissioner would generally not take this approach where tax avoidance is involved or the previous practice has been exploited in an unintended way.[3]

4.12 The IGT considers that if the Government had intended that taxpayers would receive certainty by requiring changes to the ATO's administrative practice to only operate prospectively (unless an arrangement involved tax avoidance, fraud or evasion), then it has been extremely difficult to achieve for the following reasons:

- Significant practical difficulties exist in establishing a GAP under the law itself (as highlighted in the AGS legal advice).
- The IGT is only aware of one case where the Commissioner has decided not to undertake compliance action for prior periods on a particular issue because

2 Treasury, *Report on Aspects of Income Tax Self Assessment*, Canberra, August 2004.
3 Paragraph 3.132 of the Explanatory Memorandum to the Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005.

taxpayers acted in accordance with a GAP, as the law relies on the Commissioner exercising his powers of general administration not to undertake compliance action for prior periods on particular issues where taxpayers acted in accordance with a GAP. During the finalisation of this review, the ATO provided the IGT with 14 cases where the ATO had applied its views only prospectively. However, it is not clear whether this was done because of the existence of a GAP.

4.13 These reasons are discussed in more detail below.

Significant practical difficulties with establishing a GAP

4.14 The ATO's position is that a GAP generally requires a habitual or customary adoption of a view in multiple cases of which the Commissioner is aware and accepts by administering the law consistently with that practice. This means that:

- establishing ATO acceptance of a GAP requires consideration of all relevant circumstances. At the very least, existence of the practice needs to be made clear to the ATO (and made with a purpose of eliciting a response from the ATO with respect to the asserted practice) and the ATO continued to administer the relevant law consistently with the relevant practice.

- public statements of how the Commissioner intends to administer the law may help to evidence a GAP, but are not enough in themselves to establish a GAP (notwithstanding potential indications to the contrary in paragraph 3.130 of the explanatory memorandum to the Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005 — as set out above). What is needed is evidence that the view has been serially applied — that is, a repeated application of the view to taxpayers' affairs needs to be established.

4.15 This view is confirmed by the AGS legal advice.

4.16 This view raises significant practical difficulties in establishing whether a GAP exists or not.

4.17 Firstly, on the above view, it is extremely difficult for taxpayers to definitively determine whether a GAP exists or not. They may not know if that practice has been applied by the ATO widely or not. Even if their adviser may be aware, their adviser is prevented by the secrecy provisions from adducing the requisite evidence. Also, the ATO itself may not know if a GAP exists because the IGT has observed in other reviews that the ATO does not consistently record which precedential decision it applies in making interpretative decisions in advice products, audits and disputes (see for example, agreed action item in Chapter 4 of the IGT's report on the *Review into Aspects of the Tax Office's Settlement of Active Compliance Activities: Report to the Assistant Treasurer*).

4.18 Secondly, the above view requires a relatively high hurdle to be cleared in establishing whether the ATO is aware of, and accepted, a practice adopted by taxpayers. For example, the AGS legal advice indicates that a GAP could be established where senior ATO officers are made aware of the industry practice on successive occasions with the purpose of eliciting a response as to whether the ATO accepts the

industry practice. However, a GAP will not be established where the ATO is aware of the practice, but does not agree with the practice. On the face of it, this view may appear to give clear guidance on whether a GAP exists or not. This ATO view raises significant practical difficulties in determining whether a GAP exists, and if so, at what point in time it does.

4.19 Take the following scenario for example (which is based on conduct seen in the examples raised with the IGT). New law may have been enacted and a small number of taxpayers applied for private rulings on particular arrangements that involved this new law. ATO officers follow the technical decision-making requirements of escalating the applications to the ATO's Centres of Expertise because there is no ATO precedential view. A precedential ATO view is formed and documented in a published ATOID and favourable rulings are issued. Other taxpayers entered arrangements on the basis of this view also; however, they did not apply for rulings given the time and costs involved. They relied on the view in the ATOID. They thought that until the ATO withdrew the ATOID, ATO officers would continue to be directed by the Commissioner to apply that view in materially similar circumstances. Several years later one of the taxpayers sought to enter a materially similar arrangement and sought another private ruling. This time the ATO escalated the ruling application to the tax counsel network (TCN) realising that a different conclusion may likely be reached this time, largely because of a new ATO view in another area of the law which impacted its thinking on how the relevant provision should apply. The ATO alerted the relevant industry to its potentially adverse view during a consultative forum meeting and sought community input. Months later the ATO advised that it was involved in discussions with Treasury seeking policy clarification. A year after alerting the industry to a potential new view, the ATO advised the industry that a draft public ruling was to issue shortly.

4.20 In examining the certainty that taxpayers have in relation to subsequent ATO active compliance action, on one view one could argue that a GAP existed up until the time the ATO advised the industry of its potentially adverse view. The ATO has arguably accepted the taxpayer practice because the ATO was made repeatedly aware of the practice in private rulings and was expected to respond as to whether the ATO accepted that practice. The ATO gave favourable private rulings and did not alert taxpayers to its potential adverse view until several years later.

4.21 On an alternative view, one could also argue that the ATO never accepted the practice. Firstly, according to the ATO's legal advice, public statements about how the ATO intends to administer the tax laws (such as ATOIDs) do not establish a GAP unless there is other evidence that indicates customary or habitual ATO administration consistent with the view expressed in the public statement. Secondly, 'senior officers' were not made repeatedly aware of the practice, only the relatively lower level officers (the Centres of Expertise) received and considered the ruling applications — once the relatively more senior TCN officers were made aware of the practice they were involved in an internal dialog on the technical issue and once they concluded that their view was likely to be adverse (albeit taking some time) it was communicated to the community. Thirdly, the explanatory memorandum to the Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005 indicates that a small number of single private rulings will not evidence a GAP (this is likely due to the risk framework that the legislation provides for the private ruling system — a trade-off between

providing timely certainty on the application of the tax laws to a private ruling applicant while at the same time limiting the ATO's risk of giving incorrect advice to a single case). However, evidence of a significant number of uncontradicted private rulings on an issue over time may evidence a GAP.

4.22 On this alternative view, therefore, there was no GAP. This means that those who obtained private rulings would be protected under the binding advice framework. However, those that relied on the ATOID would be exposed to subsequent adverse compliance action.

Commissioner's power of general administration not to undertake compliance action for prior periods on particular issues

4.23 Even if a GAP exists, the Commissioner will still need to exercise his power of general administration to apply views prospectively only. There are a number of ATO publications which set out the ATO's interpretation of how the Commissioner exercises this power.

4.24 Paragraph 32 of PSLA 2008/3 indicates that additional primary tax protection may effectively be available in certain circumstances:

> If there is a change to a general administrative practice the ATO would usually communicate the change by way of a public ruling. However, 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 ATO 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 ATO will amend assessments only where tax avoidance is involved or the practice has been exploited in an unintended way.

4.25 This statement reflects the Government's expectation set out in paragraph 3.132 of the explanatory memorandum to the Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005.

4.26 Since 1992, the ATO has expressed an intention to not take compliance action with retrospective effect where it has contributed to taxpayers generally adopting a certain practice in lodging their tax returns (see for example, paragraph 16 of taxation ruling TR 92/20).

4.27 In addition, the ATO's TR 2006/10 outlines the ATO's public ruling system. Paragraphs 60 to 69 set out the ATO's position that public rulings will generally have retrospective and prospective effect. Paragraphs 61 to 62 of that ruling note, however, that there may be circumstances where it will depart from this general approach:

> 60. The 'date of effect' guidelines provided in paragraphs 61 to 69 of this Ruling are not intended to be rigid rules that must be adhered to without due regard to the effect on the revenue or the extent to which entities might be disadvantaged. Rather, the guidelines provide a guide as to the appropriate date of effect provision that might generally be adopted to ensure consistency in the use of date of effect provisions in public rulings.

> 61. At all times these guidelines need to be administered in a commonsense manner in light of the particular issues dealt with in a public ruling.
>
> 62. It is recognised that there may be situations where, for the proper administration of the relevant provisions, it will be necessary to depart from the guidelines. For example, where giving a public ruling both a past and future application would, on an objective consideration of all the factors, produce an unfair, absurd, unjustifiable or impractical result.

4.28 Neither PSLA 2008/3 or TR 2006/10 set out any procedural steps or relevant criteria for considering whether to only apply a view prospectively. The current ATO process for considering the exercise of the Commissioner's power of general administration is currently set out in PSLA 2009/4. This process relies on ATO officers to initiate a process and prepare a submission, for the Commissioner's consideration, that the ATO not undertake compliance action for prior periods on a particular issue.

4.29 Under PSLA 2009/4, in considering whether to exercise the Commissioner's power of general administration not to undertake compliance action for prior periods on a particular issue, a number of criteria are to be considered by ATO officers. These are set out in paragraphs 22 and 23 of the appendix B to the PSLA 2009/4:

> 22. The Commissioner cannot use his powers of general administration to accept non-compliance with the law. However, as part of his duty of good management, the Commissioner can decide not to undertake compliance action on a particular issue for prior years or periods.
>
> 23. In determining whether or not to undertake compliance action for prior years or periods on a particular issue that affects a class of taxpayers or industry group, the Commissioner will consider all of the circumstances, including:

- the estimated amount of revenue at risk;
- the potential number of taxpayers affected;
- the cost of identifying and pursuing non-compliance;
- the extent to which some taxpayers have complied with the ATO view in respect of the issue, where known;
- whether the ATO has contributed to non-compliance;
- the likely impact on future voluntary compliance by taxpayers if compliance action is not taken;
- the relative priority of the compliance risk compared to other identified risks;
- the strength of the ATO view on the issue; and
- any proposed change of law affecting the issue including the proposed date of effect of any such change.

4.30 Industry was concerned that these criteria did not sufficiently consider the ATO's facilitation or contribution to the formation of industry practices. It was also considered that they were unduly directed towards revenue protection. The criteria are discussed in more detail in Chapter 5.

4.31 However, the interaction between PSLA 2008/3 and PSLA 2009/4 is unclear. PSLA 2009/4 is a lawful direction to staff that no-one but the Commissioner can exercise the power of general administration to not take compliance action on an issue for prior periods. Paragraph 32 of PSLA 2008/3 indicates the subject matter for the exercise of the power of general administration in relation to GAPs. PSLA 2008/3 does not set out any procedural matters inconsistent with PSLA 2009/4. However, the ATO advises that paragraph 32 of PSLA 2008/3 is not subject to the process set out at paragraphs 22 and 23 in Appendix B to PSLA 2009/4 and a submission to the Commissioner is not required in order to apply the practice set out in paragraph 32. This means that there is an absence of available material that gives guidance on the process and relevant considerations in exercising this discretion not to take compliance action for prior periods on a particular issue where taxpayers have acted in accordance with a GAP. The ATO has agreed to clarify the interaction of these two practice statements.

Application of GAP in exercising the Commissioner's power of general administration

4.32 Notwithstanding this process, the IGT is only aware of one case in which the Commissioner exercised his powers of general administration not to undertake compliance action for prior periods on a particular issue because taxpayers had self-assessed in accordance with a GAP. It is important to note, however, that during the finalisation of this report, the ATO referred the IGT to 14 public rulings which, in whole or part, only had a prospective effect and were said to demonstrate:

> [the ATO's] application of the administrative policy in paragraphs 31-32 of PS LA 2008/3, consistent with our previous practice described in TR 92/20. They also demonstrate that we apply some rulings on a prospective basis even where there is no GAP, consistent with the principle set out at paras 61 and 62 of TR 2006/10.
>
> … The prospective application of the view in each case will not necessarily reflect an acceptance that a prior ATO general administrative practice existed, nor acceptance of a specific industry practice (indeed, in some instances, there may have been several differing industry practices).

4.33 It should be noted that it is unclear as to whether the prospective date of effect of these rulings is due to the existence of a GAP. Prospective effects can be decided for a range of reasons, as set out in TR 2006/10, PSLA 2008/3 and PSLA 2009/4. It is also unclear whether the views in these rulings had not already been sought to be applied in compliance activities before these rulings were finalised.

4.34 In the case that the IGT examined, the ATO identified in 2001 a potential compliance concern in relation to a temporary five-year exemption from income tax for specified management fee income earned by life companies in respect of certain life insurance policies. This exemption was a transitional arrangement, part of the legislative reform of the tax treatment of the insurance industry. During client reviews

in 2001, the ATO concluded that the existence of certain types of policies established the eligibility for the exemption. Following industry prompting to provide more certainty, the ATO issued an ATOID in late 2002 and gave a favourable private ruling which confirmed the earlier client review approach. However, following a more detailed compliance project in 2004, the ATO reconsidered its view in light of the additional facts it obtained and engagement of higher level technical officers. In late 2005, the ATO withdrew the ATOID saying that it was reconsidering its position. The ATO finalised its view in late 2006 after a review by external counsel and input from industry representatives. External counsel concluded that the evidence that would establish eligibility for the exemption was different to that previously thought — the effect of which would expose the industry to an estimated $490 million in amended assessments. However, until the ATO announced in April 2007 that the Commissioner would not seek to apply his view retrospectively, the industry was left with the impression that he would. The ATO decided to take no compliance action because it accepted that due to its prior conduct there was a GAP. Also relevant to the ATO's decision was that because the legislative provision was a transitional measure it had no further prospective effect. Additionally, the ATO also considered that the external counsel's view was not free from doubt. This is the only case in which IGT has observed the Commissioner exercising his power of general administration not to undertake compliance action for prior periods on a particular issue where taxpayers acted in accordance with a GAP.

Conclusions

4.35 In the absence of binding advice, the law as currently applied, allows the ATO to apply its views retrospectively without protection against primary tax for taxpayers. The examples that were raised in submissions to the IGT show that the main problem is not that one binding advice clearly changes another binding advice, but that there are disagreements over whether a previous ATO view or practice existed or the ATO rejects having accepted an industry view of which taxpayers and their representatives believe the ATO to have been aware and which they believe the ATO had accepted. The situation is further compounded by ATO delays in firstly identifying its compliance concerns and, secondly, finalising its position in relation to those concerns.

4.36 The Commissioner may exercise his power of general administration not to undertake compliance action for prior periods on particular issues where taxpayers act in accordance with a GAP. However, on the ATO's view, taxpayers face significant practical difficulties in establishing whether a GAP exists or not.

4.37 If the Government's intention was to provide certainty to taxpayers by changes to tax administration only operating prospectively where they rely on longstanding practices or GAPs (unless involving tax avoidance, fraud or evasion), then it should consider whether the current arrangements clearly achieve this aim and, if not, what changes should be made.

4.38 Community consultation on this matter could prove useful in clearly understanding the practical difficulties faced by taxpayers in establishing eligibility to any proposed arrangements as well as an understanding of the potential reduction in the amount of ATO guidance if all ATO guidance was made binding. This may include a consideration of whether the many different types of advice products that the ATO

issues, and the varying degrees of certainty that these products provide, should be rationalised. It should be noted that the more certainty that attaches to a particular advice product may mean that the ATO would issue less of that particular advice product and, therefore, safeguards may be needed in this regard.

RECOMMENDATION 1

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

ATO Response

This recommendation is a policy matter for Government.

The ATO is of the view that the current legislative framework provides certainty and protection to taxpayers through the public and private rulings regimes. The law also provides protection for taxpayers from penalties and interest charges where a taxpayer self assesses in accordance with ATO advice (other than a ruling) or a general administrative practice.

As pointed out by the Inspector-General, the ATO's administrative policy is generally not to apply its view of the law retrospectively where that view is less favourable to taxpayers than a previous ATO general administrative practice. The issue or concern raised by the Inspector-General is about determining when a general administrative practice exists. The existence of such a practice is a question of fact to be determined having regard to all the facts and circumstances. This involves a consideration and weighing of relevant factors.

It is difficult to see how the concern raised by the Inspector-General would be practically addressed by a law change which either seeks to define an ATO general administrative practice or provides protection from primary tax where a taxpayer acts or self assesses in accordance with such a practice.

