



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

# The Management of Tax Disputes

**A report to the Assistant Treasurer**

**Inspector-General of Taxation**

**January 2015**



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30 January 2015

The Hon Josh Frydenberg MP  
Assistant Treasurer  
Parliament House  
Canberra ACT 2600

Dear Minister

**Review into the management of tax disputes**

I am pleased to present you with my report of the above review which was undertaken at the request of the House of Representatives Standing Committee on Tax and Revenue (the Committee) to assist with the large business and high wealth individual (HWI) themes of its *Inquiry into Tax Disputes* (the Inquiry). The Inquiry had been referred to the Committee by the then Acting Assistant Treasurer, Senator the Hon Mathias Cormann.

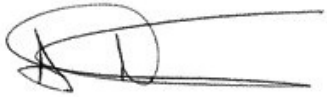
The underlying cause of the concerns raised, with respect to the ATO's management of tax disputes, is a lack of independence between its original decision makers and its officers reviewing such decisions upon the taxpayer's request. Arguably, the ATO has had the least amount of separation between these functions when assessed against revenue authorities of comparable jurisdictions. It is, therefore, not surprising that many taxpayers felt that their cases were not being independently reviewed and that the system was not treating them fairly and equitably.

In response to these concerns, the ATO has recently begun to take action mainly with respect to large businesses and HWIs. In this report, I acknowledge these recent improvements and recommend further structural separation which would include the establishment of a separate and dedicated Appeals Group to be headed by a new Second Commissioner. The Appeals Group would be responsible for managing pre-assessment reviews, objections and litigation for all taxpayers including small businesses and individuals. Such separation provides the highest level of independence whilst retaining the review function within the ATO. It facilitates a fresh and impartial review of the taxpayer's case whilst ensuring that any settlements are adequately scrutinised and in the best interest of the community.

I recognise that creating a separate agency rather than a new Appeals Group within the ATO would provide the ultimate level of independence, however, I am of the view that such a course of action should only be pursued if significant concerns persist after the recommended structural change has been implemented.

I offer my thanks for the support and contribution of professional bodies, tax practitioners and taxpayers. I would also like to thank the Committee and the ATO for their professional cooperation and assistance in the conduct of this review.

Yours faithfully,

A handwritten signature in dark ink, appearing to be 'Ali Noroozi', with a stylized, elongated horizontal stroke extending to the right.

Ali Noroozi  
Inspector-General of Taxation

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## EXECUTIVE SUMMARY

On 2 June 2014, the then Acting Assistant Treasurer, Senator the Hon Mathias Cormann, referred an *Inquiry into Tax Disputes* (the Inquiry) to the House of Representatives Standing Committee on Tax and Revenue (the Committee). The Committee adopted the Inquiry and announced that it would consider, amongst other things, ‘whether a separate agency should manage ATO [Australian Taxation Office] litigation, whether the ATO should have a separate appeals area, or if current arrangements should continue.’ On 11 June 2014, the Committee requested that the Inspector-General of Taxation (the IGT) undertake a review into the large business and high wealth individual (HWI) themes of the Inquiry.

The IGT had previously examined different aspects of the ATO’s approach to dispute management and resolution, including objections, settlement, litigation and the use of alternative dispute resolution (ADR). Furthermore, the IGT has also considered the ATO’s compliance approach to large business and HWIs in separate reviews. In this review, the IGT has drawn on this body of work, submissions to the current review as well as additional research and analysis including comparisons with the revenue authorities of the United States of America, Canada, the United Kingdom, New Zealand and Ireland.

The IGT has observed that the underlying cause of many concerns raised in submissions appears to be a lack of separation between the ATO’s original decision makers and its officers who review such decisions at the request of taxpayers. This has given rise to a lack, or perceived lack, of independence leading taxpayers to believing that their cases were not reconsidered afresh and they were denied a fair hearing.

Accordingly, some taxpayers are of the view that they cannot have their matter objectively reconsidered until they reach the Administrative Appeals Tribunal (AAT) or the Federal Court of Australia. Such view is supported by the ATO’s statistics. For example, in 2013–14, 85 per cent of taxpayer disputes were resolved without hearing when they reached the AAT. While there are a range of reasons for matters being resolved at such a late stage, the high rate of resolution indicates that a substantial proportion of cases are not being appropriately reconsidered by the ATO before the taxpayer invokes external review procedures.

Following earlier IGT reviews, the ATO has embarked on a program of work to improve its compliance and dispute resolution approaches particularly in relation to large businesses and HWIs. As a result, stakeholders have acknowledged recent improvements in the ATO’s approach to these market segments. Such improvements include the transfer of the objections function from the Compliance Group to the Law Design and Practice Group for taxpayers with \$100 million or more annual turnover and the introduction of a process to review ATO initial positions before assessments are issued for taxpayers with annual turnovers of \$250 million or more.

Whilst the ATO’s recent initiatives represent a positive step in relation to its management and resolution of tax disputes, there is a need for further improvements which are sustainable over time and made available to all taxpayers including small business and individual taxpayers. These taxpayers are the least likely to be in a position to take a dispute

to the AAT or the courts due to the significant financial and opportunity costs incurred both upfront and progressively throughout disputes.

Therefore, the IGT has recommended the creation of a separate and dedicated Appeals Group, led by a new Second Commissioner, to embed the improvements within the ATO structure and provide a framework that is less dependent on the views and ideals of the ATO leadership of the day. It will also bring the ATO more in line with comparable international revenue authorities.

The new Appeals Group would manage and resolve tax disputes for all taxpayers including the conduct of pre-assessment reviews, objections and litigation as well as championing the use of ADR throughout the dispute cycle. The separation from both the ATO's compliance and legal advisory functions would facilitate a fresh and impartial review of the taxpayer's case by empowering officers of the new area to resolve disputes through the most appropriate means, taking into consideration the individual circumstances of the taxpayer, their case and assessment of the ATO's precedential view. Additionally, the new area would ensure that settlements are appropriately scrutinised and in the best interests of the community.

The IGT notes that some stakeholders have suggested the need for a separate agency to be established to manage tax disputes. While the IGT recognises that the creation of a separate agency would represent the highest levels of independence, there are challenges associated with this option, including increased costs and overlap with existing external review bodies, such as the AAT. The IGT believes that this course of action should be considered in future if significant concerns persist following the implementation of the recommended separate Appeals Group.

The IGT has sought to achieve the highest level of independence whilst retaining the dispute management function within the ATO. In this regard, the need for the Appeals Group to be headed by a new Second Commissioner is paramount as such roles are statutorily appointed and their tenure and remuneration is pre-determined by the Government and the Remuneration Tribunal respectively and not the head of the relevant agency. Such an arrangement accords with the views of the International Monetary Fund on the separate leadership of an internal appeals function where organisational and practical separation (such as through a separate agency) cannot be achieved.

While the report has largely focused on improvements to the governance framework for tax disputes, the Committee's terms of reference have highlighted a number of other areas for examination including the collection of revenues due, efficiency, effectiveness and transparency, use and publication of performance information and the legal framework for tax disputes. The IGT has considered and briefly discussed these issues, noting that they have either been examined in prior IGT reviews, will be the subject of current IGT reviews or there are current developments which may impact on these matters and that further time should be afforded before they are examined.

The IGT believes that the appropriate implementation of the recommendation in this review will result in a more efficient, effective and transparent tax dispute management process to which all taxpayers will have equal access and will have confidence that they will be treated fairly and equitably.

# CHAPTER 1 — INTRODUCTION

## REASON FOR THE REVIEW

1.1 On 2 June 2014, the then Acting Assistant Treasurer, Senator the Hon Mathias Cormann, referred an Inquiry into Tax Disputes (the Inquiry) to the House of Representatives Standing Committee on Tax and Revenue (the Committee).<sup>1</sup> The Committee adopted the Inquiry and announced that it would consider, amongst other things, ‘whether a separate agency should manage ATO [Australian Taxation Office] litigation, whether the ATO should have a separate appeals area, or if current arrangements should continue.’<sup>2</sup>

1.2 On 11 June 2014, the Committee sought the assistance of the Inspector-General of Taxation (IGT) and requested<sup>3</sup> that the IGT review the large business and high wealth individual (HWI) themes of the Inquiry. The ATO defines large businesses as those with annual turnover exceeding \$250 million and HWIs (also known as highly wealthy individuals) as those controlling more than \$30 million or more in net wealth.<sup>4</sup> For the purposes of this review, the IGT has adopted the ATO’s definition and consulted with the Committee to ensure that the spectrum of taxpayers would be canvassed by either the IGT or the Committee.

1.3 The IGT accepted the Committee’s request and issued terms of reference on 19 June 2014 which reproduced those of the Inquiry.<sup>5</sup>

## SUMMARY OF STAKEHOLDER CONCERNS

1.4 In response to this review, stakeholders have acknowledged recent improvements in the ATO’s handling of tax disputes. However, they have also highlighted a range of ongoing concerns including:

- difficulties with ATO conduct during compliance activities relating to information requests, position papers and a lack of early ATO engagement when signs of dispute emerge;
- a lack of independence of the objections function;
- specific issues with the ATO’s ‘internal independent review (IR) process’ to review ATO position papers for large business taxpayers;

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1 House of Representatives Standing Committee on Tax and Revenue, Parliament of Australia, ‘Inquiry into Tax Disputes’ (2014) <[www.aph.gov.au](http://www.aph.gov.au)>.

2 House of Representatives Standing Committee on Tax and Revenue, Parliament of Australia, ‘Inquiry into tax disputes launched’ (Media Alert, 6 June 2014).

3 *Inspector-General of Taxation Act 2003* para 8(3)(d).

4 Commissioner of Taxation, *Annual Report 2013–14* (2014) p 58-59.

5 Copies of the Terms of Reference together with the Committee’s Media Alert are provided in Appendix 1.

- the unavailability of the pre-assessment reviews, such as the above IR process, to all taxpayers;
- a lack of independence of the litigation function from the compliance function, leading to unnecessary litigation; and
- a lack of transparency and accountability in relation to settlements.

## **FOCUS OF THIS REVIEW**

1.5 The management of tax disputes, or aspects thereof, have been the subject of a number of previous IGT reviews which has led to recommendations being made directly to the ATO to improve its processes and approach. The ATO has agreed and taken steps to implement the majority of these recommendations.

1.6 Given the earlier IGT reviews on this subject matter and the ATO's response, as well as resourcing and timeframe constraints, the IGT has determined that it would be most beneficial in this report to consider whether recent improvements could be enhanced and embedded through appropriate structural change. The IGT has also considered specific improvements such as providing a framework to enhance original decision making to reduce disputes and to place a greater emphasis on fairness and timeliness.

1.7 While the IGT has been requested to undertake the review with a specific focus on the large business and HWI themes of the Inquiry, some comparison with other market segments are inevitable. In doing so, the IGT has drawn from his earlier reviews, submissions to this review and to the Inquiry as well as public hearings conducted by the Committee. The IGT has also used examples raised in submissions made to this review to illustrate ongoing concerns relating to systemic issues previously examined in earlier reviews.

1.8 Additionally, it should be noted that whilst the majority of disputes within the large business and HWI market segments tend to arise in relation to active compliance activities such as audits and risk reviews, disputes may also arise in the context of other ATO actions or 'products' such as private rulings or Advance Pricing Agreements in the transfer pricing sphere.

## **STRUCTURE OF THIS REPORT**

1.9 Chapter 2 provides background by examining the historical development of the administrative framework for the management of tax disputes within Australia as well as more recent changes in the ATO including those arising from previous IGT reviews. This chapter also makes comparisons with certain overseas revenue authorities.

1.10 Chapter 3 identifies the existing problems with the current system of administering tax disputes and highlights the need for reform.

1.11 Chapter 4 considers the different options for reform, including independence through appropriate structural separation between the main functions of the ATO,

namely: compliance, law interpretation and appeals including objections. In doing so, the IGT draws on overseas practices as well as the Australian experience in arriving at the recommendation for reform.

1.12 As the focus of this report is on the potential benefits of structural change, certain specific issues outlined in the Committee's Terms of Reference, as adopted by the IGT may be dealt with in greater detail in other current or future IGT reviews. For completeness, discussions on these other issues have been consolidated within Chapter 5 of the report.