In the ATO's view, the examples provided to the Inspector-General indicate that the real issues arising from this review are twofold. First, there are sometimes disagreements over whether either a previous ATO practice existed or the ATO consciously accepted or contributed to a practice or view adopted by taxpayers. Secondly, some examples show a difference of view about the meaning and scope of an existing ATO view expressed in a ruling or other product.

The ATO notes the Inspector-General's conclusion that on the basis of disagreements about previous ATO practices and delays in finalising ATO positions on some compliance concerns "taxpayers' perceptions of changes in views or practices are justified in some circumstances". In the ATO's view, however, there is no evidence of so called u-turns where the ATO has applied a change of view retrospectively. In fact, as pointed out at paragraph 4.32 of the report, we have identified 14 public rulings issued over the last 4 years where the ATO view, either wholly or partly, had only a prospective effect. In each of these cases it was considered appropriate in the circumstances to apply the view only on a prospective basis.

The better approach to addressing the concern raised by the Inspector-General is for the ATO to provide more guidance on the circumstances and factors which are relevant in determining when the ATO will only apply its view of the law prospectively. This is discussed at Recommendation 2.

CHAPTER 5 — ATO ADMINISTRATIVE ACTION TO REDUCE ADVERSE EFFECTS OF PERCEIVED U-TURNS ON TAXPAYERS

ATO process and criteria for deciding to retrospectively apply new or clarified views

5.1 As set out in the previous chapter, the current law relies on the Commissioner exercising his powers of general administration not to undertake compliance action for prior periods on particular issues where taxpayers self assess in accordance with a general administrative practice (GAP). There are a range of concerns with this administrative process and criteria, which are discussed below.

Overarching principles

5.2 On one view, the ATO's ability to apply views retrospectively promotes a desirable deterrent effect on those seeking to take inappropriate advantage of uncertainty or ATO errors in non-binding material. It may also encourage taxpayers to seek clarity and raise the ATO's awareness of all issues where the law was unclear.

5.3 However, this approach may also penalise taxpayers where they follow the law or ATO advice in good faith or hold a reasonable belief that the ATO had knowingly accepted the practice. The examples demonstrate that some areas of ATO change have been, in what were thought by a broad cross-section of the tax profession, a reasonably settled and longstanding accepted practice of application of the law.

5.4 For example, when the Division 7A provisions were first enacted into the *Income Tax Assessment Act 1936* (ITAA 1936), small businesses sought clarity on whether unpaid present entitlements which were used by trustees in their businesses would be considered 'loans' for the purpose of that Division. From 1999, the ATO answered the issue as an 'FAQ' on its website. Several questions on this issue were asked, all of which (until February 2009) concluded that such arrangements were not loans and Division 7A would not be triggered. However, in 2008, the ATO identified compliance concerns in a small number of cases. In 2009, a senior tax official publicly stated that in these circumstances Division 7A could be triggered. Tax practitioners perceived a change in ATO approach on the issue and that it may be applied to commercial arrangements (estimated by some to number up to 460,000) which were already entered into in reliance on what was thought to be an ATO awareness and longstanding acceptance of such a tax treatment. The IGT notes that in December 2009, the ATO issued a draft ruling which proposes to apply part of its view prospectively. The IGT notes that, at the time of writing, there was still significant private sector dissatisfaction and it is likely that there will be further debate on this issue.

5.5 The examples that were raised in submissions to the IGT show that frequently there are disagreements as to whether the ATO is changing a previous view or approach or merely clarifying it. A 'clarification' is said to be consistent with prior advice and therefore, on one view, retrospective application of that view is justified

because the ATO always held that view. To a large extent these disagreements are due to the inherent difficulties with definitively determining whether a subsequent view or its application is clearly a 'change' or not. Take, for example, recent compliance action on 'exploration expenditure' under the Petroleum Resource Rent Tax regime. On one view the ATO's recent compliance activities in relation to the application of the law in relation to feasibility studies arguably narrowed the purpose and nature of 'exploration or prospecting expenditure' — when compared to paragraph 51 of taxation ruling TR 98/23. It could be argued that the ATO officers placed more weight on different paragraphs in the ruling with the effect of reducing the scope of exploration expenditure in relation to feasibility studies and when those studies could be conducted. On another view, it could be argued that the application is entirely consistent with the ruling.

5.6 Overall, the IGT considers that the distinction between 'changed' views and 'clarified' views is unhelpful because it does not resolve the tensions that underlie the perceptions of unfair ATO treatment — that is, reasonable taxpayer reliance on the ATO's administration of the law at the time that taxpayers relied on that ATO conduct.

5.7 In this context, the IGT considers that the overarching aim of the Commissioner's exercise of his power of general administration should be the fair and reasonable treatment of taxpayers by striking an appropriate balance between:

- protection for taxpayers where the ATO has facilitated or contributed to formation of taxpayer views which are inconsistent with subsequent ATO views; and

- preventing a laissez-faire situation where any position could be arguably justified on a particular area of uncertainty before the ATO releases its formal view.

Criteria for exercise of Commissioner's power

5.8 A broad cross-section of the tax profession was also concerned with the criteria that the ATO chooses to consider in exercising the Commissioner's power of general administration. They consider without guiding principles or a self-executing process, the criteria set out in paragraphs 22 and 23 of the appendix B to the PSLA 2009/4 (set out above) provide scope to justify decisions made with the objective of revenue protection, rather than seeking to achieve what is fair and equitable for all.

5.9 The IGT believes that there is scope for improving the current processes so that proportionate and fair outcomes can be better achieved in a manner that instils greater public confidence. More could be done to ensure that such decisions are guided by clearly stated principles, with reference to considerations that are clearly relevant. The decision-making process should be transparent and instil public confidence that the competing principles have been appropriately balanced. Taxpayers should be able to input into such a process every time the ATO proposes a new, changed or clarified view.

5.10 The IGT has worked with the ATO, with input from industry and tax practitioners, to develop mechanisms that should help to reduce the adverse impacts of changed and delayed ATO advice. These are set out in recommendation 2 below.

5.11 Generally, the criteria seek to determine the extent to which the ATO facilitated or contributed to the practice, and if so, make any change prospective in effect. Other criteria also need to be considered, such as whether the taxpayer has taken reasonable care in adopting a practice which is devoid of legal merit. Naturally, the ATO has an overriding power to seek compliance on a retrospective basis where there is fraud, evasion or tax avoidance involved.

RECOMMENDATION 2

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

(a) Process steps

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

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

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

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

RECOMMENDATION 2 (CONTINUED)

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

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

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

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

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

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

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

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

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

ATO response

The ATO agrees with the recommendation but has reservations about the relevance of criterion (c) (iii).

In considering the circumstances when an ATO view should only be applied prospectively, it is important to have regard to the legal framework under which the ATO administers the taxation laws. A taxpayer's liability is determined in accordance with the law subject to where a ruling issued by the ATO applies to the taxpayer. A public, private or oral ruling is binding on the Commissioner if the ruling applies to the taxpayer and the taxpayer relies on it.

The legal framework which supports the ATO's advice and guidance products is aimed at striking a balance between the needs of specific taxpayers to have certainty in their affairs and the need to protect the public revenue and thereby provide fairness to all taxpayers. It is the general community which bears the cost where the ATO makes a mistake in a legally binding document, while the taxpayer who has been able to rely on that document has received a benefit not available to others.

The outcome of the Review of Self-Assessment (ROSA) clearly envisaged two main forms of ATO advice:

- Legally binding advice where taxpayers who reasonably rely on it would be protected from having to pay any further primary tax in accordance with the law, as well as penalties and interest charges, and
- Other advice, which we call guidance, which provides more general information to assist taxpayers where taxpayers who reasonably rely on that guidance would be protected from penalties and interest charges.

This legal framework is the starting point for deciding whether, under the Commissioner's powers of general administration, there are circumstances which warrant the ATO deciding only to apply its view of the law on a prospective basis.

The ATO is of the view that the examples provided to the Inspector-General do not provide evidence of the ATO applying a change of view retrospectively. Some of the examples refer to opinions expressed in discussion papers which were issued by the ATO to facilitate consultation before the ATO formed its view on the particular issue. As pointed out in the report at paragraph 5.5, other examples demonstrate a difference of view about whether the ATO was merely clarifying an earlier view.

We agree with the process steps outlined in part (a). The ATO has for a number of years considered the appropriate date of effect of advice expressed in public rulings, as evidenced by the significant number of issued draft and final public rulings that have had special date of effect arrangements. TR 2006/10 (and TR 92/20 before it) sets out the principles and guidelines to be followed in deciding the date of effect of public rulings. The Rulings Panel provides advice on the appropriate date of effect.

The ATO agrees with the principles reflected in part (b). These are consistent with the approach outlined in TR 2006/10 and PS LA 2008/3 (and TR 92/20 before them).

> The ATO agrees with the criteria in part (c) apart from reservations about the relevance of point (iii). We will consider this further during consultation with taxpayer representatives. Where more than one possible interpretation is open in respect of an issue the ATO may consult with Treasury in seeking to understand the purpose or object of the particular provisions. However, the ATO's view is not determined by any such advice received. The ATO applies legally accepted principles of statutory interpretation, which means taking a purposive approach to the interpretation of the law which has regard primarily to the words of the relevant provisions read in the light of the scheme of the Act and the history and objects of the provisions.
>
> The ATO agrees with the Inspector-General that the criteria must be considered as a whole and it is a weighing of the various criteria which will determine whether the ATO will apply its view only on a prospective basis. For example, the identification of an issue in an audit where no action was taken because it was not considered to be a sufficiently high risk does not by itself mean that the later application of the ATO view in respect of that issue should only be on a prospective basis.

5.12 The IGT will maintain a watching brief over the development of the ATO's administrative practice. Additionally, in accordance with current IGT practices, the IGT will review the implementation of these actions at a future date.

Taxpayer protection where the ATO is unaware of the issue

5.13 On one view, the GAP provisions generally reveal that the level of intended taxpayer protection effectively depends upon ATO acceptance of the practices that taxpayers adopt under the law. 'Acceptance' does not require positive action on the ATO's part. However, it does require that the ATO is, at least, aware of the practice.

5.14 Situations can also arise where the ATO may be unaware of an issue, taxpayers take positions which are inconsistent with an ATO view that is eventually released and there is no question of tax avoidance — for example, where taxpayers self-assess their tax liabilities under new law in the absence of any ATO indications of its technical interpretation or application of the law to facts.

5.15 In these cases, arguably, there is already protection — that is, against penalty and interest but not primary tax, provided that the taxpayer takes reasonable care and the position adopted constitutes a reasonable arguable position (RAP). If primary tax protection were afforded to an inappropriately low standard of interpretation of new law in the absence of ATO awareness, it could encourage tax avoidane as well as ATO responses in issuing 'protective' position papers, thereby reducing prospective certainty.

5.16 If the taxpayer requires protection against additional primary tax in these circumstances, a private ruling can be sought. But the problem can be with the time taken to obtain a private ruling from the ATO. This issue is currently being addressed in another IGT review, the review into the ATO's administration of private rulings.

5.17 Another difficulty is that often there is significant disagreement between the ATO and taxpayers in relation to whether reasonable care was taken and whether the taxpayer has a RAP. Taxpayers assert that the ATO appears to reject RAPs on the basis

that the position does not agree with the ATO's view — that is, the ATO has a different assessment of the legal probability of the correctness for the taxpayer's view. Taxpayers point to a number of court decisions reversing ATO 'no RAP' decisions in support of their assertions. Taxpayers also argue that the ATO should take a wide interpretation as to whether there is a RAP in cases involving new law. However, this issue is outside the scope of this review, but has arisen in a number of other contexts and may be a potential review topic on the IGT's forward work program.

CHAPTER 6 — ATO ENGAGEMENT WITH TAXPAYER COMMUNITY

6.1 ATO-taxpayer community engagement on technical issues (such as the interpretation of the law or application of the law to particular facts) needs to deliver cogent views that properly consider the potential range of applicable factual circumstances.

6.2 The ATO has a range of vehicles for community engagement to assist in developing its views — for example, the public rulings process and consultative forums. Determining the right vehicle for community engagement on technical issues is a difficult matter.

6.3 On the whole, and concerns with timeliness aside, the ATO as a Government agency generally engages with the community well — for example, the public rulings program provides a means for significant taxpayer community input and a general level of transparency in the technical decision-making process.

6.4 However, there is room for improvement in relation to the use of technical discussion papers (such as 'Discussion Papers', 'Consultation Papers' and 'Issues Papers'), specifically concerning:

- the purpose of technical discussion papers and their interaction within the broader ATO-taxpayer community consultation framework; and
- the manner and tone of some technical discussions and interactions.

6.5 There is also room for improvement in relation to a number of other issues that may arise during the development and finalisation of the ATO's technical views, including:

- the potential to give interim guidance pending the development and finalisation of ATO views;
- the use of various other vehicles to alert taxpayers and initiate technical discussions;
- the use of circuit breakers to overcome impasses in the technical development process; and
- the treatment of contemporaneous compliance action.

6.6 In relation to issues of timeliness, the quick identification of significant revenue risks and the quick resolution of technical issues minimises the adverse effect of retrospectively applied views. However, the examples that were raised in submissions to the IGT show that there are long periods of delay due to:

- the time taken to finalise ATO views; and
- the time elapsing before the ATO becomes aware of its compliance concerns.

6.7 These issues are discussed further below.

Discussion of technical issues including discussion papers

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

6.9 However, the examples show that the underlying purpose and objective of technical discussion papers within the consultation framework, and the wider perception of these papers, may not be currently well articulated or understood.

6.10 As a result of raising this issue with the ATO, the ATO advised that it is considering tightening the internal processes for release of discussion papers on technical issues. It considers that there are at least two areas where discussion papers could be issued:

- pre-public ruling consultative documents, which the ATO considers should in the future rarely be issued (as a general rule) because draft public rulings provide an appropriate consultation mechanism in most cases. A standard template may be adopted providing for a standard disclaimer, a preferred view (if available) and alternative views; and
- National tax liaison group (NTLG) discussion papers, which the ATO considers should be issued generally in response to issues raised through NTLG forums or to facilitate the implementation of new measures.

6.11 The IGT observes that draft rulings will provide the community with the ATO's preliminary view for comment and is part of its usual ruling program process. The 'pre-public ruling consultative document' also appears to be an intended precursor to a future public ruling. 'NTLG discussion papers' should provide a vehicle for the community to initiate discussion on technical issues.

6.12 Although the ATO's advice above clarifies its intended use of the above documents in a public ruling process, it remains unclear how the ATO will interact with the taxpayer community while it develops its technical views that arise in audits

and in the process of developing private rulings. This is important because the ATO's compliance concerns that arose during audits and private rulings were the areas which generated most of the examples of purported delayed or changed ATO views in submissions to the IGT. This indicates a need for a clearer framework for taxpayer engagement on the development of ATO views, especially in circumstances where the ATO is progressing compliance action on the basis of undeveloped ATO views.

6.13 The IGT has observed that in compliance projects the ATO has a preference for developing views as it progresses a small number of compliance cases with the intention of applying that view more broadly. This may be a result of the ATO's preference for leveraged activities. However, there are inherent risks in developing a view for broader application through a particular compliance case — namely, the risk that such views do not sufficiently consider variations on the examined arrangement or that the examined arrangement is not representative of the issue. The IGT has observed this result in other reviews also — see for example, Point 2 under paragraph 3.21 in the *Review into Aspects of the Tax Office's Settlement of Active Compliance Activities: Report to the Assistant Treasurer.*

Tone and manner of ATO engagement on technical discussions

6.14 The examples show that technical discussion papers are currently perceived as promoting a particular ATO view rather than an impartial discussion of the technical issues. Such perceptions promote defensive positions and hinder effective technical discussions. For example, tax practitioners considered that the December 2008 draft practice statement, *Taxation of the section 95 net income of a trust*, did not sufficiently represent the alternative arguments. This was important because the document set out how compliance staff should take action in compliance activities pending the resolution of the technical issue.

6.15 These perceptions are strongly held where the views in technical discussion papers are applied in compliance activities. For example, in 2008, the ATO was consulting on its views regarding research and development expenditure in relation to contracts for result (amongst others). At the same time it was assessing taxpayers as 'high risk' in relation to these issues and in accordance with the views set out in the consultation paper, which it acknowledged to be 'more controversial'.

6.16 Promoting a particular favoured ATO view or approach in technical discussion papers may be a result of ATO experience that community engagement is greater on issues when it indicates some of its thinking. It may also be a result of the ATO's willingness to reserve an ATO position on issues in an environment where it may be uncomfortable to formally express its view, particularly on emerging contentious areas.

6.17 However, it appears that this ATO approach has been perceived as 'testing the market'. While this may be appropriate in certain circumstances, it causes an adverse reaction (especially, in combination with other ATO conduct) by taxpayers and their advisers that result in them taking defensive positions.

6.18 The examples also show that there are other factors that appear to impact negatively on taxpayers and their advisers in these circumstances. These factors include:

- disagreements over whether ATO action is 'changing' previous ATO approaches or just 'clarifying' them — for example, in response to private sector submissions that there was a change in ATO approach on the interaction of Division 820 of the *Income Tax Assessment Act 1997* (ITAA 1997) and the transfer pricing provisions in relation to guarantee fees and interest deductions (the 'Division 820 issue'), the ATO said in its discussion paper that nothing was intended to be contrary to previously issued ATO advice and the ATO considered it appropriate to retrospectively apply the views. The IGT has observed these disagreements in other reviews also. For example, the ATO views taken in relation to taxpayers' GST claims in the charter boat industry which the IGT examined in the review into aspects of the ATO's settlement of active compliance activities. See also chapter 2 of *Review of Tax Office's management of complex issues — Case study on service entity arrangements*.

- insufficient ATO assurances that views (being adopted in active compliance activities at the same time that they are subject to technical development processes) have been subject to an appropriate level of technical due diligence and the views are that which the ATO will stand by. For example, in relation to the Division 820 issue, during this review the ATO withdrew its discussion paper (which it was seeking to apply in some of its compliance activities) and provided (as a result of significant industry urging to do so) a revised draft ruling and a 'rule of thumb' as a measure of interim guidance.

- the ATO not clearly demonstrating to taxpayers that it understands how its views interact with other areas of the law. As a result, taxpayers say that they are concerned that the ATO does not dispel their apprehension that the view will be applied to circumstances that the ATO has not foreseen — for example, the discussion paper issued in relation to the Division 820 issue was said to omit a range of unconsidered issues, such as the impact on section 974-80 requirements, the potential exposure to double taxation with foreign jurisdictions and how the matter would be handled under the Mutual Agreement Procedures.

- (in circumstances where the ATO does not give interim guidance) technical discussion papers that are left in abeyance, or development into a public ruling is significantly delayed, following critical feedback or pending Treasury's action or further consideration — for example, the ATO's draft discussion paper on section 974-80 of the ITAA 1997 which was withdrawn after substantial industry critical feedback and pending the ATO's discussions with Treasury. Also, the ATO withdrew taxation ruling TR93/15 (concerned with the capital gains tax implications of earn-out arrangements) and issued a replacement draft ruling TR2007/D10 in October 2007. This draft ruling has not been finalised. Tax practitioners are concerned with the prolonged delay, especially as they consider that the view was settled by TR93/15 and was relied on for more than 14 years. They were also concerned that the ATO has signalled in its Compliance Program that it will examine this issue in compliance activities for small to mid-sized businesses and therefore there is no binding advice on which taxpayers can rely.

The January 2010 Rulings Program notes that the finalisation date for the ruling is yet to be announced, pending consideration of its discussions with Treasury.

6.19 These factors directly impact on the positions taken and the manner of engagement adopted, significantly impeding the ATO's ability to effectively engage with the taxpayer community on the significant technical issues.

6.20 However, the examples also show that some of the approaches that the ATO has taken lend themselves to minimising this defensive reaction and improving taxpayer community engagement — for example, the ATO informally engaging with tax practitioners by talking through the issues with interested parties (either over the phone or in meetings) before 'putting pen to paper' and formally consulting on the development of its view. Also, providing taxpayers with a mechanism to enable them to raise the implications of views as those views were being developed appeared more likely to improve taxpayer confidence and engagement.

6.21 For example, in relation to a proposed capital markets ruling, tax practitioners comment favourably that ATO officers sought to test views by phoning key practitioners before releasing a draft ruling. As a result of these conversations, the ATO became aware that it had only considered one of four possible applicable commercial arrangements. Through these calls the ATO was able to avoid significant adverse comment if the ruling had been released without taking these other arrangements into account.

6.22 Although these approaches may not be commonly used, where they are used it has enabled the ATO to arrive at a reasonably informed view and improved taxpayer engagement in technical discussions.

6.23 Potential exists to use technical discussion papers more broadly as an opportunity for greater community engagement and mutual understanding through genuine dialogue. If a paper is to benefit the community more appropriately it must deliver its message more effectively and be better understood. This understanding needs to be in respect of the role of the paper in itself and the community engagement framework of which it forms a part. The IGT considers that if technical discussion papers are used as a tool to engage in dialogue and develop a common understanding of the issues, real success will come from genuine and perceived commitment by broader stakeholders.

Interim ATO guidance to taxpayers

6.24 Interim ATO guidance to taxpayers is important to provide prospective certainty during the periods in which significant technical issues are being resolved. Without interim guidance taxpayers are exposed to an increased risk of adverse ATO views. This erodes prospective taxpayer certainty and erodes confidence in the ATO.

6.25 The examples also show that, notwithstanding the fact that the ATO may take many years to finalise its views, the ATO provides no interim guidance unless significant external pressure is brought to bear on the ATO to do so.

6.26 For example, in the *F C of T v Phillips* case ((1978) 8 ATR 783), the Full Federal Court affirmed that fees paid to a related service entity are deductible provided they are commercially realistic. In 1998, the ATO commenced a compliance project on particular industries which it considered may have uncommercial fee arrangements. Audits were started. From 1999 to 2005, tax practitioners consistently asked the ATO at various forums (such as consultative forum meetings, meetings with tax practitioner bodies as well as in relation to press coverage of the issue) the question of what were commercially realistic rates. The ATO gave indicative guidance in its ruling, TR 2006/2, and an associated booklet in April 2006.

6.27 On the one hand it may be difficult for the ATO to give firm indications until the range of existing arrangements is understood. However, interim guidance may be needed to help taxpayers minimise the risk of subsequent adverse active compliance action, especially where resolution of technical issues is expected to take many months or years.

6.28 The ATO may not be able to, as a matter of course, adopt a 'middle ground' that taxpayers can use as an interim measure pending finalisation of an ATO view. On one view, the Commissioner may not knowingly countenance an approach that he considers may be contrary to that law. (Note, however, that paragraphs 3.59 and 3.60 of the explanatory memorandum to the Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005 may indicate an intent that the Commissioner may do so where the interests of certainty are important). Also, as a practical matter, sometimes there may not be any middle ground or the need for an interim measure is not apparent before consultation with the community has taken place.

6.29 In light of the extended delays in some cases in finalising ATO views and the need for the taxpayer community to take steps to avoid subsequent adverse ATO action, the IGT considers that the ATO should do what it can to provide guidance that would minimise the risk of subsequent adverse compliance action — for example, examining the potential for 'interim' rulings that either only apply for a limited period of time or protect against penalties but not primary tax (as was the case in the November 2009 practice statement PS LA 2009/7 *Approach to certain trust issues involving Division 6 of Part III of the Income Tax Assessment Act 1936 pending resolution of the Bamford litigation*).

ATO taxpayer alerts

6.30 Taxpayer alerts issued by the ATO allow it to quickly communicate to taxpayers its concerns that certain arrangements amount to tax avoidance. This alerts taxpayers to take great care when dealing with these specific arrangements. The IGT considers that notwithstanding that a technical discussion process is underway, where the ATO reasonably understands a compliance concern and the ATO is concerned that the specific arrangement amounts to tax avoidance, the ATO should not be prevented from issuing a taxpayer alert. In these circumstances it is in taxpayers' interests to be quickly alerted to ATO concerns over tax avoidance.

6.31 Submissions have also raised concerns that some taxpayer alerts covered a wide range of arrangements that also appeared to capture compliant arrangements as subjects of possible tax avoidance action. The IGT has observed that the ATO has made

efforts to target taxpayer alerts towards those specific arrangements with which it is concerned. The IGT considers that there is a need to ensure that such targeting is improved promptly and continually.

Public statements

6.32 The examples show that there is a degree of uncertainty about the purpose of certain ATO public statements — such as compliance concerns raised in speeches or public documents issued by senior tax officials. On one view they could be seen as alerting taxpayers to ATO concerns. However, they may not be sufficiently understood by the taxpayer community without further explanation and interaction. Therefore, when compliance action is taken, it transpires that the technical issues may not have been sufficiently discussed with externals to an extent that the ATO action can be seen by the broader community as justified.

6.33 For example, in August 2006 the ATO highlighted as a compliance risk 'significant acquisitions and divestments, especially the tax outcomes of private equity investment groups, infrastructure groups and financial intermediaries to businesses conducting significant acquisition or divestment transactions' in its 2006-07 Compliance Program. In late 2009, the ATO took action to stop payments made to an offshore private equity firm following the public float of an Australian company group. This subsequent action raised significant adverse public comment.

6.34 Better public understanding of the ATO's actions and views could have been facilitated through a discussion paper (which could have been issued shortly after the concern was raised in the Compliance Program) with the ATO's preferred view being subsequently set out in a draft ruling. This would have provided the ATO with an opportunity to obtain information and intelligence in a non-adversarial form more quickly, while at the same time allowing the taxpayer community to give input on the technical issues as well as the factual circumstances to which the views could apply.

Who should initiate technical discussions and when

6.35 Raising significant compliance concerns to public awareness as soon as the ATO becomes aware of them helps taxpayers to take action to minimise the risk of subsequent adverse ATO views — either by structuring arrangements differently to avoid the risk, or by electing not to enter the arrangements.

6.36 However, the examples show that the ATO may wait several months, sometimes years, before it alerts taxpayers of its compliance concerns in a manner that helps taxpayers avoid the risk of subsequent adverse ATO views. For example, the ATO issued class rulings (a form of public binding advice) for around a ten-year period in the late-1990s to mid-2000s. The rulings considered a certain type of payment as exempt income because of a broad view that the ATO took of the legislative provisions. A few years ago, the ATO narrowed its interpretation of the legislative provision — leading to a different tax outcome for the type of payment in question. However, the ATO did not alert taxpayers to this new view and did not withdraw the previous rulings. A couple of years ago, a taxpayer applied for a materially similar class ruling to the previous class rulings. The ATO made numerous information requests but never indicated a change in the prior view. After several months, when

the ruling became urgent the ATO disclosed its concern that it had changed its interpretative approach to the provision. However, after more taxpayer interactions (hampering the taxpayer's operations), the ATO obtained a better understanding and a favourable ruling was issued.

6.37 The examples also show that in many cases broader public awareness of the ATO's concerns were often initiated by the private sector — for example, questions asked of the ATO at national tax liaison group meetings because of dissatisfaction with ATO responses given during specific compliance activities that were conducted over several years. Where the ATO did initiate public awareness of concerns with sufficient particularity (for example, through discussion papers or discussions at technical consultative forums), resolution was comparatively faster.

6.38 The IGT considers that the ATO could do more to help taxpayers avoid the risk of subsequent changed or delayed ATO views by alerting taxpayers to its compliance concerns earlier. The question of when the ATO should inform taxpayers and tax advisers about technical issues it is considering involves the exercise of judgement. On the one hand, some taxpayers want to be made aware of all of the ATO's concerns as soon as possible so that they may take action to mitigate their tax risk exposure. However, routinely publishing a list of all ATO concerns could be counter-productive, since it would require corporates to risk manage issues that may not eventuate as matters of significance. Therefore there is a need for some threshold for the disclosure. This threshold would be best set through ATO and taxpayer community dialog.

ATO delays in finalising technical views and the need for accessible technical decision-making circuit breakers

6.39 The examples also show that once the ATO becomes aware of a significant compliance concern it engages its technical and information gathering resources to develop its view. In some cases it may not have enough information to fully understand the issues. In other cases it has the information but the issues raise alternative views on the law or alternative applications of the law to the facts. It may take many years before the ATO finalises its views on its compliance concerns.

6.40 The reasons for these delays are said to include: a desire to provide advice on theoretical 'grey areas' of the law; a lack of enough people with the requisite skills or experience to quickly conclude the issue; protracted internal debates while the ATO is formulating its view, such as issues 'bouncing back and forth' between different ATO officers; and, the ATO's technical escalation processes may be attempting to operate on limited facts because officers were unable to gather enough information from taxpayers.

6.41 The taxpayer community acknowledges that reliable ATO views may take some time to develop and finalise, but is concerned with the actual periods of elapsed time to do so — especially where this is compared to the timeframes in which taxpayers are expected to determine the application of the tax laws to their affairs.

6.42 This issue has been identified in many other IGT reviews (an aspect of which is being assessed in the follow-up review of the implementation of the

recommendations in the IGT's *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*).

6.43 The examples highlighted potential to improve the use of 'circuit breakers' to overcome impasses in the resolution of technical and compliance issues.

6.44 In relation to significant issues resulting in new, changed or clarified views, there is no recognised process to trigger a circuit breaker. The examples show that this depends upon the type and amount of pressure brought to bear by external organisations and the degree to which they can access senior tax officials.

6.45 Also where hotly contested issues rely on policy views, there is broad taxpayer distrust that the ATO has presented alternative arguments to Treasury in a manner that accurately puts the alternative argument and that properly tests the ATO's position (in examining the examples provided to the IGT, there was insufficient evidence to make a finding in this regard).

6.46 On one hand it could be said that any reductions in timeframes would result in a reduction of robustness of views. For example, the public rulings process is considered to be one of the more robust technical development processes — but it involves extended timeframes.

6.47 However, the IGT has observed that where round table discussions have occurred they have facilitated the quick and considered resolution of complex matters so long as they involved key ATO decision-makers, key taxpayer/industry representatives and, where the underlying policy was uncertain, key Treasury officials.

6.48 For example, in November 2008 the ATO developed a potential view that deductions under section 25-90 of the ITAA 1997 would be quarantined to the year in which relevant non-assessable non-exempt income was derived in relation to section 25-90. A senior ATO technical officer raised this thinking with a key practitioner in February 2009 and then in a consultative forum in March 2009. Industry thought that this view would be contrary to the underlying purpose of the provisions because the tracing and quarantining concepts were no longer relevant to deductions in relation to non-assessable, non-exempt income and that industry understood this to be a deliberate Government policy decision. After industry's urging to do so, key tax practitioners, key ATO technical decision-makers and key Treasury officials met in May 2009 to discuss the issues. This enabled a real-time examination and appraisal of the strengths and weaknesses of the alternative views, in an environment in which the policy setting could be explored. The process also obviated concerns about a lack of taxpayer trust in the ATO correctly conveying to Treasury the private sector views in a manner that tested the ATO's view. As a result, ATO technical decisions were made within a matter of months and a draft ruling was issued in September 2009 and finalised in December 2009. Compare this example with the Division 820 issue in which such a circuit-breaker was not used. The ATO became aware of the issue in October 2003 and it was raised to broader public awareness by industry in August 2005. The ATO developed and publicly consulted on its views by releasing a draft tax determination in November 2007 and a discussion paper in June 2008. It met with

Treasury in September 2009 and then withdrew those earlier papers and issued draft rulings in late 2009. The ATO plans to finalise the rulings by June 2010.

6.49 Circuit breakers are resource intensive for senior management and external senior partners. However, the cost of downstream disputes can be avoided by investing time and effort up front. These triggers should balance the significance of the issue and the imposition on senior ATO technical decision makers' and senior private sectors advisers' time. The IGT considers that these processes would be best co-designed and implemented by tax practitioner and industry representatives and the ATO. The involvement of Treasury in matters of significant economic implication is also important so it can quickly appraise and alert Government to potential need for policy or law change. Taxpayer involvement in these discussions would improve the quality of that advice.