1.13 Chapter 6 consolidates the IGT's observations and sets out the recommendation for reform to Government.



## CHAPTER 2 — BACKGROUND

2.1 Taxpayers involved in disputes with revenue authorities usually follow a resolution process set out in law which may include internal review, such as objections or appeals processes, as well as external review such as those afforded by tribunals and courts. In addition to these statutory processes, revenue authorities may establish administrative procedures for their staff and taxpayers which are aimed at resolving disputes earlier, at lower cost and with less formality.

2.2 This chapter first describes the evolution of these processes in Australia. Thereafter, the current processes and structures of certain overseas revenue authorities are set out for comparative purposes and analysis.

### EVOLUTION OF AUSTRALIAN TAX DISPUTE RESOLUTION PROCESSES

#### Change from full assessment tax system to self assessment

2.3 Prior to 1986, Australia had a full assessment tax system in which the ATO bore the risk of applying the law to the facts provided by taxpayers. Taxpayers' income tax liabilities were assessed by ATO officers in the 'assessing' section on the basis of information provided by taxpayers.<sup>6</sup> ATO assessors would generally conduct a cursory examination of the facts provided in the return before issuing the assessment. Essentially, the ATO's issuing of the assessment and its verification of the return happened at the same time. Any amendments made by the ATO were reflected in the original notice of assessment (NOA) issued to the taxpayer.

2.4 The ATO could amend an original NOA only if it transpired that the taxpayer had not provided all the facts. Taxpayers could object to the original NOA and any amendments. Such objections were initially handled by the same ATO assessor, in most cases, who was authorised to amend the assessment if there was a mistake on the facts. Where the validity of the objection 'depended on the technicalities of tax law', the assessor referred the matters to an appeals section in the ATO.<sup>7</sup>

2.5 Taxpayers dissatisfied with the ATO's objection decisions could have their matter heard by Taxation Boards of Review. These Boards were composed of three members who were appointed by the Governor-General on recommendation of Cabinet. Two members were chosen from the legal and accounting professions, whilst the chair was usually chosen from the senior officers of the ATO.<sup>8</sup>

2.6 ATO officers from a section called 'Appeals and Advisings', which was separate from the compliance sections, were responsible for the preparation and presentation of cases before the Boards of Review.

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6 Australian Taxation Office (ATO), *Working for all Australians 1910–2010* (2010).

7 Ibid.

8 Administrative Review Council (ARC), *Review of Taxation Decisions by Boards of Review* (1983) p 8.



2.7 The Boards could refer questions of law to the relevant State Supreme Court for judicial determination. Taxpayers could alternatively have their matter heard by way of appeal to that Court at first instance. These Courts could hear the matter *de novo* as they were not subject to the constitutional constraints currently imposed on the Federal Court of Australia (Federal Court) which now has jurisdiction in federal tax matters.<sup>9</sup>

2.8 With the introduction of the self assessment system in 1986, taxpayers began to bear the risks associated with applying the law to the facts and assessing their own liabilities. The NOA became a key milestone for both the taxpayer and the ATO. Under section 175A of the *Income Tax Assessment Act 1936* (ITAA 1936), taxpayers dissatisfied with an assessment may object against it in the manner set out in Part IVC of the *Taxation Administration Act 1953* (TAA 1953).

2.9 The ATO also shifted its resources away from assessing tax returns to other functions such as conducting audits and providing advice.<sup>10</sup> Audits were carried out by the Taxpayer Audit Group (TAG), whilst advice to taxpayers was provided by the Taxpayer Assistance Group. Additional advice to taxpayers and ATO officers was available from the Legislative Services Group of which the Chief Tax Counsel was a part.<sup>11</sup> The TAG, Taxpayer Assistance Group and Legislative Services Group were all led by First Assistant Commissioners who each reported directly to the relevant Second Commissioner. The Chief Tax Counsel also reported directly to a Second Commissioner.

## Dissolution of the Boards of Review

2.10 In 1986, the Taxation Boards of Review were dissolved and the administrative review of ATO objection decisions was transferred to the newly created Taxation Appeals Division within the Administrative Appeals Tribunal (AAT).<sup>12</sup> From 1 September 1987, the State Supreme Courts' jurisdiction to hear federal tax matters was transferred to the Federal Court.<sup>13</sup> Since that time, taxpayers have been able to apply to the AAT for a merits review, which may substitute the decision of the Commissioner for a preferable one.<sup>14</sup> Taxpayers may appeal decisions of the AAT to the Federal Court, but only on questions of law.<sup>15</sup> Where the AAT has re-exercised the discretion of the Commissioner (such as varying a penalty remission decision), the taxpayer may only appeal if the AAT made an error in arriving at its decision (such as taking into account an irrelevant consideration).<sup>16</sup>

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9 Wayne Gumley, 'The Taxation Appeals System: An Administrative Law Perspective' (Working Paper, No 96/5, Monash University, Syme Department of Banking and Finance, October 1996) p 17.

10 Above n 6.

11 Joint Committee on Public Accounts (JCPA), Parliament of Australia, *Report No. 326 An Assessment of Tax, A Report on an Inquiry into the Australian Taxation Office* (1993) pp 32 and 266.

12 *Ibid* p 23. The AAT was already in existence from 1976 but did not have jurisdiction over taxation decisions until 1986.

13 *Jurisdiction of Courts (Miscellaneous Amendments) Act 1987*.

14 *Administrative Appeals Tribunal Act 1975* s 43(1).

15 *Administrative Appeals Tribunal Act 1975* s 44(1).

16 *Waterford v The Commonwealth of Australia* (1987) 163 CLR 54 at 57.



2.11 Taxpayers may also appeal objection decisions directly to the Federal Court. As the Federal Court exercises judicial power under Chapter III of the Constitution, it undertakes a judicial review of the decision. Thus the Federal Court does not make a fresh decision, but may order the Commissioner to vary an assessment only if the decision is wrong in law. Effectively, this leaves the AAT as the last point of merits review for taxpayers.

## Formation of the Appeals and Review Group

2.12 Additional restructuring within the ATO led to the formation of the Appeals and Review Group (ARG) in 1988 which, until 1994, handled all taxpayer objections to ATO assessments. The ARG also handled the litigation function of the ATO.<sup>17</sup> The ARG was led by a First Assistant Commissioner who reported directly to a Second Commissioner. The formation of the ARG was a response to the prior Government reviews of the Kerr and Bland Committees<sup>18</sup> and was designed to better support administrative review principles such as independence, fairness and accessibility. It has been noted that ARG staff were well-educated and relatively senior, with appointment to the ARG being competitive.<sup>19</sup>

## Parliamentary Inquiry and the resulting ATO restructure in the 1990s

2.13 In 1993, following an inquiry, the Joint Committee of Public Accounts (JCPA) made a number of recommendations to improve the administration of the tax system including that the resources of the ARG be allocated to the general decision making areas of the ATO.<sup>20</sup> In the JCPA's view, the ARG's main function of internally reviewing ATO decisions before assessments were finalised or prosecutions were undertaken should have been applied in all cases and not only those cases in which taxpayers had objected.<sup>21</sup>

2.14 In 1994 the ATO made structural changes in response to those recommendations by subsuming the appeals function into the compliance area. The ARG was disbanded and subsumed into the then newly created compliance business lines<sup>22</sup> which replaced the TAG.

2.15 Each compliance business line focused on a particular market segment such as 'large business', 'small business' and 'individual non business' or specific types of

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17 Above n 11, p 270.

18 *Commonwealth Administrative Review Committee Report* (Chair JR Kerr) Parl Paper No 144 of 1971; *Final Report of the Committee on Administrative Discretions* (Chair Henry Bland) 1973. These reviews into administrative decision making highlighted both the need for Government departments to strengthen their internal review processes and for reform to the system of external administrative review of government decisions.

19 Bernard Marks, Submission 26 to the House of Representatives Standing Committee on Tax and Revenue, *Inquiry into Tax Disputes* (12 August 2014) p 6.

20 Above n 11, p 271.

21 *Ibid.*

22 JCPA, Parliament of the Commonwealth of Australia, *Report 344 – A Continuing Focus on Accountability – Review of the Auditor-General's Reports 1993-94 and 1994-95* (1996) p 12.

taxes, such as 'withholding and indirect taxes'.<sup>23</sup> Each line was led by a Deputy Commissioner who reported to a Second Commissioner.

2.16 As a result of this restructure, each compliance business line now contained the audit and objections functions as well as 'solicitor-type' work.<sup>24</sup>

## **Restructure of ATO technical and legal areas**

2.17 During the early 1990s, the Tax Counsel Network (TCN) was established as a source of internal advice as well as oversight of the rulings system. The TCN has been responsible for managing the development of the ATO's view of the law<sup>25</sup> and for providing technical advice to other ATO areas including compliance teams and objections officers.<sup>26</sup> The TCN reported to a Deputy Chief Tax Counsel (DCTC) who in turn reported to the Chief Tax Counsel.

2.18 In 1999, the ATO established the ATO Legal Practice which reported to a DCTC. Litigation functions previously undertaken by the compliance business lines were either centralised within ATO Legal Practice or approved by the DCTC. Case ownership, however, remained with the business lines.<sup>27</sup> The aim of this centralisation was to ensure that the 'right issues are being litigated, at the right time, with the best arguments, and without duplication of effort' and lessons are learnt and captured.<sup>28</sup> Under a number of service level agreements, ATO Legal Practice represented the ATO in the courts and tribunals, provided instructions to external legal service providers as well as internal legal advice to business line staff on a range of tax and non-tax matters.<sup>29</sup>

2.19 In 2004, the ATO Legal Practice was transformed into the ATO's Legal Services Branch which further centralised and nationalised the ATO's approach to litigation.<sup>30</sup> The Legal Services Branch was part of the Law and Practice business line which was led by a First Assistant Commissioner who reported directly to the Second Commissioner – Law.

## **The Ralph Review**

2.20 During 1999, the Review of Business Taxation (Ralph Review) was also published, which provided a comprehensive review of Australia's business taxation system. It included observations and recommendations in relation to dispute resolution processes between the ATO and taxpayers. For example, it noted that, with

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23 Above n 6. See also: Michael D'Ascenzo, 'Current status of tax in Australia and the directions of the Australian Taxation Office towards 2000' (Speech presented to the Brisbane and Regional Winter Tax Schools, 10 May 1996).

24 ATO, 'ATOextra' (internal ATO document, 5 July 1999) p 11.

25 ATO, 'Law Design and Practice Plan 2014-15' (internal ATO document, undated) p 4.

26 ATO, 'Guidelines on the Audit, Objection and Litigation end to end process in PGH' (Internal ATO document, 13 January 2014). See also: ATO, 'Engaging Tax Technical Expertise (PG&I)' (Internal ATO document, 28 March 2014).

27 Above n 24.

28 Ibid, p 10.

29 ATO, 'ATOextra' (internal ATO document, 20 September 1999) p 25.

30 Inspector-General of Taxation (IGT), *Review of Tax Office management of Part IVC litigation* (2006) p 51.

the move to self assessment, Australia's tax laws with respect to objections was now more likely to be a source of delay, especially where the dispute concerned the application of the Commissioner's view in a public ruling.<sup>31</sup> As a result, the Ralph Review recommended improvements to the tax disputes resolution process which included, in certain circumstances, provision for taxpayers to 'by-pass administrative processes and refer a dispute directly to the appropriate independent tribunal or court.'<sup>32</sup>

## IGT SUBMISSION TO THE OCTOBER 2011 FEDERAL TAX FORUM

2.21 In his submission to the former Government's 2011 Tax Forum (Tax Forum Submission), the IGT outlined a suite of recommendations for reform and improvement of the governance of the ATO.<sup>33</sup> Relevantly, the IGT recommended improving the accountability of the ATO by establishing an advisory board to advise the Commissioner on the general management of the ATO. This recommendation echoes that of the 2009 *Australia's Future Tax System* review.<sup>34</sup>

2.22 Moreover, the IGT recommended the injection of additional private sector experience and perspectives into ATO management by the appointment of two additional Second Commissioners.<sup>35</sup> One of these additional Second Commissioners was to head up a new appeals area, to specifically deal with objections and litigation, which would enhance the independence of the appeals function through greater separation from the compliance area.<sup>36</sup>

## PREVIOUS IGT REVIEWS

2.23 In previous reports, the IGT has examined different aspects of the ATO's approach to compliance verification in respect of large business and HWIs, namely the:

- *Report into the ATO's large business risk review and audit policies, procedures and practices* (the Large Business Review);<sup>37</sup> and
- *Review into the ATO's compliance approaches to small and medium enterprises with annual turnovers between \$100 million and \$250 million and high wealth individuals* (the SME/HWI Review).<sup>38</sup>

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31 Review of Business Taxation (J T Ralph, chairperson), The Treasury (Cth), *A Strong Foundation: Discussion Paper: Establishing Objectives, Principles and Processes* (AGPS, 1999) p 122.