6.50 The above discussion on the ATO's engagement with the taxpayer community on technical issues leads to the following recommendation.

RECOMMENDATION 3

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

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

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

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

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

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

RECOMMENDATION 3 (CONTINUED)

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

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

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

ATO response

The Tax Office agrees with the recommendation.

We have already advised the tax professional bodies through the National Tax Liaison Group that we will be tightening our processes and practices around the use of discussion papers. Feedback received from the professional bodies has been to the effect that discussion papers can be useful but that they need to take a balanced approach with both the preferred ATO view or thinking as well as alternative views. We agree with the Inspector-General's comments at paragraph 6.28 that we are not able, as a matter of course, to provide interim guidance pending finalisation of our view on a particular issue. But we will continue to consider interim approaches on a case by case basis such as we did in 2009 with the 'rule of thumb' approach in relation to the transfer pricing of interest payable on certain cross-border related party loans.

The concept of circuit breakers for resolving significant or contentious issues is already deployed within the Tax Office. For example, priority technical issues are closely monitored by the Chief Tax Counsel and the senior level Priority Technical Issues Committee which intervenes when issues remain unresolved after a reasonable period of time.

As pointed out in response to recommendation 2, the ATO does consult sometimes with Treasury in seeking to understand the purpose or object of particular provisions as part of the process for deciding the ATO's interpretative view.

We agree that we should continue to improve the use of circuit breakers to try to resolve issues in a timely way.

Contemporaneous ATO compliance action

6.51 The examples also show that in some cases the ATO compliance area will move to apply views, even though the views are subject to consultation and discussion.

6.52 For example, in relation to Division 7A of the ITAA 1997, the ATO was pursuing approaches in audits that were inconsistent with its answers to FAQs on its website, even before a senior officer gave public indications that the ATO was re-examining its response to the issue. Another example saw the ATO release a consultation paper in relation to certain research and development deductions. That paper acknowledged that certain views were 'more controversial'. However, taxpayers were concerned that the ATO was applying these more controversial views in risk reviews to arrive at conclusions that the taxpayer arrangements were of high risk.

6.53 On one hand, the ATO must take action to investigate and address compliance concerns as and when it identifies them. The ATO may not be able to give a moratorium on compliance action while a general ATO view on technical issues is finalised. This may be due to concerns about time limits, competitive neutrality and public debt interest considerations and the need for certainty. Generally speaking, the ATO also finds that compliance activity expedites its understanding of the issue and its resolution through consideration in relation to real factual scenarios. However, these objectives need to be balanced with fairness where prior ATO conduct appeared to accept prior views and practices.

6.54 This issue is closely linked to the Commissioner's exercise of his power of general administration not to undertake compliance action for prior periods on particular issues, which is discussed further above.

RECOMMENDATION 4

Where:

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

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

ATO response

The ATO agrees with the recommendation to follow the agreed process and criteria set out in recommendation 2 in applying its view of the law in audit cases.

Delayed ATO awareness of compliance concerns

6.55 The impact on taxpayers of adverse ATO views that are applied retrospectively increases where extended periods of time elapse before the ATO becomes aware of its compliance concerns.

6.56 The examples show long time periods (sometimes amounting to many years) between taxpayers adopting practices or views and the ATO identifying its compliance concerns (concerns with practices that are perceived to be of sufficient risk to revenue). In some cases this may be due to the ATO not acting on information available to it. In other cases it may be because of changing business arrangements. For example, in 1993 the ATO issued a tax determination TD 93/135 (a form of binding advice) which the banking industry relied on (together with wording in the explanatory memorandum to the relevant law) to effectively allow an entity to choose whether to book a qualifying offshore banking activity on the entity's offshore banking unit or domestic unit. Affected taxpayers claim that for 14 years the ATO did not disagree with the practice in audits or otherwise. However, in 2007 the ATO considered that some emerging business arrangements were inconsistent with the intention of the Tax Determination. The ATO expressed reservations about the practice to the industry. It released a consultation paper that contradicted this practice and proposed a withdrawal of that tax determination. It should be noted that, at the time of writing, the issue is not finalised.

6.57 As another example, section 73B of the ITAA 1936 was enacted in 1985 to provide concessional deductions for certain research and development (R&D) expenditure. In 1987, the ATO issued taxation ruling IT 2442 (non-binding advice, although the ATO will consider itself administratively bound by it) in which it stated at paragraph 45 that:

> It might be that a company is approached by a client and asked to develop a product or process which is required by the client for use in the client's business. If the R&D necessary to develop the product was done at risk of the company — i.e., the client was required to pay for the final product only if the R&D was successful [a contract for result] — the company performing the R&D could qualify for the section 73B concession since it would in fact be performing the R&D activities on its own behalf — i.e. to produce a saleable product.

6.58 A specific anti-avoidance provision, section 73CA, was later enacted in 1990. In June 2008, the ATO issued a technical discussion paper (a 'Consultation Paper') in which it indicated that section 73CA could now apply to commercial contracts for result notwithstanding the fact that the contract might be predominantly for the production of a product or good, and notwithstanding the possibility that failure to perform the contract might mean an absence of consideration flowing to the company. It is also important to note that in relation to section 73B deductions, there is no time limit for their subsequent amendment. Therefore, taxpayers' claims made many years ago were exposed to the potential retrospective application of ATO views. However, ultimately the ATO did not adopt the view, based on the advice of the Public Rulings Panel.

6.59 The reasons for delays may be that the ATO may not become aware of, or concerned with, a particular practice until it is of a sufficient level of revenue risk. The issue may also not always be obvious until something triggers the ATO's awareness — such as new law which interacts with pre-existing law, or, audits on emerging business arrangements. This means that when the ATO finds that its view does not properly reflect the law, it must change or clarify its view.

6.60 The examples show that, generally, the ATO becomes aware of emerging issues either through audits or by taxpayers and their representatives raising matters to the ATO's attention, which are, to a large extent, through the ATO's consultative forums (such as the national tax liaison group), and to a smaller extent through the ATO's binding advice products (such as private ruling applications and the public rulings program).

6.61 On one view, taxpayers and their advisers could alert the ATO to compliance concerns before practices develop — for example by applying for private rulings or seeking to put the issue on the public rulings program. This would go some way to minimising the time that elapses between practices developing and ATO awareness of compliance concerns. However, the purpose of the binding advice regime is to provide certainty to taxpayers. Even if one were to impose an obligation on taxpayers to do so it may not be able to be practically fulfilled in a timely manner if this significantly increases the demand for binding advice. Even then, the examples show that it would not have alerted the ATO to a substantial number of the practices with which the ATO was concerned. This is because in these examples taxpayers and their advisers did not believe there was any uncertainty about the application of the law until subsequent ATO action — they believed that there was a settled position.

6.62 There is scope for taxpayers to better contribute to ATO awareness of areas of uncertainty and compliance concerns. However, the IGT considers that there is a need to further improve the framework for taxpayer engagement to facilitate this type of interaction to achieve that outcome. Over-reliance on the community to identify significant compliance concerns forces the ATO to become reactive to developments, sometimes many years after the development has taken place. Also, consultative forums themselves may not become aware of these matters.

6.63 The IGT also considers that the ATO could do more to minimise the time that elapses between taxpayers adopting practices or views and the ATO identifying its concerns.

RECOMMENDATION 5

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

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

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

ATO response

The ATO agrees that it should be proactive in seeking to identify areas of uncertainty or compliance risks by engaging with taxpayers and their representatives. We are committed to engaging with professional and industry bodies and professional firms to identify issues. Our existing range of consultative forums is extensive but we agree to supplement existing forums by initiating technical discussions with legal and accounting firms.

However, in order to improve the timely identification of areas of uncertainty and compliance concerns, tax advisers and professional bodies also need to play their part by proactively bringing issues to the ATO's attention and engaging in discussions with us.

Another way of improving the timeliness in identifying areas of compliance concerns would be for taxpayers to disclose potential issues in their annual tax returns.

Broader concerns with ATO technical processes

6.64 The examples raised in submissions also indicate that the taxpayer community is concerned with certain elements of the ATO's technical development processes, including:

- The extent to which the ATO is prepared to be bound by material not cleared by the tax counsel network (TCN);
- The extent to which the ATO fully and robustly tests alternative views when resolving technical issues that are the subject of significant compliance action;
- the degree to which taxpayers can be confident in ATO assurances that its views are aligned with Treasury's understanding of the policy objective of the relevant law; and
- whether in resolving compliance concerns in specific cases, the ATO adequately considers the implications for the broader community of the position taken — for example, by adopting a new technical interpretation in relation to what the ATO perceives to be a particular egregious arrangement in an audit, without considering the possible effect of that interpretation on other taxpayers who may have taken appropriate positions and reasonably relied on previous ATO guidance in good faith.

6.65 An examination of these concerns is outside the scope of this review, but has arisen in a number of other contexts and may be a potential review topic on the IGT's forward work program.

APPENDIX 1 — TERMS OF REFERENCE AND SUBMISSION GUIDELINES

BACKGROUND

On 10 March 2009, the Assistant Treasurer, the Hon Chris Bowen MP, directed the Inspector-General to review and report on concerns in relation to any perceived Tax Office delayed or changed approaches — so called 'U-turns' — on significant interpretative matters or on past administrative practices. Particular concerns were raised with the retrospective effect of changed Tax Office views or practice and with their consequential adverse impact.

If substantiated, these concerns raise the systemic tax administration issues of adequacy of prospective certainty and taxpayer protection against the retrospective effect of Tax Office views.

During consultation on the Inspector-General's work program, representatives of businesses and the tax profession pointed to recent examples of purported delayed Tax Office views and Tax Office changes to pre-existing views or practices. These include the Tax Office's approach to service trusts, managed investment schemes, transfer pricing and thin capitalisation rules, royalty withholdings on copyright payments, trust cloning and the taxation of trusts more generally.

Generally, the examples purport to evidence four different types of cases that give retrospective effect to a delayed Tax Office view or an actual or perceived Tax Office change to a pre-existing view or practice.

These four types of cases involve the Tax Office releasing new advice or guidance which allegedly differs from one of the following previous categories of views or practices:

- a Tax Office binding view — for example, a public ruling;
- a Tax Office non-binding view or practice — for example, a private ruling which is binding only in relation to the rulee;
- an industry practice developed in absence of Tax Office guidance and/or unchallenged by the Tax Office for a significant period of time despite the Tax Office being well aware of the practice; or
- a view adopted by taxpayers on new law and in relation to which there was no Tax Office view for a significant period of time.

The Inspector-General now seeks to establish whether there is substantiated evidence of these examples and consideration of the issues that the examples may raise. In investigating whether there was an actual delay or change, the Inspector-General will view the relevant Tax Office files and may interview Tax Office staff to identify the reasons for the Tax Office's delays or changes, the steps it took to minimise adverse outcomes for taxpayers and identify potential improvements.

Terms of reference

In accordance with subsection 8(2) of the *Inspector-General of Taxation Act 2003*, the Inspector-General conducts the following review at the direction of the Minister.

The Inspector-General will review any examples of circumstances in which stakeholders claim the Tax Office has delayed or changed its approach on significant interpretative matters or on past practices, with a particular focus on:

(a) whether the perceptions that the Tax Office has changed its approach with retrospective effect are justified;

(b) how the Tax Office provides 'prospective certainty' (to the extent it can) when announcing its views;

(c) whether the time taken by the Tax Office to announce its approaches and the way it has applied them have caused adverse consequences for taxpayers; and

(d) what options taxpayers could or should have in these circumstances and whether any alternative processes would deliver improvements.

Submissions

The Inspector-General invites written submissions to assist with this review. Submissions should address the terms of reference set out above and the issues and questions outlined in the attached submission guidelines. It is not expected that each submission will necessarily address all of the issues and questions raised.

The closing date for submissions is 31 May 2009. Submissions can be sent by:

Post to:Inspector-General of Taxation

GPO Box 551

SYDNEY NSW 2001

Fax to: 02 8239 2100

Email to: changereview@igt.gov.au

The Inspector-General intends to publish submissions on his website, unless the submitter has clearly requested that the submission remain confidential.

SUBMISSION GUIDELINES

2.1 These guidelines envisage that, broadly, your submissions will be divided into two parts.

2.2 The first part would provide a detailed account of evidence of the delay or change in views or practices that you believe have occurred.

2.3 Assuming that there is an actual delay or change or your perceptions that there was a delay or change are justified, the second part seeks your recommendations as to how to deal with such situations.

2.4 The following is provided to assist you in developing these two parts of your submission.

Evidence of delayed or changed view or practice

2.5 A summary of around 20 recent examples of purported delayed Tax Office views or Tax Office changes to pre-existing views or practices has been brought to the Inspector-General's attention. These include the Tax Office's approach to service trusts, managed investment schemes, transfer pricing and thin capitalisation rules, royalty withholdings on copyright payments, trust cloning and taxation of trusts more generally.

2.6 To determine whether there has been a delay or change, the Inspector-General now requests more specific details on each of these examples, as well as any other relevant examples that taxpayers or tax practitioners have experienced.

2.7 At the outset of your submission, it is important to fully state the previous view or practice (including the evidence for that view or practice) and whether it falls in one or more of the following categories:

- a Tax Office binding view;
- a Tax Office non-binding view or practice;
- an industry practice developed in absence of Tax Office guidance and/or unchallenged by the Tax Office for a significant period of time despite the Tax Office being well aware of the practice; or
- a view adopted by taxpayers on new law and in relation to which there was no Tax Office view for a significant period of time.

2.8 It is then important to explain the subsequent Tax Office view that you believe changed the previous view or practice. It is important to recognise the limits of the Inspector-General's scope for inquiry, as he cannot reach conclusions on the merits of one view over another where those views determine tax liabilities under the tax laws. Therefore, the difference between the previous view or practice and the change should be clearly outlined. You should also set out how you and the Tax Office characterise the difference. For example, is it a change, clarification or expansion of what already existed? To the extent that you disagree with the Tax Office characterisation, reasons should be provided.

2.9 In investigating whether there was an actual delay or change, it may be useful to provide a time line of events evidencing how the previous view or practice was developed through to when the alleged change occurred and beyond.

2.10 Any adverse impact of the purported delay or change should then be set out and quantified, particularly those resulting from the retrospective effect of the purported change. These might include unanticipated tax liabilities (including tax, penalties and interest) for prior years, increased ongoing compliance costs and potential restructuring of significant commercial arrangements.

2.11 It would also be useful to set out why you believe such adverse consequences were not justified. For example, in relation to new law on which there is no Tax Office guidance, you may wish to demonstrate that you took a position that you believed was reasonable in the circumstances. In which case you should also include the Tax Office's opinion on whether your position was reasonably arguable.

2.12 In preparing submissions, you may find it useful to refer to the following documents:

- ATO, Miscellaneous Taxation Ruling, MT 2008/2 Shortfall penalties: administrative penalty for taking a position that is not reasonably arguable;
- Treasury, Report on Aspects of Income Tax Self Assessment, 2004, pages 13-17 in relation to 'general administrative practice' and pages 58-60 in relation to a 'reasonably arguable position';
- Explanatory Memorandum to Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005, paragraphs 3.130 to 3.132 on 'general administrative practice';
- ATO, Taxation Ruling, TR 2006/10 Income tax, fringe benefits tax and product grants and benefits: Public Rulings, paragraphs 70 to 74 in relation to 'general administrative practice';
- ATO, Taxpayers' Charter and related documents, such as Getting advice from the Tax Office; and
- IGT, Review of the Potential Revenue Bias in Private Binding Rulings Involving Large Complex Matters, paragraphs 3.31-3.36 and 5.20-5.25 on the Tax Office's approach to statutory interpretation.
- ATO, PS LA 2008/3: provision of advice and guidance by the Tax Office.