32 Ibid, p 148.

33 IGT, *Tax Forum – next steps for Australia, A submission to the Tax Forum* (September 2011).

34 Australian Government, *Australia's future tax system*, Report to the Treasurer (December 2009) recommendation 115.

35 *Taxation Administration Act 1953* s 4. Section 4 limits the current number of Second Commissioners to three.

36 Above n 33, p 17.

37 IGT, *Report into the Australian Taxation Office's large business risk review and audit policies, procedures and practices* (2011).

38 IGT, *Review into the ATO's compliance approaches to small and medium enterprises with annual turnovers between \$100 million and \$250 million and high wealth individuals* (2012).

2.24 Whilst these reviews may have indirectly examined the management of tax disputes, the improvements identified assisted to minimise the instances of disputes arising. Relevant aspects of these reviews are briefly explored below.

2.25 In relation to the ATO's management of tax disputes more broadly, the IGT had previously undertaken a suite of reviews to examine the ATO's management of objections,<sup>39</sup> settlements<sup>40</sup> and Part IVC litigation.<sup>41</sup> More recently, the IGT undertook a *review into the ATO's use of early and alternative dispute resolution (ADR Review)*.<sup>42</sup>

## The Large Business Review

2.26 The IGT formulated a range of recommendations directed at improving the ATO's compliance approaches, risk hypothesis identification, project management and accountability, information gathering approaches, audit and risk review processes, position paper processes and interest and penalty treatments.<sup>43</sup>

2.27 Significantly, the report recommended that where a taxpayer does not agree with the ATO's position paper, the matter should be referred to a senior technical specialist for review and sign-off before the final position paper is issued.<sup>44</sup> The recommendation provided the genesis for the ATO's development of the current IR process mentioned in Chapter 1 and explored further in Chapter 3.

## The SME/HWI Review

2.28 The IGT identified key opportunities for improvement in a number of areas, including: technical capability and support; initial compliance decision making; project management; audit conduct, communication and engagement; and information gathering, including clarifying expectations for taxpayers for audits through updating a publication on the ATO's compliance approach to Small to Medium Enterprises (SME) and HWIs.<sup>45</sup>

## The ADR Review

2.29 The review broadly examined the ATO's end-to-end dispute management processes across all business lines. This report, together with projects emanating from the Attorney-General's Department, was a catalyst for fundamental shifts in the ATO's dispute resolution approach.

2.30 The IGT's recommendations included bringing early engagement and alternative dispute resolution (ADR) to the forefront of ATO dispute resolution approaches by treating all disputes as suitable for use of ADR except for a few cases

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39 IGT, *Review into the Underlying Causes and the Management of Objections to Tax Office Decisions* (2009).

40 IGT, *Review into Aspects of the Tax Office's Settlement of Active Compliance Activities* (2009).

41 Above n 30.

42 IGT, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution* (2012).

43 Above n 37, p vii.

44 Ibid, p 45.

45 Above n 38, p 1.

where the costs may outweigh the benefits, there is public interest in obtaining a judicial decision or the case involves serious criminal fraud or evasion.

2.31 A number of the other recommendations were aimed at streamlining information exchange, providing clear escalation channels, improving training for ATO officers in ADR and implementing independent evaluation of the use of ADR to resolve tax disputes.<sup>46</sup> A specific recommendation was piloting the use of in-house facilitators to assist in resolution of disputes involving smaller taxpayers with limited resources.

2.32 In 2012, the ATO began to implement the IGT's recommendations with which it had agreed. They have reported that they have had some success and positive stakeholder feedback as a result of implementing these recommendations. For example, the ATO has reported their success in establishing and using in-house facilitators. They have advised that there are now 60 trained in-house facilitators across a range of ATO business lines.

2.33 The ATO did not agree with recommendation 6.1 which drew on the above mentioned aspects of the Tax Forum Submission relating to the establishment of a separate appeals area. Whilst awaiting the Government's consideration of the latter, broadly, recommendation 6.1 required the ATO to pilot conducting the objection and litigation function in the law area, rather than the compliance area, for the most complex cases.

## OTHER COMMENTARY AND REVIEWS

2.34 There have been a number of recent reviews which have examined the ATO and its compliance approach to HWIs, namely those of the Australian Public Service Commission (APSC) and the Australian National Audit Office (ANAO). These are briefly discussed below.

### The APSC Capability Review (2013)

2.35 The APSC completed a capability review of the ATO in 2013 which assessed its ability to meet future objectives and challenges.<sup>47</sup> Amongst other things, the review identified that the ATO had a culture of risk aversion, which resulted in the elevation of decision making, protected internal consultation, staff disempowerment and a perceived lack of support for staff if a mistake is made.<sup>48</sup>

2.36 The APSC's findings accord with commentary made by the now Treasurer that 'for too long the tax office has developed an insular and inward looking culture that has put it at odds with taxpayers, particularly in relation to its overly aggressive

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<sup>46</sup> Above n 42, pp v-vi.

<sup>47</sup> Australian Public Service Commission (APSC), *Capability Review Australian Taxation Office* (2013).

<sup>48</sup> *Ibid*, p 7.

interpretations of tax laws.’<sup>49</sup> The Treasurer also observed that the ATO needed to be less adversarial and develop a relationship with taxpayers based on mutual respect.<sup>50</sup>

### **ANAO report: Managing compliance of HWIs (2014)**

2.37 The ANAO’s report broadly sought to assess the effectiveness of the ATO’s activities to promote tax compliance by HWIs by reference to a number of key criteria, including the effective conduct of compliance activities, objections and reviews.<sup>51</sup>

2.38 While the ANAO concluded that the ATO had effectively carried out a range of activities in respect of HWIs, it also observed that:

...the results of these activities have not always been commensurate with the level of effort deployed by the ATO. Over the four-year period, 90 per cent of the cash collected was from 12 per cent of the audits and five per cent of the comprehensive risk reviews undertaken by the ATO. The majority of these audits (70 per cent) and comprehensive risk reviews (84 per cent) did not have a financial outcome.<sup>52</sup>

2.39 Moreover, the ANAO noted that HWI compliance cases often involved long initial cycle times (730 days in the majority of cases) and 40 per cent of these exceeded those timeframes by an average of 352 days.<sup>53</sup> It further observed that notwithstanding the long cycle times, taxpayers objected to ATO decisions in 65 per cent of cases and were largely successful 50 per cent of the time.<sup>54</sup>

2.40 The ANAO concluded, and the ATO acknowledged, that the high rates of successful objections together with the large proportion of compliance activities without financial outcome suggested that there was room for the ATO to improve its approach.<sup>55</sup>

### **ATO CHANGES IN 2013 AND 2014**

2.41 Having regard to the reports and recommendations discussed above, the ATO has, in recent years, undergone significant changes in its senior personnel and internal structure. It has also sought to implement a concerted effort towards settling legacy disputes as well as focusing on strategies to prevent and resolve disputes more expeditiously.

2.42 The internal restructure includes all ATO business and services lines being reorganised into three groups in 2013. These groups are the Compliance Group, the People Systems and Services Group, and the Law Design and Practice (LD&P) Group. Each group is led by one of the three Second Commissioners.

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49 Joe Hockey MP, ‘Address to the National Press Club’ (Speech delivered to the National Press Club, Sydney 22 May 2013).

50 Ibid.

51 Australian National Audit Office, *Managing Compliance of High Wealth Individuals* (2014) p 16.

52 Ibid, p 17.

53 Ibid, p 18.

54 Ibid.

55 Ibid, pp 18-19.



2.43 The ATO's Legal Services Branch became part of the new Review and Dispute Resolution (RDR) business line, which not only conducted litigation and instructed Counsel but also provided other non-litigation dispute resolution processes. The RDR business line is led by a First Assistant Commissioner who reports directly to the Second Commissioner for the LD&P Group.<sup>56</sup>

2.44 The LD&P Group also contains the TCN, led by the Chief Tax Counsel who also reports directly to the Second Commissioner of the LD&P Group. The other business line belonging to the LD&P Group is the Integrated Tax Design business line which was established to provide advice to and collaborate with the Department of the Treasury (Treasury) in the formulation of policy proposals.<sup>57</sup>

2.45 The role of the LD&P Group has also been extended to include dealing with objections for larger taxpayers. On 1 July 2013, objections in relation to large businesses with turnovers over \$250 million were transferred from the Public Groups & International (PGI) business line within the Compliance Group into the RDR business line of the LD&P Group. This was expanded, on 1 July 2014, to include objections by public companies and privately held entities with turnover of more than \$100 million.<sup>58</sup>

2.46 Therefore, despite initially disagreeing to recommendation 6.1 of the IGT's ADR Review, objections for larger taxpayers have moved from the Compliance Group into the law area or LD&P Group to improve the level of independence.

2.47 Although the PGI business line no longer deals with objections, it does have a dedicated 'Disputes Prevention and Resolution' team. This team seeks to foster an improved dispute prevention and resolution capability and culture, identify and manage cases with a higher dispute risk and monitor and review dispute activity and outcomes.<sup>59</sup> This team has been responsible for the delivery of dispute resolution and engagement training to PGI officers which is seen as an important means for effecting the desired capability and cultural change.<sup>60</sup> Training is followed up with additional workshops to assess if officers have put their training into practice.

2.48 Administrative changes have also been made to provide taxpayers with additional internal dispute resolution processes prior to finalising adjustments. For example, large business taxpayers facing a potential amended assessment may request a review of the statement of audit position (SOAP) through an IR before the assessment is issued. As discussed above, the IR process was the formalisation of a previous pre-assessment review process, conducted during the position paper stage within the then Large Business and International (LB&I) business line, pursuant to a recommendation in the IGT's Large Business Review.<sup>61</sup>

2.49 The IR process is now conducted by officers in the RDR business line rather than a compliance business line to improve the level of independence from original

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56 ATO, 'ATO organisational and senior executive structure' (1 December 2014) <[www.ato.gov.au](http://www.ato.gov.au)>.

57 Above n 25, p 5.

58 Chris Jordan, 'The ATO and large business' (speech delivered to the Corporate Tax Association annual convention, 3 June 2014) <[www.ato.gov.au](http://www.ato.gov.au)>.

59 ATO, 'PG&I Disputes Prevention and Resolution Plan' (Internal ATO document, 1 July 2014) p 2.

60 Ibid.

61 Above n 37, recommendation 9.3.

decision-makers.<sup>62</sup> Furthermore, the IR process considers the technical merits of the SOAP, rather than just the process undertaken by the audit team.<sup>63</sup> IRs are purely administrative tools for addressing disputes that may arise prior to the ATO issuing an amended assessment. The IR process will be explored further in Chapter 3.

## **CURRENT INTERACTION BETWEEN THE DIFFERENT ATO AREAS DURING AUDITS AND DISPUTES**

2.50 Compliance officers may seek the advice of their manager to assist in progressing a case. If an interpretative issue arises, compliance officers are required to research the ATO's legal database for any existing ATO view and apply it to the facts where relevant. If there is uncertainty about an issue, compliance officers may seek the assistance of technical leaders within the business line. If the technical issue is not resolved, compliance officers may seek further advice from the TCN, in the LD&P Group, in accordance with each business line's processes.

2.51 Business lines are expected to adopt 'early engagement' practices, whereby taxpayers and ATO officers can discuss problems or issues before formal dispute mechanisms begin. For example, where a taxpayer is intending to object to an assessment, early engagement allows a discussion of the relevant information and issues before the objections are lodged.<sup>64</sup> Where the compliance officer intends to amend the taxpayer's assessment, these procedures are designed to focus on engaging with the taxpayer early to reach a common understanding of the relevant law, facts and evidence.<sup>65</sup>

2.52 As stated earlier, since 1 July 2013, large business taxpayers may also request an IR. The main interaction between the IR officer, compliance team and taxpayer (and their representatives) is through a face-to-face meeting called a case conference.<sup>66</sup> A formal protocol has recently been put in place to ensure that IR participants (including ATO participants) do not communicate with the IR officer outside of the case conference.<sup>67</sup>

2.53 As also noted earlier, objections for taxpayers with turnovers of \$100 million or more are managed by the RDR business line. However, all other taxpayer objections, i.e. those with turnovers under \$100 million and individuals,<sup>68</sup> are handled by objections officers in the same compliance business line where the assessment originated.

2.54 When lodging an objection, a taxpayer may include additional facts, evidence or arguments that were either not requested or otherwise not put to the auditor. The

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62 Chris Jordan, 'Tax, the way ahead' (Speech delivered at Tax Institute 28th Annual Convention, Perth, 14 March 2013).

63 ATO, 'Large Business Liaison Group minutes' (12 August 2013) <[www.ato.gov.au](http://www.ato.gov.au)>.

64 ATO, 'Large Business Amendments and Objections - Early Engagement' (5 February 2014) <[www.ato.gov.au](http://www.ato.gov.au)>.

65 ATO, 'Large Business Amendments and Objections' (4 July 2014) <[www.ato.gov.au](http://www.ato.gov.au)>.

66 ATO, 'Independent Review of Large Business and International Statement of Audit Position' (3 December 2014) <[www.ato.gov.au](http://www.ato.gov.au)>.

67 Ibid.

68 This would include small businesses and high wealth individuals.



Commissioner must make a decision in respect of the taxpayer's objection or may be required by notice to do so by the taxpayer.<sup>69</sup> Where the Commissioner fails to make a decision following the expiry of the time for him to do so under the notice, the Commissioner is deemed to have disallowed the objection and the taxpayers' rights of appeal are enlivened.<sup>70</sup>

2.55 In making objection decisions, objections officers may communicate with other ATO officers, such as the original decision maker. They may also obtain technical advice from the TCN or other areas.<sup>71</sup> However, the ATO's internal guidance cautions that:

Contact with the original decision maker should not be used as a substitute for independent re-examination of the dispute.

Whilst it is acknowledged that efficiencies can be gained through contact with the original decision maker (particularly in complex disputes) such contact should not be used to replace the reviewer's own understanding and research.<sup>72</sup>

2.56 Where an objections officer obtains additional information as a result of contact with other areas of the ATO, the objections officer is expected to contact the taxpayer before finalising their decision.<sup>73</sup>

2.57 Objections officers are also expected to seek input from technical specialists where required. These specialists may be from within the same business line (technical or case leadership) or from the TCN. However, internal ATO guidance discourages technical specialists within the same business line providing advice on a review of a decision on which they have already advised.<sup>74</sup> More recently, the ATO has also stated that TCN officers who provided advice on the audit are effectively excluded from subsequent stages of the disputes.<sup>75</sup>

2.58 Where the ATO makes an objection decision which is wholly or partly unfavourable to the taxpayer, the taxpayer may seek external review to either (or both) the AAT or Federal Court. Litigation matters are handled by the Dispute Resolution team in the RDR business line for tax matters. Other stakeholders, such as the compliance business line or the TCN have different responsibilities depending on the particulars of the case.<sup>76</sup>

2.59 At each stage of the tax disputes process, ATO officers are required to ensure that views on interpretative issues, contained in designated 'ATO view' documents, were consistently applied.<sup>77</sup> Accordingly, objections officers would be obliged to apply

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69 *Taxation Administration Act 1953* ss 14ZY and 14ZYA.

70 *Taxation Administration Act 1953* sub-s 14ZYA(3).

71 ATO, 'Working Together and Sharing Knowledge' (Internal ATO document, 29 October 2014).

72 ATO, 'Independence' (Internal ATO document, 30 October 2014).

73 Above n 71.

74 Above n 72.

75 Commonwealth, *Parliamentary Debates*, House of Representatives Standing Committee on Tax and Revenue (26 November 2014) p 12.

76 ATO, *Conduct of ATO litigation and engagement of ATO Dispute Resolution*, PS LA 2009/9, 20 November 2009, para [29].

77 ATO, *Precedential ATO view*, PS LA 2003/3, 23 April 2014.

the same ATO precedential view that the original decision maker applied during the audit. Similarly, litigation officers would be required to argue matters consistently with the existing ATO view or brief Counsel to advance arguments along those lines.

2.60 Where taxpayers seek a review or appeal of an objection decision in the AAT or Federal Court, they are limited to grounds stated in the objection. Taxpayers may include additional grounds at the discretion of the AAT or Federal Court.<sup>78</sup> At any stage during a dispute with a taxpayer, the ATO and taxpayer may agree to a settlement. The ATO Code of Settlement Practice (the Code) sets out the requirements for officers entering into settlement negotiations. All officers engaging in settlement discussions must do so in accordance with the instructions set out in the Code.<sup>79</sup> Each business line is required to have assurance and governance measures in place to ensure compliance with the Code. For example, in the Private Groups and High Wealth Individuals (PGH) business line settlement proposals are developed by compliance staff and provided to a panel of senior executives for assurance purposes. Final decision makers on settlements must be duly authorised.<sup>80</sup>

2.61 During the course of this review, the ATO refreshed its Code of Settlement which streamlined the former Code and provided additional guidance through practical examples and model deeds of settlement.<sup>81</sup> The refreshed Code of Settlement was subsequently issued in the form of a practice statement on 15 January 2015.<sup>82</sup>

2.62 Whilst decisions to settle tax disputes are made by duly authorised officers in the compliance business lines,<sup>83</sup> the RDR business line has a custodian role in relation to all ATO settlements. In this respect, the RDR business line ensures that all settlements are appropriately recorded and reports to the ATO's Integrity Adviser on the completeness and accuracy of the recorded information.<sup>84</sup>

## EXTENT OF DISPUTATION WITHIN LARGE BUSINESS AND HWIS

2.63 The numbers of disputed cases within the large business and HWI market segments are generally lower than other market segments, reflecting the smaller number of large business and HWIs within Australia when compared with other taxpayer classes. However, the proportion of disputed cases involving large businesses and HWIs is generally higher than for other market segments. This may be attributable to a number of factors including the complex nature of the transaction in these market segments and the resources of these taxpayers to challenge ATO decisions.

2.64 Furthermore, the disputes involving large businesses and HWIs represent high revenue impacts as reported by the ATO in its submission to the Committee. The

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78 *Taxation Administration Act 1953* ss 14ZZK and 14ZZO.

79 ATO, *Settlements* (PS LA 2007/5) (Withdrawn 15 October 2014) para [5].

80 *Ibid*, para [18].

81 ATO, 'Code of Settlement' (15 October 2014) <[www.ato.gov.au](http://www.ato.gov.au)>; ATO, 'A Practical Guide to the ATO Code of Settlement' (15 October 2014) <[www.ato.gov.au](http://www.ato.gov.au)>.

82 ATO, *Code of Settlement*, PS LA 2015/1, 15 January 2015.

83 All Senior Executive Service (SES) officers have the delegation to settle tax and superannuation disputes. See ATO, 'A Practical Guide to the ATO Code of Settlement' (15 October 2014) <[www.ato.gov.au](http://www.ato.gov.au)>.

84 ATO, 'Tier 3 project closure report L&P 09-01 Settlements Improvement' (Internal ATO Document, July 2009) p 12.

ATO notes that of the \$5.333 billion in liabilities which were subject to objection dispute, \$3.378 billion (or 63.3 per cent) was attributable to large businesses.

2.65 The IGT initially sought to examine the extent of disputation within the large business and HWI market segments by considering quantities of cases and liability amounts at each stage of the dispute process. The information initially sought related to the numbers of completed compliance cases (e.g., audits and reviews) and the levels of liabilities raised as a result, any objections lodged and their outcomes of those and as well as whether matters proceeded to litigation or were otherwise settled.

2.66 The ATO has advised the IGT, however, that its present reporting systems do not track the progress of cases throughout the end-to-end process. As a consequence, the ATO is unable to provide the required data, without resorting to manual processes, for the IGT to assess the extent of initial adjustments made by the ATO, the sustainability of those decisions (and therefore the robustness of ATO technical decision making) and the key points in the process at which matters are resolved or otherwise finalised.

2.67 The IGT had observed in prior reviews that such limitations constrained the ability of the ATO to assess its performance on a whole-of-case basis throughout the end-to-end compliance process.<sup>85</sup> Whilst the ATO has taken steps in recent years to improve its reporting, in the absence of such data, the ATO cannot truly assess the taxpayer experience in tax disputes.

2.68 As the ATO was unable to provide the original key information from their system reports, the IGT requested aggregated statistics of compliance activities and disputes over a seven year period in order to conduct a basic trend analysis. However, owing to the limitations set out above and the long-running nature of larger dispute cases, it is not possible to draw any connections between the different stages of the dispute process. These statistics are set out and discussed in the sections which follow.

2.69 The ATO has advised that even with the overall aggregated numbers there have been difficulties in extracting and providing figures for all years across all the areas that the IGT has requested. In part, the ATO explains that this was as a result of transitions from older legacy reporting systems to the ATO's enterprise case management system, Siebel. Certain other data (such as HWI appeals to the AAT and the Federal Court) are not captured automatically by ATO systems and therefore have to be manually extracted through reviewing case information and taxpayer records.

2.70 In the absence of ATO data provided to this review, the IGT has had to use more dated and less specific information to draw some conclusions in this regard.

## Large business dispute statistics

2.71 Tables 1 and 2 below set out disputation statistics in relation to large business over a seven year period from 2007–08 to 2013–14. These tables provide information in relation to quantity of disputed cases and the quantum of disputed amounts respectively.

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<sup>85</sup> Above n 38, p 67; See also: IGT, *Review into the ATO's administration of penalties* (2014) p 58.

**Table 1: Quantity of ATO large business compliance activities and disputes**

|                                |  | 2007-08                                       | 2008-09 | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | Total  | Average |
|--------------------------------|--|---|---------|---------|---------|---------|---------|---------|--------|---------|
| <b>Compliance activities</b>   | Total number                                   | 7,976   | 12,138  | 13,314  | 17,764  | 18,596  | 14,486  | 12,767  | 97,041 | 13,863  |
|                                | Number resulting in adjustments                | 526   | 3,933   | 1,966   | 1,033   | 780     | 813     | 829     | 9,880  | 1,411   |
|                                | Percentage resulting in adjustments            | 6.6   | 32.4    | 14.8    | 5.8     | 4.2     | 5.6     | 6.5     | 10.2   |         |
| <b>Risk Reviews and Audits</b> | Number of risk reviews completed               | 139   | 262     | 365     | 396     | 434     | 328     | 342     | 2,266  | 324     |
|                                | Number of risk reviews resulting in an outcome | 43  | 84      | 104     | 127     | 99      | 106     | 109     | 672    | 96      |
|                                | Number of risk reviews escalated to audit      | 21  | 48      | 42      | 65      | 27      | 29      | 39      | 271    | 39      |
|                                | Number of audits completed                     | 33  | 44      | 36      | 51      | 61      | 57      | 71      | 353    | 50      |
|                                | Number of audits resulting in an outcome       | 21  | 35      | 23      | 36      | 29      | 36      | 36      | 216    | 31      |
|                                | Percentage of audits resulting in an outcome   | 63.6  | 79.5    | 63.9    | 70.6    | 47.5    | 63.2    | 50.7    | 61.2   |         |
| <b>IR Process</b>              | Cases completed                                | The IR process commenced operation in 2013–14 |         |         |         |         |         | 14      | 14     | 14      |
|                                | Number supporting taxpayer position            |   |         |         |         |         |         | 7       | 7      | 7       |
|                                | Number supporting ATO position                 |   |         |         |         |         |         | 7       | 7      | 7       |
| <b>Objection stage</b>         | Total cases lodged                             | 138   | 256     | 253     | 290     | 179     | 317     | 253     | 1,686  | 241     |
|                                | Number of decisions issued                     | 95  | 174     | 163     | 195     | 116     | 168     | 161     | 1,072  | 153     |
|                                | Number of ATO decisions varied                 | 61  | 95      | 127     | 121     | 77      | 129     | 122     | 732    | 105     |
|                                | Percentage of ATO decisions varied             | 64.2  | 54.6    | 77.9    | 62.1    | 66.4    | 76.8    | 75.8    | 68.3   |         |
|                                | Number of ATO decisions upheld                 | 34  | 79      | 36      | 74      | 39      | 39      | 39      | 340    | 49      |
|                                | Percentage of ATO decisions upheld             | 35.8  | 45.4    | 22.1    | 37.9    | 33.6    | 23.2    | 24.2    | 31.7   |         |
| <b>AAT stage</b>               | Total appeals lodged                           | 68  | 14      | 12      | 7       | 9       | 12      | 4       | 126    | 18      |
|                                | Number of cases finalised                      | 17  | 10      | 68      | 15      | 4       | 6       | 7       | 127    | 18      |
|                                | Number of ATO decisions varied                 | 15  | 8       | 61      | 11      | 2       | 5       | 4       | 106    | 15      |
|                                | Percentage of ATO decisions varied             | 88.2  | 80.0    | 89.7    | 73.3    | 50.0    | 83.3    | 57.1    | 83.5   |         |
|                                | Number of ATO decisions upheld                 | 2   | 2       | 7       | 4       | 2       | 1       | 3       | 21     | 3       |
|                                | Percentage of ATO decisions upheld             | 11.8  | 20.0    | 10.3    | 26.7    | 50.0    | 16.7    | 42.9    | 16.5   |         |