2.13 In summary, we suggest that in preparing this section of your submission, you address the following issues as well as any other that you consider relevant:

a. the prior practice or view which taxpayers believed existed and why it was reasonable to rely on it;

b. the specific Tax Office conduct (if any at all) that, in your view, evidences the Tax Office's acceptance of this prior practice or view;

c. the subsequent Tax Office practice or view and why you believe it was inconsistent with the prior practice or view that was initially relied upon by taxpayers;

d. the extent to which the subsequent Tax Office practice or view had 'retrospective' effect and how it adversely affected relevant taxpayers;

e. any alternative action which, in your view, could have minimised the adverse effects; and

f. a time line of relevant events.

Dealing with a delayed or changed view or practice

2.14 At the outset, it is important to note that Tax Office views do not create or extinguish legal rights as they are only statements of administrative intent. However, it is appreciated that taxpayers seek to reduce uncertainty by assessing their liabilities in line with the Tax Office's interpretation of the law. For example, many taxpayers, particularly small businesses and individuals, may prefer to follow Tax Office views to avoid costly litigation where they feel they cannot match the resources of the Tax Office. In addition, large companies may have become more reliant on Tax Office advice in recent years due to encouragement by the Tax Office to address tax risks as a part of their corporate governance.

2.15 Whilst there is no legal obligation on the Tax Office to provide guidance, views or advice, the Tax Office has committed itself (in the Taxpayer's Charter and related documents) to giving advice and information that taxpayers can rely on. This reflects the community's expectation of a tax administrator in a self-assessment environment.

2.16 It should also be noted that the Tax Office operates on a risk management model in dealing with identified issues or risks as it considers that it does not have sufficient resources to address all issues at any given time.

2.17 With this backdrop, we need to explore the circumstances in which the Tax Office would be justified to change pre-existing views or practice, irrespective of whether such change is to apply retrospectively or prospectively.

2.18 On the one hand, if the Tax Office were to regularly change its views or practices on significant issues, there would be adverse effects not just to the taxpayers but to the economy as a whole. The uncertainty that would result may be, for example, a significant disincentive to foreign investors (as well as Australian businesses and investors) to invest in our economy. On the other hand, it may be desirable for the Tax Office to change views or practices in certain circumstances, such as to address the application of the law to new arrangements or to address compliance concerns.

Whether there is a 'change'

2.19 One specific area of interest is the distinction between a Tax Office view or practice that is a 'change' and one which is merely a 'clarification'. Where a view is said to be a clarification, it may mean that the previous view has not been changed and the subsequent advice merely articulates some of that pre-existing advice more clearly. You may wish to consider this distinction in your submission.

2.20 You should also consider what should happen where there is disagreement between taxpayers and the Tax Office as to whether there is an actual change, as opposed to a clarification.

Prospective or retrospective application of delayed or changed view

2.21 Having addressed the above, the issue arises from what date should Tax Office views apply, i.e. should the advice have retrospective effect? Also, it may be useful to identify situations where you feel such retrospective effect is not justified, bearing in mind that the law applies from the date of enactment.

2.22 If the advice constitutes a change to one of the following:

- a Tax Office binding view; or
- a Tax Office non-binding view or practice; or
- an industry practice developed in absence of Tax Office guidance and/or unchallenged by the Tax Office for a significant period of time despite the Tax Office being well aware of the practice; or
- a reasonable view adopted by taxpayers on new law and in relation to which there was no Tax Office view for a significant period of time,

you should explain to what extent retrospective application would be appropriate or not in each case.

2.23 It may be that the solution in every instance is not black and white, i.e. only having retrospective or prospective effect. You should consider whether some flexibility should be provided. Perhaps a framework could be developed where the default position is either retrospective or prospective but the Commissioner can make exceptions based on a number of well-defined factors. You may wish to suggest some of these factors.

2.24 Where you believe the change should be prospective, should the new advice have effect from the date of the advice or should the taxpayer be given a reasonable time to alter its affairs in accordance with the new advice? If the latter, what is a reasonable amount of time?

2.25 There may be cases where structures have been put in place in accordance with the previous position and restructuring is not possible due to costs or other factors. What should the Tax Office do in these circumstances?

2.26 There may also be cases where some taxpayers have knowingly taken overly aggressive positions in the absence of Tax Office advice, while others have taken positions which appear reasonable based on the law and available extrinsic materials. How can the Tax Office address deliberate non-compliance with the law in these circumstances while protecting those who sought to do the right thing?

2.27 Where you believe the change should be retrospective, should there be a limit on how far back the advice can be applied? Should this be the same as the time limits provided for amendment of assessments?

2.28 It may also be useful to consider what has prompted the Tax Office to issue a view. For example, where the Tax Office view reflects a judicial decision, they may have no choice other than to apply it retrospectively? Although the Tax Office's views are only statements of administrative intent, judicial decisions, by contrast, can have retrospective effect as they 'find' the law, i.e. state how the law has always applied.

Taxpayer protections

2.29 Related to the application of Tax Office views is the level of protection against the potential adverse consequences that may arise.

2.30 In relation to a view or practice adopted in absence of Tax Office guidance, the law does provide some protection against penalties (but not primary tax or interest thereon) so long as you can establish you have a reasonably arguable position. You may like to review the documents referred to in paragraph 2.12 above when considering whether this protection is enough and operating as intended.

2.31 In relation to any Tax Office administrative practices relied upon before the Tax Office issues the new advice, broadly, the law gives taxpayers protection against tax, penalties and interest so long as you can establish that the practice was a 'general administrative practice' and the Tax Office's new advice is published in a public ruling. The Tax Office has stated that its usual practice is to communicate any change of a general administrative practice by way of a public ruling. You may also like to review the documents referred to in paragraph 2.12 above when considering whether this protection is enough and operating as intended.

2.32 The law also provides protection against tax, penalties and interest in relation to binding Tax Office advice. You should also consider whether this protection is enough in these circumstances and whether it is operating as intended.

2.33 Notwithstanding the above, taxpayers wanting more certainty around the Tax Office's views of their particular arrangement can seek protection from tax, interest and penalties by obtaining a private ruling. This may be particularly useful where an existing view has been questioned and a new position has not been communicated. You may wish to share your views and/or experiences in this regard.

Communication of intended changes

2.34 Encompassing all of the above is the issue of how and when the Tax Office should communicate to others that it is considering publishing either a new advice or changing a pre-existing view or practice. These types of views are rarely issued without some significant event triggering the Tax Office's re-appraisal of the pre-existing view or practice or deciding to publish a new advice. For example, re-appraisal may be triggered because industry and tax professionals called for more certainty on a particular matter or because during audits the Tax Office identified compliance concerns about a pre-existing industry practice. These sorts of re-appraisals commonly involve substantial periods of time leading up to the announcement of the change.

2.35 Awareness of potential changes could be important for planning of business transactions and structures, but could also cause adverse effects in themselves. On the one hand, an announcement that the Tax Office is considering a change in a particular area may

create a level of uncertainty. On the other hand, flagging issues of potential change can also alert the community to areas of which they should take particular care.

2.36 Whilst the Tax Office is consulting with stakeholders, including the Treasury, in forming its views, what position should taxpayers take in the interim? For example, where the existing view or practice has been questioned and no new position has been finalised, the uncertainty around potential tax liabilities may deter businesses from entering into economically beneficial transactions. Businesses may perceive a risk that the ultimate Tax Office view could result in potentially unprofitable transactions.

2.37 What assistance can the Tax Office provide in the above circumstances and how should the Tax Office conduct its consultation process? Ultimately the question is how can the Tax Office best provide prospective certainty in these communications and which events should trigger such a communication.

2.38 You may also wish to consider how Tax Office auditors should approach issues that are subject to these consultation processes. Before these consultation processes are finalised, should auditors rely on views expressed during these processes when checking taxpayers' compliance?

Other issues

2.39 Having addressed the above, your submission may raise other issues that you wish the Inspector-General to consider.

2.40 For example, the complexity of the law may have some impact on whether you think the Tax Office should provide further advice or guidance. Generally, the Tax Office is involved in consultations on the design of new tax laws and how these are intended to operate. You may wish to comment on whether this is enough or whether more certainty is needed within certain periods and how that could be best delivered, recognising that tax law administration often involves compromise between competing objectives, such as compliance costs, certainty and Tax Office resources. It should also be noted that the Tax Office has stated that it can only provide its view on the law once it is enacted.

2.41 Related to this matter is how the Tax Office selects issues on which to provide advice. You may wish to consider whether this process operates effectively, recognising that the Tax Office has limited resources and relies to a large extent on industry and tax professionals (for example, through its various consultative forums) to identify areas for greater certainty, in addition to the Tax Office's own identification of compliance concerns. Should this approach to selecting issues affect how subsequent Tax Office views are applied?

2.42 The Inspector-General is also open to considering other issues and invites you to raise any other areas that would lead to improvements in relation to delayed Tax Office advice or changes to pre-existing views or practice on significant issues.

2.43 In summary, we suggest that in preparing this section of your submission, you address the following questions as well as any other that you consider relevant:

1 In what circumstances would the Tax Office be justified to change a pre-existing view or practice?

2 In what circumstances should a Tax Office view be called a 'change' or 'clarification'? What consequences should flow from this?

3 What should happen where there is disagreement between taxpayers and the Tax Office as to whether there is an actual change of view or practice?

4 To what extent is retrospective application of a new view desirable, where that new view changes the following:

- a Tax Office binding view;
- a Tax Office non-binding view or practice;
- an industry practice developed in absence of Tax Office guidance and/or unchallenged by the Tax Office for a significant period of time despite the Tax Office being well aware of the practice; or
- a reasonable view adopted by taxpayers on new law and in relation to which there was no Tax Office view for a significant period of time.

5 Where you believe the change should be prospective, should the new advice have effect from the date of the advice or should the taxpayer be given a reasonable time to alter its affairs in accordance with the new advice? What is a reasonable amount of time?

6 In issuing new advice, how can the Tax Office address deliberate non-compliance with the law while protecting those who sought to do the right thing?

7 Where you believe the change should be retrospective, should there be a limit on how far back the advice can be applied?

8 Is the protection provided for a 'reasonably arguable position' enough and operating as intended?

9 Is the protection provided for a 'general administrative practice' enough and operating as intended?

10 Is the protection provided for binding Tax Office advice enough and operating as intended?

11 How could the Tax Office best provide prospective certainty in communications on potential new advices or changes in views or practice and what event should trigger such communications?

12 How should the Tax Office seek compliance whilst consulting on potential changes to pre-existing views and practices?

13 What other issues would you like the Inspector-General to consider?

APPENDIX 2 — PRIVATE SECTOR PROVIDED EXAMPLES OF PURPORTED DELAYS AND CHANGES IN ATO VIEW

A.2.1 As a result of the IGT calling for submission in this review, the following was provided as purported examples of delayed or changed ATO views. The summaries of the issues below were current as at the time provided by the private sector to the Inspector-General. It is likely that further action has taken place since that time.

A.2.2 Apostrophes in the numbers column below denote an example that was examined in more detail by the IGT.

Number	Issue	Summary
1	Miscellaneous issues	A range of issues mentioned by name but without any explanation.
2	APRA calculations for thin capitalisation purposes	It is claimed that the thin capitalisation rules for banks were constructed on the basis that you could rely on APRA calculations for ease of compliance purposes, as evidenced by the relevant explanatory memorandum. The ATO says that financial institutions cannot rely on their calculations for APRA purposes and may need to do separate tax calculations to 'notionally' risk weight assets. Industry says that the ATO's view will lead to a double counting of life subsidiary assets in thin capitalisation calculations. Therefore, they will need to hold more capital for tax than for APRA purposes.
3*	GST "stop the clock" letters — MT 2008/D4	On 29 October 2008, the ATO released MT 2008/D4, which tax practitioners say imposed a higher standard for refund notification requirements than had been previously accepted by the ATO. Tax practitioners say that the ATO applied this approach retrospectively.
4*	Section 25-90 of the ITAA 1997 — Deductions relating to foreign non-assessable non-exempt income	Industry thought that tracing and quarantining concepts were no longer relevant to deductions in relation to non-assessable, non-exempt income (NANE income), as evidenced by the relevant explanatory memorandum and lack of ATO comments in relevant private binding rulings and audits over the last 8 years. The ATO has recently indicated that it was taking the view that section 25-90 of the ITAA 1997 would operate on a cash basis — that is, quarantining the debt deductions to the year in which relevant NANE income was derived. The basis for this view seems to be the different wording used in sections 8-1 and 25-90. Industry says that this view would expose taxpayers to reverse deductions claimed, as it is extremely common for debt deductions to exceed dividend deductions from foreign subsidiaries in any year. Industry says that the ATO could have declared that it is reviewing section 25-90.

Number	Issue	Summary
5	Offshore banking unit concessions	Previously financial institutions had chosen whether their offshore activities constituted offshore banking activities at the outset of activities and set up accounting systems on that basis and say that they have relied on TD 93/135 for 14 years. The ATO now thinks that the TD is not consistent with OBU law. In December 2007, the ATO released a consultation paper that proposed the withdrawal of the TD. It was unclear if this withdrawal would be applied retrospectively.
6*	Section 215-10 of the ITAA 1997 — Certain non-share dividends by authorised deposit taking institution are unfrankable	Industry says that the reason for section 215-10 of the ITAA 1997 is that the Government acknowledged Australian financial institutions would be at a competitive disadvantage if they couldn't raise money offshore and get a deduction. Therefore, if financial institutions are in an offshore competitive market they should get the same tax treatment, as long as certain conditions were met. Industry says that the ATO appears to have changed its view on this issue and representatives of financial institutions say that because of this change the hybrid market is now problematic. In a meeting, the ATO indicated that section 215-10 does not apply to Australian sourced capital and that stapled securities will be treated as a single scheme (based on TD 2008/D8). Industry says that this view will mean that it is no longer cost effective to raise Tier 1 capital through the issue of stapled securities. This will severely restrict the scope of raising Tier 1 hybrid capital and impedes the management of capital positions, determining the costs of capital and diversifying exposure.
7	Service trusts	Tax practitioners say that from 1978 to 2005 in relation to service entities, mark-ups of 50 per cent on the direct costs of staff and 6 to 8 per cent on the cost of plant and equipment were commonly used and accepted by the ATO (for example, the ATO's audit manual). In 2005, the ATO released a draft ruling indicating these mark-ups were not acceptable and the view would be applied retrospectively. This issue was examined as a case study in the IGT's review of the ATO's management of major, complex issues.
8*	Guarantee fees and interest deductions and their interaction with Division 820 of the ITAA 1997 and the transfer pricing provisions	This issue concerns an overlap between the transfer pricing and thin capitalisation rules in relation to debt arrangements. Industry and tax practitioners are concerned that the ATO's recent approach of 'reconstructing capital structures' to determine whether debt deductions are at arm's length (including the role that the credit rating of the parent entity plays) is contrary to prior industry practice. They say that prior ATO statements relating to this issue never indicated such an approach and it would be unreasonable to expect taxpayers to have discerned this approach from the previous law, extrinsic materials, ATO guidance and ATO compliance activities.
9	Trust cloning	Although the ATO says that its understanding of the underlying policy for CGT event E2 was that the exception was only to apply to cases where a single existing trust merely changed its trustee, the ATO does accept that the text of the law allows transfers between two pre-existing trusts to occur. However, the ATO believes that the exceptions should be read narrowly because of its understanding of the underlying policy.
10*	Trusts — sections 95 and 97 of the ITAA 36 — net income of the trust estate	The issue relates to the correct interpretation for section 97 of the ITAA 1936 in relation to the terms "a share of the income of the trust estate" and "that share of the net income of the trust estate". Tax practitioners understand that trusts law rules prevails in determining the terms in question and therefore could allow trustees to determine the character of the receipt and stream it to certain beneficiaries. The ATO considers that the terms should be interpreted according to tax law and that the trust deed or exercise of the trustee's discretion cannot alter the character of the receipt.