**Table 1 (continued)**

|                      |                                    |      |      |      |      |      |      |      |      |    |
|----------------------|------------------------------------|------|------|------|------|------|------|------|------|----|
| <b>Federal Court</b> | Total appeals lodged               | 125  | 31   | 47   | 21   | 18   | 33   | 16   | 291  | 42 |
|                      | Number of cases finalised          | 60   | 39   | 155  | 30   | 26   | 31   | 35   | 376  | 54 |
|                      | Number of ATO decisions varied     | 49   | 24   | 141  | 15   | 13   | 28   | 20   | 290  | 41 |
|                      | Percentage of ATO decisions varied | 81.7 | 61.5 | 91.0 | 50.0 | 50.0 | 90.3 | 57.1 | 77.1 |    |
|                      | Number of ATO decisions upheld     | 11   | 15   | 14   | 15   | 13   | 3    | 15   | 86   | 12 |
|                      | Percentage of ATO decisions upheld | 18.3 | 38.5 | 9.0  | 50.0 | 50.0 | 9.7  | 42.9 | 22.9 |    |

Data source: Australian Taxation Office

Note 1: Values have been rounded to the nearest whole number. Percentages have been rounded to one decimal place.

Note 2: Compliance activities are counted on an activity basis (e.g., if three activities are undertaken in relation to one taxpayer return then three will be counted).

Note 3: 'Risk reviews and audits' only include numbers of income tax risk reviews and audits undertaken by the PGI business line and does not include those relating to GST, other heads of tax or activities by other ATO business lines (with the exception of the 2013–14 financial year in which the PGI business line undertook risk reviews and audits in relation to resources rent tax).

Note 4: Objections cases are counted on a correspondence basis (e.g., if a taxpayer lodges three separate objection applications, each for a different year of return, it will be counted as three objections).

Note 5: Litigation cases are counted by the number of applications received and outcomes on that application (e.g., if a taxpayer lodges multiple applications, each will count as a litigation case). Litigation figures in the Federal Court include matters in the Full Federal Court.

Note 6: Due to different case counting rules at each stage of the process and limitations of the ATO's automated reporting systems, these numbers are not directly reconcilable.

Note 7: During the objection stage 'varied' includes cases allowed in full or in part. During the AAT and Federal Court stages 'varied' includes cases determined fully or partially in the taxpayer's favour, those resolved prior to hearing (such as by settlement) or those conceded by the ATO.

Note 8: During the objection stage 'upheld' includes cases which were disallowed. During the AAT and Federal Court stages 'upheld' includes cases decided in the ATO's favour or those which were withdrawn by the taxpayer.

## Compliance activity outcomes

2.72 As set out in Table 1 above, the ATO has reported that over the past seven years it has undertaken a total of 97,041 compliance activities which averages to 13,863 per year. The level of total compliance activities steadily increased between 2007–08 (7,976) through to 2011–12 (18,596) before falling in the most recent years to 14,486 and 12,767 activities in 2012–13 and 2013–14 respectively.

2.73 Notwithstanding the high levels of compliance activity undertaken by the ATO, the level of adjustments is low. Over the seven year period, the ATO made a total of 9,880 adjustments which accounts for 10.2 per cent of all compliance activities. The level of adjustments increased considerably between 2007–08 (526) and 2008–09 (3,933) before slowly declining in later years with only minor increases in 2012–13 and 2013–14.

2.74 However, the compliance activities not only represent audits but also include a range of lower level verification activities applicable to the large market segment including outbound correspondence and outbound calls.<sup>86</sup> As a result, the ATO has

86 ATO, *Annual Plan 2013–14 Program Structure and Activity Definitions Appendix* (2014) pp 9, 10–12.

advised that a measure of the ATO's performance against total compliance activities alone is inconclusive as not every compliance activity is designed to lead to an adjustment.

2.75 Table 1 also sets out the numbers of risk reviews<sup>87</sup> completed with outcomes, those referred to audit and the numbers of audits<sup>88</sup> completed with outcomes. Such outcomes may be financial or non-financial and may also be favourable to the taxpayer.

2.76 Table 1 shows that over the seven year period, the ATO completed a total of 2,266 risk reviews and 353 audits. Over this period, the ATO averaged 324 risk reviews per year and 50 audits. When considering the level of outcomes against audits completed, there is an outcome in more than half of these completed cases (61.2 per cent).

### **Internal independent review outcomes**

2.77 As discussed earlier, the IR process has provided an avenue for large business taxpayers to discuss any areas of disagreement with the ATO prior to the issue of amended assessments. Data provided in Table 1 shows that in 2013–14, 14 IRs were completed with approximately seven cases being found in favour of the taxpayer and seven in favour of the Commissioner (when the issues in those cases are counted, 54 per cent were in the Commissioner's favour and 46 per cent in the taxpayer's favour<sup>89</sup>).

2.78 As at 31 October 2014, a further six IRs have been completed with five found in favour of the Commissioner and one in favour of the taxpayer. In total therefore, 20 IRs have been completed, with 40 per cent of cases resulting in the taxpayer's favour and 60 per cent in the Commissioner's favour.

### **Objection outcomes**

2.79 For large businesses, the objection stage remains the first step in the statutory disputes resolution process. Statistics from Table 1 show that over the past seven years, the ATO has finalised 1,686 objections (an average of 241 per year) from large business taxpayers and issued decisions in 1,072 of those cases (an average 153 per year). These statistics do not include cases which were invalid, withdrawn or otherwise disposed of without a decision. During the closing stages of this review, the ATO has provided data demonstrating that a large number of large business objections were not preceded by ATO compliance activity and were initiated by taxpayers. However, it is not clear how many such cases involved taxpayers seeking to ensure their tax return was in accordance with the ATO view whilst objecting to that ATO view or seeking ATO confirmation of their view in a similar manner to a private ruling application.

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87 Includes client risk reviews, pre-lodgment compliance reviews, specific reviews, transfer pricing record reviews and research & development reviews.

88 Includes large business audits, specific issue audits, transfer pricing audits and research & development audits.

89 Above n 4, p 73.



2.80 The data in Table 1 demonstrates that objection outcomes fluctuate from year to year. However, the IGT notes in every year, more than 50 per cent of cases resulted in the ATO's initial decision being varied (i.e., the taxpayer's objection was wholly or partly allowed). Importantly, more than three quarters of ATO decisions were varied in three out of the seven years (2009–10, 2012–13 and 2013–14).

2.81 Over the seven year period, 68.3 per cent of all objection decisions resulted in ATO original decisions being varied for a range of reasons including taxpayers not providing all relevant information during the audit stage or, initially, the ATO not adequately analysing the relevant facts and evidence or incorrectly applying the law to the facts.

### **Litigation outcomes**

2.82 Appeals to the AAT and the Federal Court remain a relevant factor in large business tax disputes notwithstanding that the ATO's statistics show that the numbers of appeals filed in both forums have decreased from 2007–08 with only a relatively small number being filed in more recent years.

2.83 In total, Table 1 shows that the AAT has finalised 127 matters over the past seven years. The statistics highlight the high level of success that large businesses have had in the AAT with all but three years showing that the ATO's original decision was varied by the AAT in 80 per cent or more cases. The exceptions were 2010–11, 2011–12 and 2013–14 which had 73.3 per cent, 50 per cent and 57.1 per cent respectively.

2.84 In total, 83.5 per cent of cases which proceeded to the AAT resulted in a variance of the ATO's original decision.

2.85 Litigation in the Federal Court also yielded similarly high levels of favourable outcomes for taxpayers. Over the seven year period, 77.1 per cent of ATO decisions were varied as a result of Federal Court litigation. As with the AAT, the IGT notes that, on an annual basis, 50 per cent or more of cases resulted in the ATO decision being varied. Favourable taxpayer outcomes were particularly high in 2009–10 and 2012–13.

2.86 The high rates of variance resulting from objections and litigation suggest a need for more robust engagement at the compliance stage, as the IGT has previously highlighted in earlier reviews. The introduction of the IR process has assisted to divert matters away from objection and litigation disputes. However, a more concerted effort to improve decision making appears to be warranted based on the ATO's statistics. Such efforts could include a more focused approach to information gathering to expeditiously obtain relevant facts and evidence.

**Table 2: Quantum of revenue in large business compliance activities and disputes**

|                              |   | 2007-08  | 2008-09 | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | Total    | Average |
|------------------------------|---|--|---------|---------|---------|---------|---------|---------|----------|---------|
| <b>Compliance activities</b> | Amounts raised from compliance activities \$(M)   | \$3,325  | \$2,136 | \$3,342 | \$2,343 | \$2,391 | \$2,353 | \$2,221 | \$18,110 | \$2,587 |
| <b>IR Process</b>            | Potential liability amounts subject to IR \$(M)<br><br>Potential amounts after IR \$(M) | The ATO has advised that data is not available as liability information was not quantifiable during the IR process |         |         |         |         |         |         |          |         |
| <b>Objection stage</b>       | Amounts disputed \$(M)  | ATO data not available   |         |         |         |         | \$5,445 | \$3,208 | \$8,653  | \$4,327 |
|                              | Amounts allowed in part or full \$(M)   |  |         |         |         |         | \$1,007 | \$1,276 | \$2,283  | \$1,142 |
| <b>AAT stage</b>             | Amounts disputed \$(M)  | \$19   | \$184   | \$31    | \$26    | \$2     | \$14    | \$315   | \$591    | \$84    |
|                              | Amounts varied \$(M)  | \$7  | \$132   | \$3     | \$7     | \$0.6   | \$5     | \$256   | \$410    | \$59    |
| <b>Federal Court</b>         | Amounts disputed \$(M)  | \$1,389  | \$2,555 | \$1,528 | \$1,873 | \$4,009 | \$516   | \$1,253 | \$13,123 | \$1,875 |
|                              | Amounts varied \$(M)  | \$195  | \$1,525 | \$1,375 | \$1,147 | \$1720  | \$333   | \$664   | \$6,960  | \$994   |

Data source: Australian Taxation Office

Note 1: Values have been rounded to the nearest whole number unless the number is less than 1.

Note 2: Federal Court includes matters in the Full Federal Court.

2.87 Table 2 above sets out the quantum of revenue raised and varied at different stages of dispute. The ATO has not provided information concerning liability figures during the IR process as ATO senior management have advised that liability was not quantifiable at that stage.

2.88 Over the past seven years, the ATO reports that through its compliance activities, it has raised a total of \$18.11 billion which averages to \$2.587 billion per year. The amount fluctuates from around \$2.1 billion to \$2.4 billion with spikes in 2007-08 and 2009-10. Over the last two years, \$8.653 billion was the subject of objections of which \$2.283 billion (26.4 per cent) was allowed in full or in part. As noted above, the objection figures may contain those which did not originate from ATO compliance activities.

2.89 In the AAT, a total of \$591 million was the subject of dispute with more than half of this figure occurring in the most recent financial year (\$315 million in 2013-14). As a result, \$410 million (or 69.4 per cent) was varied which is largely consistent with the outcomes in Table 1.



2.90 In the Federal Court, a significantly larger sum of \$13.123 billion over seven years was the subject of dispute with a total of \$6.96 billion being varied. This represents 53 per cent of the total disputed liability and an average annual adjustment of \$994 million.

## High Wealth Individual statistics

2.91 The extent of disputation in relation to HWIs, while not as high as those for large markets in the quantity of cases, still represents a significant revenue impact. The ATO's data reporting in relation to HWIs also has significant gaps, particularly in relation to disputes which proceed through to litigation and the quantum of adjustments in earlier years.

2.92 Tables 3 and 4 below set out the disputation statistics in relation to HWIs. The ATO has advised the IGT that owing to the transition of HWI case management legacy systems to Siebel in 2011-12, it was unable to provide much of the data prior to this year.

**Table 3: Quantity of HWI compliance activities and disputes**

|                              |                                     | 2007-08 | 2008-09 | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | Total | Average |
|------------------------------|-------------------------------------|---------|---------|---------|---------|---------|---------|---------|-------|---------|
| <b>Compliance activities</b> | Total number                        | 465     | 964     | 882     | 717     | 779     | 798     | 859     | 5,464 | 780.6   |
|                              | Number resulting in adjustments     | 26      | 70      | 62      | 103     | 126     | 134     | 211     | 732   | 104.6   |
|                              | Percentage resulting in adjustments | 5.6     | 7.3     | 7.0     | 14.4    | 16.2    | 16.8    | 24.6    | 13.4  |         |
| <b>Objection stage</b>       | Total cases finalised               |         | 34      |         | 199     | 96      | 94      | 277     | 700   | 140     |
|                              | Number of decisions issued          | 24      | 20      | 22      | 141     | 77      | 52      | 193     | 529   | 76      |
|                              | Number of ATO decisions varied      | 13      | 2       | 19      | 86      | 48      | 31      | 145     | 344   | 49      |
|                              | Percentage of ATO decisions varied  | 54.2    | 10.0    | 86.4    | 61.0    | 62.3    | 59.6    | 75.1    | 65.0  |         |
|                              | Number ATO decisions upheld         | 11      | 18      | 3       | 55      | 29      | 21      | 48      | 185   | 26      |
|                              | Percentage of ATO decisions upheld  | 45.8    | 90.0    | 13.6    | 39.0    | 37.7    | 40.4    | 24.9    | 35.0  |         |

**Table 3 (continued)**

|                      |   |      |     |       |       |       |      |       |      |     |
|----------------------|---|------|-----|-------|-------|-------|------|-------|------|-----|
| <b>AAT stage</b>     | Total appeals lodged                    | 3    | 0   | 1     | 3     | 3     | 9    | 1     | 20   | 3   |
|                      | Number of appeals withdrawn by taxpayer | 1    | 0   | 0     | 0     | 1     | 1    | 0     | 3    | 0.4 |
|                      | Number of ATO decisions varied          | 0    | 0   | 1     | 3     | 2     | 8    | 1     | 15   | 2   |
|                      | Percentage of ATO decisions varied      | 33.3 | 0.0 | 100.0 | 100.0 | 66.7  | 88.9 | 100.0 | 75.0 |     |
|                      | Number of ATO decisions upheld          | 2    | 0   | 0     | 0     | 0     | 0    | 0     | 2    | 0.3 |
|                      | Percentage of ATO decisions upheld      | 66.7 | 0.0 | 0.0   | 0.0   | 0.0   | 0.0  | 0.0   | 10   |     |
| <b>Federal Court</b> | Total appeals lodged                    | 0    | 0   | 9     | 5     | 1     | 3    | 5     | 23   | 3   |
|                      | Number of appeals withdrawn by taxpayer | 0    | 0   | 0     | 0     | 0     | 1    | 0     | 1    | 0.1 |
|                      | Number of ATO decisions varied          | 0    | 0   | 9     | 5     | 0     | 1    | 3     | 18   | 3   |
|                      | Percentage of ATO decisions varied      | 0.0  | 0.0 | 100.0 | 100.0 | 0.0   | 33.3 | 60.0  | 78.3 |     |
|                      | Number of ATO decisions upheld          | 0    | 0   | 0     | 0     | 1     | 1    | 2     | 4    | 0.6 |
|                      | Percentage of ATO decisions upheld      | 0    | 0   | 0     | 0     | 100.0 | 33.3 | 40.0  | 17.4 |     |

Data source: Australian Taxation Office

Note 1: Values have been rounded to the nearest whole number unless the number is less than 1. Percentages have been rounded to one decimal place.

Note 2: Compliance activities are counted on an activity basis (e.g., if three activities are undertaken in relation to one taxpayer return then three will be counted).

Note 3: Objections cases are counted on a correspondence basis (e.g., if a taxpayer lodges three separate objections for three years of returns, this will count as three objections). Objections data for 2007-08 and 2009-10 was taken from information provided to the IGT during his 2011 SME/HWI review. The number of cases varied in those years is the balance of objection decisions which did not uphold the audit decision. The difference between 'total cases finalised' and 'number of decisions issued' is due to objections being determined invalid, no further action was required, were withdrawn or were otherwise settled.

Note 4: The ATO has advised that the 277 objection cases finalised in 2013-14 were as a result of a project to clear to aged cases. These included 217 objection matters received in earlier years.

Note 5: Litigation cases are counted by the number of applications received and outcomes on that application. If a taxpayer lodges multiple applications, each will count as a litigation case. Data for 2007-08 and 2008-09 only includes case numbers where the source data identified or indicated whether the matter was filed in the AAT or the Federal Court. Litigation cases in the Federal Court include matters in the Full Federal Court.

Note 6: Due to different case counting rules at each stage of the process, these numbers are not directly reconcilable.

Note 7: 'Varied' during the objections stage includes cases allowed in full or in part. 'Varied' in the AAT and Federal Court stages include cases determined fully or partially in the taxpayer's favour, those resolved prior to hearing (such as by settlement) or those conceded by the ATO.

Note 8: 'Upheld' during the objections stage includes cases which were disallowed. 'Upheld' in the AAT or the Federal Court stages include cases decided in the ATO's favour or those which were withdrawn by the taxpayer.

2.93 Over the past seven year period, the ATO has reported that a total of 5,464 compliance activities were completed (averaging 780.6 per year) with 732 of these resulting in adjustments. The level of adjustment (13.4 per cent) is low when considered against total compliance activities. The data shows that the level of adjustments has steadily increased over the past seven years, with the most recent year reporting an adjustment rate of 24.6 per cent. As with the large business statistics in Table 1, the ATO has advised that the numbers of reported compliance activities

include lower level verification actions which are not designed to lead to an adjustment.

2.94 Over the same period, the ATO's data showed that 529 objection decisions were issued with 65 per cent of these resulting in the original ATO audit decision being varied (that is, allowed in full or in part). In all years except 2008–09, the proportion of objection cases resulting in variance exceeded 50 per cent.

2.95 The ATO has advised that its case management system does not separately classify HWI taxpayers in litigation cases. The IGT review team worked with the ATO to identify other sources of information from which litigation statistics may be extracted, including from information previously provided to the IGT in the 2011 SME/HWI review. Owing to the ATO's reporting limitations, the data in Table 3 should only be taken to be an indication of the litigation levels concerning HWIs.

2.96 Over the seven year period, the data shows that 20 matters were finalised in the AAT, with 15 resulting in the ATO's decision being varied (75 per cent), two in which the ATO's decision was upheld (10 per cent) and three others which were withdrawn (15 per cent). Similar outcomes were observed in the Federal Court with a total of 23 matters finalised, 18 cases in which the ATO's decision was varied (78.3 per cent), four where it was upheld (17.4 per cent) and one which was withdrawn (4.3 per cent).

2.97 Owing to the limited nature of the data provided by the ATO and the small sample size, the IGT is unable to draw any meaningful statistical conclusions in this regard. However, the IGT notes that the low levels of litigation cases are indicative of stakeholder comments that HWIs are more likely to settle than litigate.

**Table 4: Quantum of revenue in HWI compliance activities and disputes**

|                              |   | 2007-08  | 2008-09 | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | Total   | Average |
|------------------------------|---|--|---------|---------|---------|---------|---------|---------|---------|---------|
| <b>Compliance activities</b> | Amounts raised from compliance activities \$(M) | \$340  | \$525   | \$363   | \$839   | \$888   | \$1,091 | \$995   | \$5,041 | \$720   |
| <b>Objection stage</b>       | Amounts disputed \$(M)                          | ATO data not available   |         |         |         | \$270   | \$186   | \$726   | \$1,182 | \$394   |
|                              | Amounts allowed in part or full \$(M)           |  |         |         |         | \$250   | \$25    | \$313   | \$588   | \$196   |
|                              | Percentage of amounts allowed in part or full   |  |         |         |         | 92.6    | 13.4    | 43.1    | 49.7    |         |
| <b>AAT stage</b>             | Amounts disputed \$(M)<br>Amounts varied \$(M)  | Data not available as the ATO does not separately report on HWI appeals to the AAT           |         |         |         |         |         |         |         |         |
| <b>Federal Court</b>         | Amounts disputed \$(M)<br>Amounts varied \$(M)  | Data not available as the ATO does not separately report on HWI appeals to the Federal Court |         |         |         |         |         |         |         |         |

Data source: Australian Taxation Office

Note 1: Values have been rounded to the nearest whole number. Percentages have been rounded to one decimal place.

2.98 While the quantity of compliance activity and adjustment in relation to HWIs may not be as high as for large business, the levels of revenue involved are nonetheless significant. Over the past seven years, the ATO reports that a total of \$5.041 billion was raised (averaging \$720 million per year). Liabilities raised in respect of HWIs have steadily increased between the 2007–08 and the 2012–13 years with the exception of the 2009–10 and 2013–14 financial years.

2.99 Table 4 also sets out the level of disputed amounts in objections totalling \$1.182 billion over a three year period from 2011–12 to 2013–14 with 49.7 per cent of that amount, or \$588 million, reversed.

2.100 As with Table 3, the ATO has been unable to provide the quantum of liability in dispute during litigation because its systems do not separately classify HWI litigation cases.

## INTERNATIONAL APPROACHES

2.101 In line with the Committee's terms of reference and to provide a broader basis for comparing the ATO's dispute resolution approach, the IGT has considered the tax disputes processes currently in operation in a number of other jurisdictions. In doing so, the IGT review team undertook research into a number of regimes of comparable Organisation for Economic Cooperation and Development (OECD) countries. These countries are the United States (US), the United Kingdom (UK), Canada, New Zealand and the Republic of Ireland all of which have legal systems which have evolved from English common law.

2.102 The IGT review team engaged directly with the above revenue authorities (as well as in some cases external stakeholders) to obtain a further understanding of their tax disputes management processes in practice.

### United States of America

2.103 The principal national revenue authority in the US is the Internal Revenue Service (IRS). Disputes may arise between the IRS and taxpayers following completion of an audit (known as 'examinations') and any resulting proposed amendments to the taxpayer's liability (known as 'adjustments').