Number	Issue	Summary
11	Trusts — income streaming, CGT and capital beneficiary agreements	This is a specific aspect of the issue in example #10.
12*	Section 974-80 of the ITAA 1997 — equity interest arising from arrangement funding return through connected entities	Industry says that section 974-80 of the ITAA 1997 was intended to operate in limited circumstances, as evidenced by the relevant supplementary explanatory memorandum, and, that the ATO Discussion Paper circulated in March 2007, indicates a wider operation. Industry says that this view will affect genuine commercially based financial transactions and is proposing to adopt an interpretation which is contrary to the explanatory memorandum. The ATO claimed it had no flexibility to adopt an administrative solution and confirmed that the explanatory memorandum to the legislation was not consistent with how the ATO was applying the law. Industry is concerned that the ATO has taken more than 6 years to say that it does not agree with the explanatory memorandum and chosen to adopt a contrary interpretation rather than seek to amend the law. The matter is now with Treasury, which is expected to respond to industry concerns.
13	Farm-out arrangements	The ATO has released a discussion paper reviewing the longstanding farm-out ruling IT 2378 and is canvassing a change in interpretation whereby the farm-out of wildcat exploration interest (that is, a prospecting interest at the grass roots stage) could trigger CGT or assessable balancing charges.
14*	Managed investment trusts — the distinction between capital and revenue	The ATO has expressed concerns whether industry is appropriately treating an investment portfolio on revenue or capital account. The issue is now part of a review by the Board of Tax.
15	Capitalisation of labour costs	In July 2008, the ATO issued a discussion paper that indicated to tax practitioners that it intended to adopt a view that was aligned with accounting principles when determining whether certain labour costs were to be held on revenue or capital account. Tax practitioners considered that this was a change in established practice.
16	Royalty withholding tax on copyright payments	Industry says that draft ruling TR 2007/D5 does not correctly reflect the law and would impose overly prohibitive burdens on Australian businesses. This draft ruling proposes to treat a sale of rights under a copyright as royalties.
17	Supply chain management in business structures	Tax practitioners say that supply chain management in business structures (that is, the process of planning, implementing and controlling certain operations of the supply chain, from suppliers to end users, as efficiently as possible) has been used for a long time and the ATO has been aware of it for a long time. These structures can give rise to a range of complex tax issues and risks, including capital gains tax, transfer pricing and the research and development concessions. Tax practitioners say that the ATO is now reviewing this area and are concerned that the ATO will retrospectively apply changed approaches.

Number	Issue	Summary
18	The standard for valid notifications under MT2008/D4	Refer to example #3.
19	Petroleum resource rent tax — scope of exploration costs	In February 2009, the ATO released TR 2009/1. The ATO took a view that stopped taxpayers from transferring deductible exploration expenditure inherited via the purchase of equity in other projects, and offsetting these against profits from other projects with the effect of reducing their liability to the petroleum resource rent tax. The previous industry understanding was that where a company bought an additional interest in a project, the inherited exploration expenditure would be transferable to other projects. Industry points to long-term decisions that had been made under the previous treatment, which were subsequently negatively affected through the release of the ruling.
20	Salary sacrifice and charitable donations	The Government announced that workplace giving arrangements (from after-tax earnings) for Victorian bushfire victims represent an appropriate mechanism for avoiding the fringe benefit tax (FBT) problems associated with salary sacrifice when making donations. However, industry says that it is not presently the Government's intention to extend the exception to other deductible gift recipients. Industry says that a number of organisations have had salary sacrifice arrangements in place for some time for other deductible gift recipients, but were unaware of the ATO's view of the FBT provisions. Industry disagrees with the ATO's view. They have asked the ATO to publish an interpretive product that sets out its reasoning in more detail than simply asserting that the arranger rules result in an FBT liability for the employer.
21*	Division 7A of the ITAA 1936, section 100A and unpaid present entitlements	This example involves 2 aspects: i. A senior ATO official commented publicly that unpaid present entitlements could be treated as loans under Division 7A of the ITAA 1936. This is of concern to tax practitioners as this was contrary to information published on the ATO's website over the years in relation to unpaid present entitlements. They are unsure in what situations unpaid present entitlements will be treated as loans under Division 7A. In particular they would like to know if the ATO is seeking to apply its views generally and retrospectively. ii. The senior ATO official also commented publicly that unpaid present entitlements could potentially trigger the application of section 100A. This is of concern to tax practitioners as no guidance has been provided so far. They are unsure in what situations the ATO would be looking to use s.100A in the context of unpaid present entitlements. In particular they would like confirmation that its use will be limited to defined and blatant avoidance arrangements (and an explanation of what those arrangements are).

Number	Issue	Summary
22	Bonus share plans	Tax practitioners say that the ATO has held the view to date that a bonus share plan, properly constituted, does not provide the shareholder with the choice, and thus subsection 6BA(5) of the ITAA 1936 does not apply, therefore, the shareholder can treat the bonus share plan as giving rise to a 'delusional spreading of cost base', without an amount being assessable as a dividend. In TD2008/D17, the draft view expressed in paragraphs 24 to 25 is that the legal analysis and differentiation between bonus shares and dividend reinvestment plans is not relevant for purposes of section 6BA. Tax practitioners are concerned that there is no detailed analysis in the determination.
23*	CGT consequences of earnout arrangements — TR 2007/D10	An earnout arrangement is used in a sale of business as a mechanism to quantify the goodwill of the business. The arrangement is used as an alternative to a fixed amount supplemented by representations and warranties to deal with any failure to achieve anticipated outcomes after the sale. The ATO released a discussion paper which highlighted changes from the earlier TR 93/15 to the draft TR 2007/D10. The ATO informed the tax profession in March 2009 that it was deferring the finalisation of the ruling pending discussions with Treasury.
24*	Not at risk research and development — sections 73B and 73CA of the ITAA 1936	The ATO considers that section 73CA of the ITAA 1936 can apply to fixed price contracts for result. The ATO released a discussion paper on section 73CA not at risk research and development. The ATO indicated in March that a draft ruling on the scope and application of section 73CA is due to be released fairly soon. Industry is concerned that the paper suggests that fairly straightforward commercial arrangements could be caught by the provisions.
25	Reasonably arguable position and reasonable care	Tax practitioners say that ATO audit teams are applying a 25% no reasonably arguable penalty (RAP) in cases where there is a RAP objectively, but no evidence that the taxpayer took external advice at the time of entering the arrangement. They say that this approach is contrary to prior ATO practice and contrary to the policy basis for culpability penalties. The ATO recently issued MT 2008/1 on the issue. Tax practitioners say that there is so much wiggle room that any position on RAP penalties can be developed by the ATO. They say that ATO auditors are reading MT 2008/1 as "you can't have a RAP without taking reasonable care". Tax practitioners say that the prior ATO practice was that a RAP was an objective assessment — it either existed or not — and did not depend on the steps that the taxpayer took at the time of entering the arrangement.
26	Simpler super legislation and deferred annuities	Taxpayers are concerned that the 2007 Simpler Superannuation legislation (operative from March 2007) is deficient in that it does not cover deferred annuities — entities which were covered by all previous legislation. They say that they were assured by Government that these annuities were covered by the legislation. However, the ATO does not believe that they are covered by the new legislation.

Number	Issue	Summary
27	Eligible termination payments and pre-July 1983 components	The *Tax Laws Amendment (Simplified Super) Act 2007*, enacted in March 2007, provided concessional treatment on voluntary contributions to superannuation if made before July 2007. The ATO issued a facts sheet and ATOID 2007/131 saying that the non-taxable pre-July 1983 component of an eligible termination payment would count towards this limit. Tax practitioners say that this view is inconsistent with treatment of other non-taxable components and contrary to Government policy.
28	Revenue apportionment in credit card businesses for input tax credit claims	Credit card businesses have mixed revenue streams for GST purposes — some supplies are taxable and some input taxed. Therefore, there is a need to apportion costs according to the extent of creditable purpose. In June 2000, the ATO released GSTR 2000/22 which said that the net revenue approach is the most appropriate for financial supplies and the gross approach for taxable supplies. In April 2006, the ATO replaced GSTR 2000/22 with GSTR 2006/3 requiring that apportionment be 'fair and reasonable'. In the absence of any express comment in GSTR 2006/3 expressing concern with the use of 'net' revenue, industry proceeded on the basis that the ATO accepted that 'net' revenue was appropriate. Tax practitioners say that in a position paper issued to industry in January 2009, the ATO expressed a change in its position regarding the use of 'net' or 'gross' interest by not accepting the use of 'net' revenue for measuring financial supply income in the apportionment methodology of a credit card business. Industry says that the ATO has stated that this 'new' approach will apply retrospectively from April 2006 rather than from January 2009, which when tax practitioners say that the ATO made the change. Industry considers that the ATO should withdraw the position paper and undertake an industry consultation process that leads to a broad based ruling that sets out the principles of apportionment.
29	Treating deferred income as ordinary income	Tax practitioners say that ATO officers consider that, in the context of infrastructure trusts, tax deferred income is ordinary income and therefore assessable under section 6-5 of the ITAA 1997. They argue that this view is inconsistent with the policy objectives of promoting investment in the infrastructure industry.
30	Non-forestry managed investment schemes	This issue was the subject of the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into agribusiness managed investment schemes (MIS).
31	Charter boats	The issue relates to the ATO's approach to income tax deductions and GST claims in relation to charter boats. The issue was examined in the IGT's review into aspects of the ATO's settlement of active compliance activities.
32	Employee share plans	[confidential information] The issue relates to the Government's policy to improve employee equity participation in Australian businesses and the ATO's actions in relation to delays in providing rulings, views taken in rulings and views taken in the Administrative Appeals Tribunal.

Number	Issue	Summary
33	Interest deductibility and tracing of funds — TR 2000/2	Involves a case of denying interest expenses incurred on commingled funds relying on paragraph 50(a) of the ITAA 1936, TR 2000/2 and case law that purportedly does not require a direct trace of funds when determining deductibility of outgoings under subsection 51(1) of the ITAA 1936.
34	Range of issues dealing with sale of pre-CGT shares and application of penalties	Issues involve: • determining the cost base of receivables for the purposes of CGT Event K6 — said to be contrary to the examples in TR 2004/18 and TD 2008/29; • the method of calculating the capital loss in respect of the sale of post-CGT shares — said to be contrary to paragraph 104-10(4) of the ITAA 1997 and TR 2000/1, TR 2005/23, and TR 2006/14; • determining the date of disposal for the purposes of CGT Event K6 — said to be contrary to established legal principles; and • the imposition of culpability penalties in a capricious manner — said to be contrary to Ruling MT 2008/2.
35	Employee benefit arrangements	The issues relates to the ATO's compliance action against employee benefit arrangements in the late 1990s and 2000s.
36*	[Confidential issue — relates to taxpayer specific facts]	The taxpayer says that the ATO has told it that a previous advance opinion (given before the private binding ruling regime was put in place) that the ATO gave on the taxpayer's business structure was wrong and has now changed its view.
37*	TR 2009/D2 — Trading stock — trade incentives offered by sellers to buyers	Industry is concerned with the retrospective application of proposed views in TR 2009/D2, which they say is contrary to prior ATO views and industry practice. Industry says that TR 2009/D2: • says that accounting conventions and commercial principles are irrelevant for the purpose of valuing trading stock, whereas TR 2006/8 says that they are; • has ignored TR 96/6 in which it said that the intention and conduct of the parties was relevant for the purpose of treating 'credits' to purchasers; and • is contrary to the industry practice that settlement discounts are a trade discount to reduce the purchase price of stock. Industry says that in 2003 the ATO said it would issue a public ruling on the issues, however, 6 years is too long a time to allow uncertainty to continue. They say that if the ATO confirms the views in the final ruling, it must provide justification for the reversal of longstanding positions.

Number	Issue	Summary
38	Taxpayer Alert TA 2009/11 — retail premiums received by shareholders	In May 2009, the ATO released a facts sheet and Taxpayer Alert 2009/11 that said that retail premiums are unfranked dividends or ordinary income where they are received by shareholders who do not take up shares under a rights issue or entitlement offer. This means that those shareholders will not be able to access the CGT discounts or offset CGT losses against any gain on cessation of rights. Industry says that this position is contrary to the reasoning in the McNeil case and also the explanatory memorandum to the legislation that was introduced to overcome the McNeil decision *(Tax Laws Amendment (2008 Measures No.3) Act 2008*). Taxpayers for the 2008 year would have lodged tax returns on the basis of the explanatory memorandum, and are now exposed to penalties and interest. Industry says that either the ATO should issue a binding ruling to confirm the explanatory memorandum or run a test case quickly if they believe the explanatory memorandum is incorrect. In any event, industry asks why the explanatory memorandum was issued if the ATO had a contrary view.
39	TR 2006/8: The cost basis of valuing trading stock for taxpayers in the retail and wholesale industries	Industry is concerned with the broadening of cost basis in valuing trading stock to include more than the cost price of goods. Industry says that TR 98/2 says that only costs incurred up to the point that a saleable product exists are required to be absorbed into the cost of trading stock (e.g. paragraph 9 says transport costs in transporting the finished product are not included). Paragraph 33 of the ruling says that the production process ends when the saleable product is first stockpiled. Transport costs incurred after this point do not have to be absorbed (paragraph 115). The ATO released TR 2006/8 which requires taxpayers to include in the cost of stock, transport costs beyond those incurred in bringing the stock to a point where it is on hand; and storage costs where the storage is at a site which is remote to the place from which the stock is sold. Industry argues that this view is contrary to the requirements of the law and TR 98/2, and also contrary to Accounting Standard AASB 102.
40	[Confidential issue — relates to taxpayer specific facts]	Relates to certain purported concessions that the ATO gave in determining the effect of certain legislative provisions.
41*	ATO interpretation of certain exempt income tax provisions	Tax practitioners say that up until 2007, the ATO took a broad view of the scope of an exemption in many class rulings. From that time the ATO took a narrower view, but did not make this view known publicly. Class rulings applied for after this time were generally withdrawn when the applicant was told the ATO had decided to make a negative ruling. A ruling on the issue was applied for in mid 2008. The ATO spent several months issuing information requests and only disclosed the change of view when the need for the ruling became urgent. Ultimately, the ATO issued the ruling requested.

Number	Issue	Summary
42	Superannuation entities claiming foreign investment fund exemptions	In late 2004, tax practitioners raised with the ATO that the interaction between the foreign investment fund (FIF) exemption (section 519B of the ITAA 1936 — enacted in 2004) for complying superannuation funds and foreign hybrid rules meant that the net income from foreign hybrids would still be included in any FIF income because the foreign hybrid would not qualify for the FIF exemption. This would impose significant administrative burdens on the super funds because the underlying investment was required to be identified in undertaking FIF calculations. Tax practitioners proposed that the law be changed or the ATO issue a ruling so that in circumstances where a complying super fund had an interest in net income from a foreign hybrid it would be allowed to disregard any FIF income and not have to be calculated by the super fund at all. In February 2006, the ATO released ATOID 2006/40 which contradicted this. Tax practitioners pointed out that this was contrary to what the ATO had previously verbally agreed. In late 2007 the ATO said that the ATOID was wrong and reissued another rectifying the view. The ATO said that it would release a public ruling on the issue.
43	Section 23AJ precedence over s23AH if dividend derived through a foreign permanent establishment	In October 2007, the ATO released ATOID 2007/184 that said that where an Australian company derives non-portfolio dividend (within the meaning of section 317 of the ITAA 1936) through its permanent establishment overseas, the dividend will not be non-assessable non-exempt income (NANE income) under section 23AH but NANE income under section 23AJ. If under section 23AH then the expenses incurred in deriving the NANE income are not deductible, whereas if under section 23AJ then certain deductions are available under section 25-90 of the ITAA 1997. The ATO withdrew the ATOID in April 2009 saying that “it is reconsidering the position stated in the ATOID”. At the date of the submission no replacement has been released or listed on the Rulings Program.
44*	Meaning of “exploration” under the petroleum resource rent tax	Industry had previously largely relied on the income tax view of “exploration” for petroleum resource rent tax (PRRT) purposes. The income tax view was that until a decision to mine was made, the expenditure was generally exploration expenditure in nature. This would include expenditure to determine the commerciality of the project. This view was based on the text of paragraph 40-730(4) of the ITAA 1997 and TR 98/23 and PBR 77089. However, the ATO has taken recent compliance action on the basis that expenditure that relates to determining the commerciality of a project (as opposed to the commerciality of resources) may not necessarily be exploration expenditure in nature for PRRT purposes. Industry says that if a new view contradicts an old view, then the new view should be clearly stated to all taxpayers. Until such time, the old view should continue to apply.