2.104 Generally, where the IRS proposes to make an adjustment, the IRS issues the taxpayer with a '30-day letter' package which includes an explanation of the proposed adjustments and a notification that the taxpayer has the right to appeal the proposed changes within 30 days.<sup>90</sup>

2.105 Taxpayers who disagree with the adjustments may refer their matter to the IRS Office of Appeals for internal review. If the taxpayer does not respond to the 30-day letter, or if the taxpayer could not reach agreement with the Office of Appeals,

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<sup>90</sup> Internal Revenue Service (IRS), *Publication 556: Examination of Returns, Appeal Rights, and Claims for Refund* (September 2013) <[www.irs.gov](http://www.irs.gov)> p 5.

the taxpayer is issued with a 'Statutory Notice of Deficiency'.<sup>91</sup> The taxpayer has 90 days in which to file a petition with the US Tax Court to challenge the deficiency.<sup>92</sup> Taxpayers may seek assistance from the Office of Appeals after the petition has been filed if the latter has not previously reviewed the case, i.e. after the 30-day letter. If the taxpayer does not file the petition within the required timeframe, the deficiency is assessed and subsequently becomes a legal liability.<sup>93</sup> A diagrammatic representation of the appeals process employed by the IRS is contained in Appendix 3.

2.106 The Office of Appeals is an 'independent organisation' within the IRS whose mission is to 'help taxpayers and the government resolve tax disagreements' without litigation.<sup>94</sup> The Office was established administratively in 1927 and was codified by the *Internal Revenue Service Restructuring and Reform Act of 1998* (IRS Reform Act). It is headed by the Chief of Appeals who reports directly to the IRS Commissioner. The fact that the head of Appeals reports directly to the Commissioner is considered important to uphold the independence of the Office of Appeals. It should also be noted that employees of the Office of Appeals generally work in office space that is physically separate from the rest of the IRS.

2.107 In order to preserve the independence of appeals officers, the IRS Reform Act requires the IRS to implement measures to generally prohibit *ex parte* communication between the appeals officer and other IRS officers 'to the extent that such communications appear to compromise the independence of the appeals officers'.<sup>95</sup>

2.108 IRS procedure, therefore, prohibits certain communications between appeals officers and officers from originating functions,<sup>96</sup> such as the examination or compliance function, unless the appeals officer provides an opportunity for the taxpayer to participate in the communication. If the taxpayer chooses not to participate, the communication between the appeals officer and the other IRS officer is no longer prohibited.<sup>97</sup>

2.109 The IRS also has a Chief Counsel who is the legal adviser to the IRS Commissioner and all IRS officers 'on all matters pertaining to the interpretation, administration and enforcement of the internal revenue laws and related statutes'.<sup>98</sup> The Chief Counsel is appointed by the President of the United States with the advice and consent of the U.S. Senate and reports directly to the IRS Commissioner for certain matters and directly to the General Counsel of the Treasury on other matters.<sup>99</sup>

2.110 The Office of Appeals has some specialised tax expertise including in areas such as transfer pricing. Appeals officers are generally permitted, but are not required, to obtain legal advice from attorneys within the Office of Chief Counsel. Appeals

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91 Above n 90.

92 The petition filing fee for the United States Tax Court is USD \$60 <[www.ustaxcourt.gov](http://www.ustaxcourt.gov)>.

93 United States Internal Revenue Code 26 U.S.C. § 6213(c).

94 IRS, Office of Appeals, 'About the Appeals Office' (6 November 2014) <<http://www.irs.gov>>.

95 *Internal Revenue Service Restructuring and Reform Act of 1998* s 1001 (a) (4).

96 Originating functions are those that make determinations that are subject to Appeals process, such as the Examination function.

97 IRS, 'Internal Revenue Manual' <[www.irs.gov](http://www.irs.gov)> IRM 8.1.10.4.1.

98 Ibid, IRM 8.1.10.3.4.1.

99 Ibid, IRM 1.1.5.1.4.

officers cannot communicate *ex parte* with attorneys in the Office of Chief Counsel, who have previously provided legal advice to the originating function regarding the same issue in the same case. In such circumstances, an attorney, who has not previously given such advice, would be appointed or the appeals officer must provide the taxpayer with opportunity to participate in the communication.<sup>100</sup>

2.111 Appeals officers are not bound by the legal advice they receive from the Office of Chief Counsel:

Appeals [officers] independently evaluate the strengths and weaknesses of the specific issues in the cases assigned to them and make an independent judgment concerning the overall strengths and weaknesses of the cases they are reviewing and the hazards of litigation. Legal advice is but one factor that Appeals will take into account in its consideration of the case.<sup>101</sup>

2.112 As the Office of Appeals is the only administrative function of the IRS with authority to consider settlements of tax controversies, it has ‘the primary responsibility to resolve these disputes without litigation to the maximum extent possible.’<sup>102</sup>

2.113 Notwithstanding the prohibition against certain *ex parte* communications, there are no legislative remedies or sanctions for breaches of this rule. Where a breach has occurred, however, the IRS does require the Office of Appeals to ‘cure’ the breach by promptly notifying the taxpayer of the communication, sharing the contents of the communication and affording the taxpayer an opportunity to respond. In some instances, the case may be assigned to another appeals officer.<sup>103</sup> Nevertheless, some practitioners in the US have noted that the absence of enforceable remedies for *ex parte* breaches within either administrative procedures or legislation ‘presents another challenge to the perception of Appeals’ independence.’<sup>104</sup>

2.114 Breaches of the *ex parte* rule also require the appeals officer who received the prohibited communication to notify their manager, who in turn notifies the manager of the employee who breached the rule.<sup>105</sup>

2.115 Where a case proceeds to litigation, appeals officers are no longer responsible for the case, as the matter is then handled by either the IRS Chief Counsel or the Department of Justice, depending on the judicial forum elected by the taxpayer.

2.116 The IRS, through the Office of Appeals, also administers ‘fast track’ settlement procedures for a range of taxpayer markets. These are ADR processes which may take place at the request of the taxpayer if the taxpayer and the compliance division (such as ‘LB&I’) have exhausted their own internal dispute resolution mechanisms.

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100 Above n 97, IRM 8.1.10.3.4.1.

101 Ibid, IRM 8.1.10.3.4.3.

102 Ibid, IRM 1.2.17.1.6.6.

103 Ibid, IRM 8.1.10.5.6.

104 Gerald A. Kafka, Rita A. Cavanagh, and Sean M. Akins, ‘Do IRS Appeals’ Office Ex Parte Prohibitions Need Strengthening?’ (30 March 2009) *Tax Notes* 1591, p 1598.

105 Above n 97, IRM 8.1.10.5.4.



2.117 In a fast track process, the Appeals Team Case Leader and appeals officers take part in the ADR process, but not in their traditional ‘appeals’ role. As a result, the *ex parte* rule does not apply during a fast track process. Taxpayers who take part in the fast track process still retain their right to appeal to the Office of Appeals should the process not result in a resolution.<sup>106</sup>

2.118 Despite the extent of the independence of the Office of Appeals from the rest of the IRS, some stakeholders would like such independence to be further bolstered. For example, concerns have been raised that many appeals officers have been promoted from the examination function and there may be a risk that these appeals officers would still have an examination mindset.<sup>107</sup>

2.119 Particular concerns have also been raised with respect to so-called campuses which deal with high volume, low value matters. The appeals officers in campuses may be recruited from within the campuses themselves. It has been argued that these officers needed to make the transition from ‘processing and production to independent thinking and discretionary judgment [which] requires a concentrated effort and focused strategy.’<sup>108</sup>

2.120 Importantly, the Office of Appeals conducts training and supervision of its junior officers to mitigate the above risks.

2.121 Recently, the Office of Appeals has been implementing the Appeals Judicial Approach and Culture (AJAC) project. The project emphasises the ‘quasi-judicial approach so that Appeals hearing officers can focus on their core mission’ as well as ‘fair and impartial decision making free from influence.’<sup>109</sup> As part of the AJAC project, IRS procedures have been modified to emphasise the following features of the appeals system:

- Appeals will not raise new issues nor reopen any issues on which the taxpayer and IRS are in agreement;<sup>110</sup>
- ‘The Appeals process is not a continuation or an extension of the examination process’;<sup>111</sup>
- Appeals should receive cases from the examination function that are fully developed and documented, such that Appeals will not refer the case back to the examination function for further development, but will attempt to settle the case as submitted taking into account factual hazards;<sup>112</sup> and

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<sup>106</sup> Above n 97, IRM 1.2.17.1.2.

<sup>107</sup> American Bar Association Section of Taxation, *Survey Report on Independence of IRS Appeals* (11 August 2007) <[www.americanbar.org](http://www.americanbar.org)> p 33.

<sup>108</sup> National Taxpayer Advocate (US) *2005 Annual Report to Congress* (2005) p 150.

<sup>109</sup> IRS, ‘Appeals Independence Part 1: What Recent Policy Changes Mean for Examination-Sourced Cases’ (Presentation to the 2014 IRS Nationwide Tax Forums, various locations, 1 July – 28 August 2014) p 5.

<sup>110</sup> Above n 97, IRM 8.6.1.6.2.

<sup>111</sup> *Ibid.*

<sup>112</sup> *Ibid.*, IRM 8.2.1.4.3.

- where the taxpayer raises new issues, information, or evidence, Appeals will forward these to the examination function for their consideration.<sup>113</sup>

## New Zealand

2.122 The national revenue authority in New Zealand is the Inland Revenue Department (IRD). Taxpayers and the IRD must follow procedures set out in Part IVA of the *Tax Administration Act 1994* (NZ) where either party proposes to amend the taxpayer's assessment. The IRD cannot amend a taxpayer's assessment without commencing these procedures.

2.123 Whilst there are technically two processes (depending on whether the IRD or the taxpayer seeks to amend the assessment), in practice, the process is largely the same. For ease of discussion, the process set out below is from the perspective of the IRD seeking to amend a taxpayer's assessment.

2.124 Where the investigator wishes to amend the taxpayer's assessment, the investigator must issue a Notice of Proposed Adjustment (NOPA) to the taxpayer, setting out the proposed adjustment as compared to the taxpayer's original position.

2.125 If the taxpayer disagrees with the NOPA, the taxpayer must reject the proposed adjustment by issuing a Notice of Response (NOR) to the IRD. Once the NOR is issued, a conference between the parties is usually scheduled although it is not a legislative requirement. The conference may be facilitated and managed by a 'senior IRD staff member with no prior involvement with the dispute'. The facilitator is not a decision maker, but rather seeks to assist the parties to reach their own resolution on all or some of the issues between them. There have been some calls for this role to be an accredited mediator that is independent of the IRD.<sup>114</sup>

2.126 Where a resolution is not reached, the IRD will issue the taxpayer with a Disclosure Notice, accompanied by a Statement of Position (SOP). The taxpayer must also issue the IRD with its own SOP. The IRD may reply to a taxpayer's SOP in certain circumstances,<sup>115</sup> or otherwise either SOP may be added to by agreement with the other party.<sup>116</sup> The SOP is a key document as the taxpayer and the IRD are thereafter limited to the issues and propositions of law contained in the SOPs when challenging the decision through external review.<sup>117</sup>

2.127 Where the matter remains unresolved, it is referred to the Disputes Review Unit (DRU) which aims to provide an impartial and objective review of unresolved disputes. The DRU was previously known as the Adjudication Unit and is part of the Office of the Chief Tax Counsel. The Chief Tax Counsel reports directly to the IRD Commissioner.

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<sup>113</sup> Above n 97, IRM 8.2.1.5.2.

<sup>114</sup> Melinda Jone and Andrew Maples, 'Mediation as an Alternative Option in New Zealand's Tax Disputes Resolution Procedures: Refining a Proposed Regime' (2013) 19 NZJTLF 301, p 322.

<sup>115</sup> *Tax Administration Act 1994* (NZ) s 89M(8).

<sup>116</sup> *Tax Administration Act 1994* (NZ) s 89M(13).

<sup>117</sup> The Taxation Review Authority or the High Court.



2.128 The Office of the Chief Tax Counsel is also a key IRD source of technical advice to both taxpayers, through its various rulings units and internally, through its Escalations and Advising Unit.<sup>118</sup> When capacity allows, DRU staff may be deployed to assist with issuing rulings or other work within the Office of Chief Tax Counsel.

2.129 The independence of the DRU from the IRD's compliance areas is enforced through regulated communication protocols. As a general approach, neither the taxpayer nor the original decision maker has direct access to the DRU officer considering the matter. For example, if a member of the DRU team requires clarification of some matter concerning the dispute, all communications must be in writing and a copy of the letter needs to be sent to the other party to the dispute. Such communication is undertaken through the Senior Technical Liaison Officer, who is also part of the Office of Chief Tax Counsel. This reinforces independence and impartiality of the DRU.