Number	Issue	Summary
45	Consolidations and trusts	Wholly owned trusts (that is, trusts where the group owns all of the interests, excluding debt interests) within a consolidated group are treated as part of the head company in calculating that company's tax liability. Industry considers that the head company or its subsidiary need be the trustee. Accordingly the net income for the trust itself is 'nil'. Industry treats payments made on debt interests by a trust as a deduction under section 25-85 of the ITAA 1997 based on the single entity rule. This view is based on a reference in the ATO's Consolidations manual that implies that a fixed trust in a consolidated group is treated as a company in that group. Industry says that the ATO recently said that if the trustee of the trust is not a subsidiary of the head company, then there is no relevant person who owes the relevant obligations under the trust deed to the beneficiaries, as these obligations will fall outside the group. Therefore, only that part of net income of the trust to which the group is presently entitled is included in the head company's tax liability. Industry says that the policy in this area needs to be clarified.
46*	Section 320-40 of the ITAA 1997	In consultation on the introduction of Division 320 of the ITAA 1997, the ATO told life companies that one-third of fee income from new members would be excluded over the period 1/7/00 to 30/6/05 if the master policy was in place before the start of that period and new members were incorporated under it after the start of that period. In late 2005, the ATO told the industry that when a new member joins the relationship would be governed by a 'new contract' for tax purposes. Industry said that this view would cause hundreds of millions of dollars through reversing tax returns. In April 2007, the ATO discontinued this view.
47	Section 128D of the ITAA 1936 and its application to trust income	Industry says that trustees are not liable for tax on income to which a non-resident beneficiary is presently entitled where section 128B of the ITAA 1936 applies to that income (section 128D give effects to this). It is treated as non-assessable, non-exempt income. This is because the final tax for non-residents is relation to certain income is Division 11A. Industry says that the ATO issued IT 2049 and TR 92/13 saying that trustees' distributions of unfranked dividend income (post withholding tax) is excluded from the trustees' income. Industry practice follows 5 steps in determining trustees' tax liability; determine net income; determine whether beneficiaries are presently entitled; for non-resident beneficiaries determine whether s.128 applies. Industry says that the ATO said that section 128D should also apply to the calculation of 'net income' (a previous step in determining distributions of trusts). This would have the effect of causing anomalies in determining trust distributions but also denying resident beneficiaries their imputation credits.
48	Petroleum resource rent tax and the treatment of indirect costs	Industry says that the ATO's treatment of indirect costs was set out in MT 93/2, but then the ATO took a different approach in audits and delivered a speech in 2005 which was inconsistent with the MT. Industry says that the Treasurer noted in the 2005-06 Budget via a press statement that his preference was that an administrative solution should be explored before any legislative amendment is considered. Industry says that four years on, the issue remains largely unresolved. Industry says that the narrow base of precedents means that individual taxpayers need to engage the ATO on a case by case basis in lengthy periods of negotiation and this creates extended periods of uncertainty, impacting on investment decisions.

Number	Issue	Summary
49	Division 7A of the ITAA 1936 — honest mistake	The ATO recently released a draft practice statement, PSLA 2843 which provides guidance on the meaning of an honest mistake or inadvertent omission for the purposes of the Commissioner's discretion under section 109RB of the ITAA 1936 to disregard a deemed dividend under Division 7A where it was a result of an honest mistake or inadvertent omission. Tax practitioners understood the Commissioner's media release in relation to PSLA 2007/20 would mean that the term 'an honest mistake or inadvertent omission' was intended to cover a "wide range" of mistakes and omissions made by taxpayers. Taxpayers were strongly encouraged to correct prior mistakes in relation to Division 7A, and were provided with a great deal of comfort that the matter would not be subject to further audit scrutiny. Despite the public ATO messages regarding taxpayers and tax agents being encouraged to take advantage of PSLA 2007/20, the ATO's views in the draft PSLA 2843 would effectively result in very few taxpayers being able to comply with PSLA 2007/20. Tax practitioners are concerned that the subsequent views of the ATO in the draft PSLA will result in the ATO being construed as misleading in relation to its advice on correcting past errors. Furthermore, if the ATO did hold the view that taxpayers would not fall within the ambit of an 'honest mistake or inadvertent omission' where their affairs were managed by a tax agent, tax practitioners find it particularly disconcerting that the ATO is writing to tax agents to make them aware of the Commissioner's discretion and offering them the opportunity to correct past mistakes.
50	Interpretation of liabilities	Tax practitioners say that the interpretation by the Commissioner of the meaning of 'liabilities' for the purposes of different divisions of the ITAA 1997 are inconsistent. They compare TD 2007/14 (which relates to Division 152 of the ITAA 1997) in which the Commissioner has effectively adopted a reference to legal debts and excluded accounting liabilities (that is, recognised accounting provisions, from this definition) with TR 2002/20 (which is the basis for some views on Division 820 of the ITAA 1997) in which the Commissioner adopts the accounting meaning of 'liabilities'. Tax practitioners appreciate that the statutory interpretation of a term needs to be considered in the context of the provisions in which the term is used and this may result in a term having different interpretations depending on the legislative context. However, they say that Division 152 and Division 820 are both provisions which are applied in a business context and to apply different interpretations of 'liabilities' without sufficient justification provides taxpayers with little comfort that the ATO is applying the income tax law fairly and consistently. Tax practitioners also note that the ATO has acknowledged that adopting an accounting meaning of 'liabilities' is likely to reduce compliance costs for taxpayers. They say that given that it is the ATO's objective to reduce compliance costs for taxpayers, in particular small business taxpayers who would lack the requisite resources and knowledge to be tax compliant, it seem the ATO's interpretation of 'liabilities' under Division 152 is contradictory to this objective.

Number	Issue	Summary
51	CGT and leasehold interests	Tax practitioners understood that the established prior practice was that the ATO did not consider leasehold property to come within the meaning of real property and felt the need to bring this to Treasury's attention, as evidenced by the NTLG Losses and CGT Sub-committee 14 November 2007 meeting minutes. The ATO has now issued TD 2009/D1 which concludes that a leasehold interest in land is 'real property' within the meaning of paragraph 855-20(a) of the ITAA 1997 and will be applied with retrospective effect. Tax practitioners are concerned that the alternate view is given such cursory acknowledgement and that in deciding to apply the view retrospectively it has given insufficient consideration of the ATO's contribution to the prior industry practice.
52	Deductibility of disability insurance premiums	On 1 July 1988, sections 267 and 279 of the ITAA 1936 were enacted (part of Part IX of the ITAA 1936) and provided deductions to superannuation funds for insurance premiums in relation to policies that provided benefits in the event of "permanent disability". The industry accepts that this term extended to "disability benefits" within the normally usage by the life insurance industry. On 1 July 2007, Part IX was replaced by sections 295-460 and 295-465 of the ITAA 1997, which provide deductions for insurance premiums in relation to "disability superannuation benefits" (as defined in s.995-1). In December 2008, the ATO told the industry that the new law had not changed the position under the old law. It said that the premiums were deductible only to the extent that the premium reflected the fund's current or contingent liabilities to provide specific benefits, the scope of those benefits being set by reference to amounts capable of being paid under a "Condition of Release" that applies to preserved benefits under the *Superannuation Industry (Supervision) Act 1993*. Industry says that at no time over the last 20 years did the ATO give any such view during audits or advice products. They say that the retrospective effect of this view will result in tax liabilities that will create asset shortfalls and may need to be funded by insurers' capital injections. It will create a need for actuarial certification requiring significant funds and in some cases may exceed the deductions claimed. The ability of funds to change arrangements may be limited as many involve many years of coverage and there may also be limited ability to claw back costs from members due to cost recoupment structures. The ATO has advised Treasury and may issue a ruling and will consider it a priority if the law does not change.

Number	Issue	Summary
53	GST vouchers and Division 100 of the *A New Tax System (Goods and Services Tax) Act 1999*	Industry was of the view that both fixed and mobile network prepaid phone cards would qualify as Division 100 vouchers, based on consultation between the Industry, the ATO and Treasury and confirmed in the Telecommunications Industry Partnership — Issues Register — Issues 15, 16 &17. On 23 March and 23 May 2003, the ATO issued GSTR 2000/37 (Agency) and GSTR 2003/5 (Vouchers). On 10 September 2008, the ATO issued addendums to GSTR 2003/5, with effect from that date. These changes would have required the Industry to make system changes to reflect the fact that the ATO considered some prepaid phone products were no longer Division 100 vouchers and some were now to be treated as stored value cards. Further the change to GSTR 2000/37 resulted in the fact that Subdivision 153-B did not apply to simplify the accounting for GST in relation to non-taxable supplies (e.g. vouchers) made through an agent (e.g. dealer). This would have required costly and time-consuming changes to contractual arrangements between the industry, its distributors, dealers and retailers. Industry says that the ATO should have consulted earlier and if the ATO considered that its longstanding view/interpretation could no longer be supported it should have supported the industry in obtaining an expeditious law change to ensure that the status quo remained.
54	[Confidential issue — relates to taxpayer specific facts]	Involves difficulties in trying to obtain rulings on specific issues.
55	Delays in class rulings	Tax practitioners are concerned with extended delays in obtaining class rulings on certain issues.
56	Pooling of Funds — TR 2005/11	Tax practitioners say that a prior practice was followed of not needing to trace funds in banks as inherently untraceable, as evidenced by TR 2005/11. They say that the ATO now says that the ruling may no longer be followed and have not indicated why this issue is being re-opened. They are concerned that the effect of any subsequent ATO view will by retroactive.
57	Section 46G profits	Tax practitioners say that a prior practice was followed that non-rebatable dividends would be determined on a net profits last basis, as evidenced by an ATO paper issued in 1996. They say that the ATO has now disowned the paper.
58	Closed end funds and Division 6C of the ITAA 1936	Tax practitioners say that a prior practice was followed that closed end funds were not unit trusts for Division 6C of the ITAA 1936, as evidenced by ATOID 2003/43. They say that the ATO has refused to rule on the issue.
59	Tax law partnerships and registration for GST purposes	Tax practitioners say that a prior practice was followed that tax law partnerships were entitled to register as an entity for GST purposes, as evidenced by PR 2005/92. They say that the ATO now says that tax law partnerships are now not entitled to register as an entity for GST purposes, as per PR 2006/47 and 2006/84.
60	Own occupation insurance	Tax practitioners say that a prior practice was followed of allowing a deduction for own occupation insurance, as evidenced by the ATO's tacit acceptance of the industry practice over 20 years. They say that since 2009 the ATO asserts that the claims were never deductible. They are concerned that the effect of the ATO's view is retroactive.

Number	Issue	Summary
61	Research and development — feedstock	The research and development (R&D) feedstock provisions were introduced in 1996 and restricted deductions at the concessional rate for expenditure on manufactured or acquired materials or goods that were transformed or processed into saleable output by an activity that was also R&D. In addition it excluded the energy costs to do that processing or transformation. Industry says that no concession was allowed on these costs unless the sale resulted in a loss compared to these feedstock inputs. This is despite the fact that concessional claims would be allowed on all the other eligible non-feedstock expenditure on R&D. Industry says that to date the guidance has been little more than rehashing the related explanatory memorandum. The ATO is currently preparing a draft ruling on feedstock. Through interactions with the ATO, industry has been getting indications of two possible significant changes in the application of these provisions: 1. The exclusion of consumables from being considered feedstock inputs is actively being questioned by the ATO in the preparation for the forthcoming ATO ruling. Industry says that this would seriously expand the costs excluded from the concession in a way that undermines the legislative intent to encourage more R&D by businesses in Australia. 2. The ATO looks like it will seek to apply a holistic calculation where there are R&D activities early in a manufacturing stream and different R&D activities later in the stream, contrary to the relevant explanatory memoranda.
62	Research and development — TR 2002/1	Industry says that after 14 years of ATO acceptance of industry standard practice on the application of the law on research and development (R&D) plant expenditure, the ATO redefined the accepted interpretation of definitions and treatment of expenditure on plant by releasing draft taxation ruling TR 1999/D14 (which became TR 2002/1). Industry says that this redefinition had two main changes: • It applied a sweeping definition to plant expenditure and sought to impose an extremely onerous eligibility test requiring that expenditure only on items which were exclusively for R&D purposes for all their life could be claimed for the purposes of the concession. • It raised the possibility that companies could face retrospective review of past claims for expenditure on plant, dating right back to the introduction of the concession in 1985. Industry says that this was so dramatic a change that so undermined the integrity of the concession that it resulted in direct intervention by the Prime Minister and new amending legislation being put in place to block the ruling's ongoing application before the ruling was finalised. Industry says that these changes by the Government were introduced because the Government recognised that, in the absence of any guidance from the Commissioner, that a broad interpretation of the 'exclusive use' test had come to be used in commercial practice and that this had apparently been accepted by the Commissioner right up to the release of the draft ruling.

Number	Issue	Summary
63	Research and development — withdrawal of rulings	Income Tax rulings IT 2552 (1989), IT 2442 (1987), and IT 2451 (1987)("the Rulings") variously contained detailed information regarding the principles and methods that should be adopted by a taxpayer in preparing a calculation of research and development (R&D) expenditure. The Rulings were administratively binding advice and while not legally binding on the Commissioner offered some level of protection to the many taxpayers who have relied upon them annually since their release. Industry is concerned that the withdrawal of the Rulings removes any tax shortfall protection, evidences a lack of industry consultation and will reduce the reliability of ATO guidance without any clearly expressed concerns, despite no concerns expressed for the last 20 years.
64	[Confidential issue — relates to taxpayer specific facts]	Relates to a difference in administrative views between another Government department and the ATO.
65	[Confidential issue — relates to taxpayer specific facts]	Relates to a purported departure from ATO views expressed in a private ruling as being "no longer appropriate or applicable" for the same arrangement in later years.
66	Division 320 of the ITAA 1997 — cash versus accruals	The tax profession cites this as an example of a view adopted by taxpayers on new law enacted in 2000 and in relation to which there was no ATO view until 2007. Initially participants adopted either a cash or accruals approach to Division 320 of the ITAA 1997. The ATO refused to rule in 2002 that cash basis was correct (as non-contentious), but subsequently ruled (refer to ATOID 2007/41) on an accruals basis.

Number	Issue	Summary
67	GST apportionment methodology applicable to asset finance businesses	For GST purposes, the GST Act treats disclosed hire purchase arrangements as a mixed supply, having two components: the taxable supply of goods; and the input taxed credit charges. The ATO's ruling, GSTR 2000/22, stated that the appropriate measure for financial supplies is 'net revenue' while the appropriate measure for taxable supplies is 'gross revenue'. In relation to disclosed hire purchase agreements in the asset finance area, industry applied this ruling to calculate the extent an acquisition was made for a creditable purpose. Industry considered that the ATO's answers to questions placed on its website (constituting a binding public ruling) until September 2006 confirmed this approach. In April 2006, the ATO replaced GSTR 2000/22 with GSTR 2006/3, which made no specific comment regarding the measurement of financial supplies, but re-stated the requirement that the apportionment methodology to be 'fair and reasonable'. Industry says that the ATO considers that the latter ruling clarified its position on the use of revenue methodology. In September 2006, the ATO also changed the answers to questions on its website to say that the use of net income from financial supplies was distortive. In December 2006, the ATO released a consultation paper (later finalised as a Practice Statement in 2008). It asserted that it was the ATO's 'longstanding view' that the net revenue approach was not an appropriate measure of financial supplies, and that taxpayers may be subject to audits. Industry is concerned that the ATO will now audit and issue amended assessments on a basis which is inconsistent with its earlier public rulings. Industry is also is concerned that taxpayers will be hampered in proving that they relied on a public ruling before September 2006 because by changing the answers on the website the ATO have in effect retrospectively altered the public ruling and removed its previous contents from view.

APPENDIX 3 — AUSTRALIAN TAXATION OFFICE'S RESPONSE

FORMAL	INSPECTOR-GENERAL	9 MARCH 2010	UNCLASSIFIED CLASSIFICATION

Australian Government
Australian Taxation Office

Mr Ali Noroozi
Inspector-General of Taxation
Level 19, 50 Bridge Street
Sydney NSW 2001

Dear Ali

Thank you for your report on the review into delayed or changed Australian Taxation Office (ATO) views on significant issues. The ATO responses to your specific recommendations are at Attachment 1. I understand that you will include our responses under the relevant recommendation in your final report.

At the outset I acknowledge and thank you for the collaborative manner in which you have conducted this review. This has helped in developing recommendations which we believe will further improve the administration of the tax system. Our involvement with the working group of key practitioners and taxpayer representatives which you established has helped to inform our understanding of taxpayer perceptions and ways to address these perceptions.

As you can see from our responses to the recommendations, we are in general agreement with recommendations 2 to 5. Whilst recommendation 1 is a matter for Government, we are of the view that the issues raised in the report are best addressed by implementing recommendations 2 to 5. In particular, we are of the view that providing more guidance on the circumstances and factors which are relevant in determining when the ATO will only apply its view of law prospectively should help to address taxpayer and practitioner perceptions about changes in ATO views and practices.

In the ATO's view, the examples provided in submissions to your review indicate the real issues arising from this review are twofold. First, there are sometimes disagreements over whether either a previous ATO practice existed or the ATO consciously accepted or contributed to a practice or view adopted by taxpayers. Secondly, some examples show a difference of view about the meaning and scope of an existing ATO view expressed in a ruling or other product.

In our view, the examples do not provide evidence of so called u-turns where the ATO has applied a change of view retrospectively. Some of the examples in the submissions in fact refer to opinions expressed in discussion papers. These papers are clearly not final views but are issued to facilitate consultation before the ATO forms its view.

As pointed out in your report, we have identified 14 public rulings issued over the last four years where the ATO view, either wholly or partly, was prospective only. These examples are set out in Attachment 2 to this letter. In each of these examples the ATO concluded that a prospective application of the view was fair and reasonable in the circumstances. The table in the attachment outlines the circumstances for each example.

We are currently tightening our processes and practices around the use of discussion papers. We are also initiating technical discussions with some professional firms in order to try to improve the timely identification of issues where there might be uncertainty or differences of view. We plan to immediately start the process of developing a new or revised draft practice statement to implement recommendation 2. We will consult with representative bodies on this draft.

Thank you for the opportunity to provide this response to your report.

Yours sincerely

Kevin Fitzpatrick
Chief Tax Counsel

[Pages 3 to 10, attachment 1 of the ATO's response, contain the ATO's responses to the IGT's recommendations.

As indicated in the ATO's cover letter above, these responses have been moved into the body of the report to remove duplication.]

Attachment 2

Public Rulings since 2005 with a prospective date of effect (in whole or in part)

Ruling number and title	Date of effect – Compliance implications
Taxation Rulings	
TR 2009/D8 - Income tax: Division 7A loans: trust entitlements	***Previous Fact Sheets*** Whilst this issue has not previously been dealt with in a public ruling, ATO fact sheets issued in the past indicated that a UPE would not be treated as a loan for Division 7A purposes. In recognition of this, in relation to those UPEs which are themselves treated as loans for the purposes of Division 7A it is proposed that the view in the draft Ruling only apply prospectively. Where, however, a UPE no longer exists and has instead been converted to an *actual* loan, it is the Tax Office view that there was no prior administrative practice or indicative view. In these situations there is no relevant outstanding UPE (instead, there is only an actual loan outstanding), and it is proposed that when finalised the Ruling would apply both before and after its date of issue to this category of arrangements.

Ruling number and title	Date of effect – Compliance implications
TR 2006/8 - Income tax: the cost basis of valuing trading stock for taxpayers in the retail and wholesale industries	***Previous Practice Statement*** This Ruling applies to years of income both before and after its date of issue, subject to 2 exceptions, both relating to former PS LA 2003/13: • PS LA 2003/13 indicated that taxpayers were not required to make adjustments for earlier years of income where they applied the principles in the practice statement (now described in the Ruling) in valuing their closing stock at cost for the year ended 30 June 2004 and subsequent years. Accordingly, the Ruling only applies to these taxpayers for calculating the cost of closing stock at 30 June 2004 and for subsequent years. • Where the returns of income for taxpayers and consolidated groups with an annual gross operating turnover of less than $10 million evidence a reasonable and practical basis to correctly bring to account their trading stock consistent with paragraph 1 of PS LA 2003/13, the Ruling applies to them in the specific manner described in paragraphs 27 to 30 and to years of income ending after the date of issue of the Ruling.
TR 2005/21 - Income tax and fringe benefits tax: charities	***Change in Tax Office approach*** The Ruling generally applies both before and after its date of issue. However, one aspect of the Ruling is to distinguish between 'charitable funds' and 'charitable institutions'. A consequence of this distinction is that charitable funds will no longer be taken to be rebatable employers for the purposes of section 65J of the FBTAA, as that provision only applies to charitable institutions. It is acknowledged in the Date of Effect section that this involves a change in the previous Tax Office administrative approach so this aspect of the Ruling only applies from 1 July 2005 (draft Ruling issued in May 2005).

Ruling number and title	Date of effect – Compliance implications
TR 2005/22 - Income tax: companies controlled by exempt entities	***Previous inconsistent taxpayer practices and confusion about Tax Office approach*** Comments on the draft of the Ruling indicated there were different approaches adopted by taxpayers and there was some confusion about the previous Tax Office practice. Comments indicated a need for a transitional period in which taxpayers could, where necessary, restructure their affairs. Accordingly the Ruling applies from 1 July 2006 (Ruling issued on 21 December 2005). This provided companies time to adjust their affairs in light of the Commissioner's interpretation of the law in this Ruling. So, if the Commissioner were to determine that a company is not exempt under Division 50 in accordance with the Ruling, the consequences of that will apply to all of its ordinary income and statutory income from 1 July 2006.

Ruling number and title	Date of effect – Compliance implications
Taxation Determinations	
TD 2010/1 – Income tax: consolidation: capital gains: does paragraph 40-880(5)(f) of the Income Tax Assessment Act 1997 prevent the deduction, under section 40-880 of that Act, of incidental costs described in subsection 110-35(2) of that Act that the head company of a consolidated group or MEC group incurs, in disposing of shares in a subsidiary member to a non-group entity, before the member leaves the group?	***Previous ATOID*** This Determination applies in cases where the incidental costs are incurred on or after 6 June 2008, the date on which a previous ATO ID on the issue that contained a contrary view, ATO ID 2004/500, was withdrawn and replaced with ATO ID 2008/96 (which formed the basis of the view expressed in this Determination).
TD 2008/16 – Income tax: is an exceptional circumstances relief payment paid to a farmer under the Farm Household Support Act 1992 'assessable primary production income' under subsection 392-80(2) of the Income Tax Assessment Act 1997?	***Previous ATOID, then no ATO view*** The Determination applies before and after its date of issue and is consistent with previous ATO ID 2004/9 that had been withdrawn in 2005 while the issue was being reconsidered. However, the Tax Office recognised that some taxpayers may have included an Execptional Circumstances Relief Payment as assessable primary production income in the period when there was no published view on its treatment, ie after the withdrawal of ATO ID and while the issue was being reconsidered. This inclusion may or may not have been to their advantage, depending on their particular circumstances. Therefore, taxpayers who had done so prior to the issue of this Determination were not required to seek amendments to their prior year assessments (though they could do so if they wish). This concession was communicated to taxpayers through the Tax Office website and also via an e-link broadcast to tax agents, and was published at the same time as the Determination

Ruling number and title	Date of effect – Compliance implications
TD 2008/28 – Income tax: when is income tax of a private company a 'present legal obligation' for the purposes of the distributable surplus calculation under subsection 109Y(2) of Division 7A of Part III of the Income Tax Assessment Act 1936?	***Change to view in draft ruling*** The Tax Office originally issued draft TD 2007/D9. Subsequent to this it changed its view and issued a revised draft (TD 2008/D8) which was then finalised as TD 2008/28. The date of effect paragraph provides that where taxpayers had relied upon TD 2007/D9 and it provided a more favourable outcome, they were entitled to rely on TD 2007/D9 up until 18 June 2008 which was the date of issue of the revised draft. This is consistent with the statement in the explanatory memorandum accompanying the ROSA law changes which states that, where a draft ruling is the Commissioner's only statement on an issue, the draft ruling will usually represent the Commissioner's general administrative practice.
TD 2007/4 – Income tax: capital gains tax: is a 'policy of insurance on the life of an individual' in section 118-300 of the Income Tax Assessment Act 1997 limited to a life insurance policy within the common law meaning of that expression?	***Change to view in draft ruling*** This Determination applied to years commencing both before and after its date of issue subject to the exception that the Determination only has a prospective date of effect to the extent that the position in it differed from its draft, TD 2006/D36. Again, consistent with statement in explanatory memorandum about draft rulings usually representing a general administrative practice.

Ruling number and title	Date of effect – Compliance implications
TD 2007/18 – Income tax: consolidation: in applying the statutory cap in section 705-40 (tax cost setting amount for reset cost base assets held on revenue account) of the Income Tax Assessment Act 1997, does the definition of revenue asset in section 977-50 of that Act include any CGT asset, a hypothetical realisation of which would have an amount reflected in the joining entity's taxable income (disregarding the single entity rule), otherwise than solely as a capital gain or capital loss?	***Change from published view in Consolidation Reference Manual (CRM)*** The Determination applies from the date of issue for assets that are consumables. The Consolidation Reference Manual (an ATO precedential document) contained a Note to a worked example dealing with consumables brought into a group. That Note said that a consumable is not a revenue asset 'since its cost rather than a net loss, is allowed as a deduction.' That Note was at odds with the view in this TD and was withdrawn from the CRM before the issue of the TD. The prospective date of effect therefore protects taxpayers who relied on the Note in relation to consumables There were (and are) no other references to revenue assets in the CRM. Taxpayers with CGT assets other than consumables would not have been entitled to rely on the Note as representing the Commissioner's view of the law in relation to revenue assets generally and therefore the Determination applies to all CGT assets other than consumables, both before and after its date of issue.
TD 2005/13 – Income tax: capital gains: if there is a change in the majority underlying interests in an asset owned by an entity, does the entity's ownership of the asset start from the change in majority underlying interests for the purpose of applying the tests in paragraphs 152-110(1)(b) and (c) of the Income Tax Assessment Act 1997?	***Change to oral view*** The Tax Office previously expressed the view at the June 2001 NTLG CGT Subcommittee meeting that if a change in the majority underlying interests in an asset happens, the relevant ownership period for paragraph 152-110(1)© purposes restarts. The Tax Office revised its view as set out in this Determination. The change was foreshadowed by the Tax Office at the June 2004 NTLG CGT Subcommittee meeting. Accordingly, paragraph 1 of this Determination applies only to CGT events that happen on or after the date of issue of this final Determination. For CGT events happening before the date of issue, taxpayers may choose whichever view is more favourable to them but must adopt the same view for both paragraphs 152-110(1)(b) and 152-110(1)(c) of the ITAA 1997 purposes.

Ruling number and title	Date of effect – Compliance implications
Goods and Services Tax Rulings	
GSTR 2008/2 – Goods and services tax: development lease arrangements with government agencies	***No prior view or practice*** The final Ruling applies before and after its date of issue. The Tax Office had not expressed a view on this issue before the draft of this Ruling. However, given the long term nature of the commitments involved and the variation in industry practices, transitional administrative arrangements were considered to be necessary. Basically, developers who were committed to a development lease arrangement prior to the release of the draft Ruling on 3 October 2007 were given the option of continuing with the previous approach that was: • the developer made a taxable supply of development services to the government agency which made a corresponding creditable acquisition • the consideration for the developer's acquisition of the land included the development services, and • supplies of completed residential premises (commonly, strata titled units) by the developer to the third party purchasers were input taxed. This was on the basis that the residential premises were considered to have been previously sold or subject of a long-term lease as part of the land supplied by the government agency to the developer. This administrative approach was communicated to key stakeholders, including GSTAS, the NTLG GST Subcommittee, the Property Council of Australia, and the Property and Development Industry Partnership. On issue of the Ruling, • Tax professionals were informed through Tax Office tax agent specific channels, • Property developers were further targeted through industry channels, such as industry associations, the Property and Development Industry Partnership and industry media (for example publications and websites), • Government agencies were informed through GSTAS and correspondence direct to State and Territory representatives.

Ruling number and title	Date of effect – Compliance implications
Goods and Services Tax Determinations	
GSTD 2008/2 – Goods and services tax: are supplies of food known as breakfast bars GST-free?	***Inconsistent practice and small number of private rulings*** The final Ruling applies before and after its date of issue. However, the Tax Office noted that there were a small number of taxpayers with favourable private rulings in relation to their particular breakfast bar products who could treat their products as GST free until the date of issue of the Determination. There had also been inconsistency of treatment through the supply chain with some manufacturers treating the supply as GST-free and retailers then treating the same product as taxable, and vice versa without the benefit of obtaining a ruling. The Tax Office, in consultation with industry, noted this inconsistency in industry practice, and the need for a transitional period to allow some suppliers to make systems or process changes. An administrative decision was made to give taxpayers 60 days from the date of issue of the Determination to make these changes. In addition, if suppliers were unable to make systems or process changes to comply with the Determination within 60 days or required assistance to implement changes, the Tax Office indicated it would consider whether additional time should be granted on a case by case basis. The Tax Office utilised the GST Food Classification Working Party to inform industry of the publication of the Determination. Tax professionals were informed through existing Tax Office tax agent specific channels, including the Tax Office website.

Ruling number and title	Date of effect – Compliance implications
Miscellaneous Taxation Rulings	
MT 2009/1 - Miscellaneous taxes: notification requirements for an entity under section 105-55 of Schedule 1 to the Taxation Administration Act 1953	***Previous Fact Sheet and Practice*** This Ruling explains the Commissioner's view of the law both before and after the date of issue. There was no previous formal Tax Office ruling on the section 105-55 notification requirements. However, there was a fact sheet *Time Limits on GST Refunds* (NAT 11645) published on the Tax Office website which links to a form *Notification of entitlement to GST refund* (NAT 11719). While the fact sheet and form gave less detail on the notification requirements than this Ruling, they were broadly consistent with it. Unlike this Ruling, the fact sheet and form did not require a taxpayer to positively assert an entitlement to a credit or refund. Furthermore, the fact sheet contained an example that may be interpreted as accepting a lesser standard for notifications. Also, in practice the Commissioner had on some occasions accepted notifications that contained only a very brief description of an entitlement. Accordingly, this Ruling provides that the Tax Office will not treat a notification lodged before the release of the draft Ruling as invalid where the notification does not assert an entitlement to the credit or refund (for example, it uses language like 'may be entitled'), or where it contains only a brief description of the nature of the entitlement.
Superannuation Guarantee	
SGR 2009/2 - Superannuation guarantee: meaning of the terms 'ordinary time earnings' and 'salary or wages'	***Change to draft Ruling and additional items to old SGRs included*** While this Ruling replaced former Rulings SGR 94/4 and SGR 94/5, the final Ruling did vary materially from the draft (SGR 2008/D2) and also covered some items of income that were not previously covered by the old SGRs. Accordingly, the date of effect of the Ruling was prospective from 1 July 2009. This allowed time for any system changes required by employers and it was the first day of a quarter for superannuation guarantee purposes.