2.130 The DRU's role is to make a decision as to whether the proposed adjustments should be made. This is based on the better view of the law and what it is considered a court would decide, rather than being based on any revenue-protective position. The decision is based on the information provided in the NOPA, NOR and each parties' SOPs. The DRU does not perform a mediation or arbitration function. It considers the dispute based on the materials provided and does not conduct further investigation into the matter.

2.131 Each dispute is considered by a team of three people who all have professional legal and/or accounting qualifications and experience in researching and analysing tax issues. The team members have differing levels of seniority and involvement in the consideration of the dispute. The final adjudication decision is made by a Disputes Review Manager.<sup>119</sup>

2.132 A comprehensive adjudication report is produced and provided to the parties. In addition to providing the adjudication decision and the reasons for that decision, the report also sets out the facts of the dispute, the issues that need to be addressed, the analysis of the legal issues involved, the application of that legal analysis to the facts of the dispute and the conclusions reached on each issue.

2.133 In the event the DRU decides in favour of the taxpayer, the IRD is bound by the DRU decision and the compliance area cannot appeal the matter further. However, where the DRU has found in favour of the IRD, the adjusted assessment will be issued by the compliance area staff involved in the dispute. The taxpayer may dispute the assessment by applying to challenge the decision in the Taxation Review Authority (TRA) or to the High Court within two months of the assessment.<sup>120</sup> Taxpayers may

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118 New Zealand Inland Revenue Department (IRD), 'About Us, Office of the Chief Tax Counsel' (7 December 2004) <[www.ird.govt.nz](http://www.ird.govt.nz)>.

119 IRD, 'The Disputes Review Unit - its role in the dispute resolution process,' (12 August 2013) <[www.ird.govt.nz](http://www.ird.govt.nz)>.

120 *Taxation Review Authorities Act 1994* (NZ) s 25(2).

also appeal to the High Court from an adverse decision of the TRA on a question of law.<sup>121</sup>

2.134 As will be discussed later in this report, a protocol exists between the IRD and the Solicitor-General of New Zealand whereby the Solicitor-General, with the assistance of the Tax and Commercial Team in Crown Law oversees all IRD litigation. However, in practice, the IRD is often represented at litigation by its own officers from the Litigation Management Unit except in more complex matters.

2.135 It is important to note that whilst New Zealand has a structured legislative pre-assessment process for resolving disputes, there is a statutory option for the IRD and the taxpayer to agree in writing to truncate the full process and to apply for external review directly to the TRA or the High Court.<sup>122</sup> The IRD's policy is to agree to a taxpayer's request to opt-out after the NOPA, NOR and conference phases in certain cases, effectively empowering taxpayers to unilaterally elect to proceed directly to external review.<sup>123</sup> However, elections to proceed directly to external review have been rare.

## United Kingdom

2.136 Tax disputes between taxpayers and the UK's national revenue authority, Her Majesty's Revenue and Customs (HMRC), have undergone significant changes since 2009 following the reform of the civil tribunal system and the introduction of a statutory right of internal review for certain tax decisions.

2.137 Following the reform of tribunals in the UK, taxpayers dissatisfied with certain HMRC decisions, such as those that amend a taxpayer's self assessment,<sup>124</sup> may appeal directly to an external review body.<sup>125</sup> These external review bodies include the Tax Chamber of the First-tier Tribunal which is an administrative tribunal that can review HMRC decisions on its merits. Decisions of the First-tier Tribunal may be appealed to the Upper Tribunal on a point of law. Further appeals may be made to the Court of Appeal with leave of the Upper Tribunal or the Court itself.<sup>126</sup>

2.138 Simple matters referred to the First-tier Tribunal are often dealt with 'on the papers' meaning they do not require a hearing or appearances on behalf of either the taxpayer or HMRC. More complex matters or those which progress through to the

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121 New Zealand Ministry of Justice, 'Taxation Review Authority - Hearing Process' (undated) <[www.justice.govt.nz](http://www.justice.govt.nz)>.

122 *Taxation Administration Act 1994* (NZ) sub-para 89N(1)(c)(viii).

123 IRD, *SPS 11/06 Disputes resolution process commenced by a taxpayer* (16 July 2013) paras [203]-[230]; IRD, *SPS 11/05 Disputes resolution process commenced by the Commissioner of Inland Revenue* (16 July 2013) paras [172]-[192].

124 *Taxes Management Act 1970* (UK) s 49A; HM Revenue and Customs (HMRC), 'ARTG2160 - Reviews and appeals for direct taxes: Appealing against a decision: What decisions can be appealed against' (undated) <[www.hmrc.gov.uk](http://www.hmrc.gov.uk)>.

125 HMRC, 'ARTG1010 - Introduction: Background' (undated) <[www.hmrc.gov.uk](http://www.hmrc.gov.uk)>. Prior to 2009, taxpayers still had a right to appeal directly to an external review body, which were the General and Special Commissioners. These Commissioners were replaced by the tribunal system.

126 HM Courts and Tribunal Service, 'Appealing to the Upper Tribunal (Tax and Chancery Chamber)' (undated) <[www.justice.gov.uk](http://www.justice.gov.uk)> pp 13-15.

Upper Tribunal and other appeal courts are managed through HMRC's Solicitor's Office and Counsel is generally briefed to appear for the revenue.

2.139 In addition to this direct right to appeal externally, taxpayers also have the right to request HMRC to first have the matter internally reviewed. Upon request of the review, HMRC is obliged to review the matter.<sup>127</sup> This is known as a statutory review. It is HMRC's experience that the statutory review process is used most typically by self-represented individual taxpayers.

2.140 Statutory reviews are carried out by review officers, who are, in most cases, outside the 'direct line management chain of the decision maker and [were] not involved in making the decision'.<sup>128</sup> Review officers are members of dedicated teams which are separate from original decision makers. They are, however, generally located in the same compliance business units, for example, Local Compliance, and are ultimately managed by the same Director-General who reports to the Chief Executive.

2.141 Taxpayers who are dissatisfied with the internal review process may appeal their case further to the First-tier and Upper Tribunals.

2.142 HMRC has an internal scrutineer in the Tax Assurance Commissioner. The Tax Assurance Commissioner oversees the overall HMRC dispute resolution process, providing assurance that disputes with taxpayers are resolved in a way that is consistent with the published HMRC Litigation and Settlement Strategy.<sup>129</sup>

2.143 The Tax Assurance Commissioner, along with two other Commissioners, is directly involved in decisions on resolving disputes for the most sensitive cases or where the potential tax at stake in the case is over £100 million. These decisions are considered after receiving recommendations from the Tax Disputes Review Board, which is an internal board composed of senior officers across HMRC.

2.144 Whilst the Tax Assurance Commissioner (who is also the Second Permanent Secretary for Tax) reports directly to the head of HMRC (being the Chief Executive and Permanent Secretary), he also reports publicly through his Annual Report on how HMRC resolves tax disputes. This includes summary details of the decisions taken by the Commissioners and other tax dispute resolution boards, together with details of the outcomes of statutory reviews and appeals to the tribunal.<sup>130</sup>

## Canada

2.145 The principal national revenue authority in Canada is the Canada Revenue Agency (CRA). Disputes between taxpayers and the CRA follow a similar path to that in Australia.

2.146 Canada has a self assessment system where taxpayers self-assess their tax liabilities and lodge returns with the CRA. Taxpayer returns are examined by the

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127 HMRC, 'ARTG1030 - Introduction: Reviews of HMRC decisions' (undated) <[www.hmrc.gov.uk](http://www.hmrc.gov.uk)>.

128 Ibid.

129 HMRC, 'Code of Governance for Resolving Tax Disputes', July 2014, p 4.

130 HMRC, *How we resolve Tax Disputes: The Tax Assurance Commissioner's Annual Report 2013-14* (July 2014).

CRA's Assessment and Benefit Services Branch (ABSB) to identify any clerical or administrative errors, whereupon an adjustment may be made as a result of those errors. The assessment made by the ABSB gives rise to a right for the taxpayer to lodge a notice of objection with the Appeals Branch for review as to whether or not the assessment accepts the taxpayer's filing position.

2.147 Taxpayers may also be subject to an audit undertaken by the Compliance Programs Branch (CPB).<sup>131</sup> During the course of the audit, taxpayers are encouraged to engage directly with audit officers to resolve any disagreements or disputes prior to the assessment being issued. Where an impasse is reached between the taxpayer and audit officer, matters may be escalated through the CRA's CPB and/or Legislative Policy and Regulatory Affairs Branch at headquarters in Ottawa.

2.148 Ultimately, it is the relevant regional office of the CRA (known as a tax services office) that issues an assessment (or re-assessment) notice accordingly. If the taxpayer disagrees with the re-assessment, they may lodge a notice of objection with the Appeals Branch which then allocates an officer to impartially review the issue and render a decision on the taxpayer's objection. The taxpayer may object to all matters within the return, not only those which were the subject of assessment/reassessment.

2.149 The ABSB, the CPB and Appeals Branch are separate and independent branches of the CRA, each headed by an Assistant Commissioner who reports directly to the Commissioner of Revenue, being the Chief Executive Officer of the CRA.

2.150 The relationship between the CPB and the Appeals Branch is governed by a protocol which clarifies the roles of the appeals officer and the auditor and aims to offer taxpayers a fair and impartial review of disputed assessments.<sup>132</sup> The protocol emphasises that:

An appeals officer handling an objection has complete **decisional independence** relative to the recommendation to confirm, vacate, or vary the assessment. Appeals officers will keep taxpayers informed of any discussion with auditors in the course of resolving the objection to ensure that the process is **fair, open, and transparent**. (original emphasis).<sup>133</sup>

2.151 The protocol does not prohibit *ex parte* communication between the appeals officer and the auditor. It does, however, require the appeals officer to advise the taxpayer that such discussions have taken place and to provide copies of records of these discussions.

2.152 Where the taxpayer provides additional information not produced at the time of the audit, the appeals officer may request the auditor to consider this information

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131 Office of the Auditor General of Canada, *Report of the Auditor General of Canada to the House of Commons* (November 2004) <<http://www.oag-bvg.gc.ca/internet/docs/20041105ce.pdf>>.

132 Canada Revenue Agency (CRA), *Protocol Between the Compliance Programs Branch and the Appeals Branch of the Canada Revenue Agency* (7 July 2005).

133 Ibid.

and advise the appeals officer in writing of their reconsideration of the material. The appeals officer then in turn will make a decision.<sup>134</sup>

2.153 Where the appeals decision is in favour of the taxpayer, the decision is final. Where the decision is not favourable to the taxpayer, the taxpayer has the option to appeal to the Tax Court of Canada. Judgments of the Tax Court of Canada may be appealed to the Federal Court of Appeal and up to the Supreme Court if required.<sup>135</sup>

2.154 Legal services are provided by the Tax Laws Services (TLS) Portfolio of the Department of Justice.<sup>136</sup> The TLS is led by an Assistant Deputy Attorney-General, who together with its staff, are employees of the Department of Justice who are allocated to the CRA.<sup>137</sup> The TLS Portfolio provides two separate services to the CRA: legal advice and litigation, on a cost-recovery basis wherein the TLS issues a bill to the CRA for services rendered.

## Republic of Ireland

2.155 The Revenue Commissioners (RC) is the national revenue authority in the Republic of Ireland responsible for the administration of Irish taxes and customs matters.

2.156 The RC has a number of administrative dispute resolution mechanisms which seek to resolve issues arising in its interaction with taxpayers. These procedures can operate in relation to any disputed issue covered by the procedures. There is also a statutory right of appeal to independent Appeal Commissioners and the Courts in relation to a number of issues including disputed tax assessments and claims for exemptions and reliefs.

2.157 The RC encourages taxpayers at first instance to engage directly with the officer handling their case to resolve any disputes which may arise. The RC considers this to be part of its day-to-day engagement with taxpayers and expects that most issues will be resolved during this process.<sup>138</sup>

2.158 Where issues cannot be resolved through day-to-day engagement, taxpayers may lodge a complaint with their local Revenue Office. The RC's procedures provide that where a taxpayer seeks to speak with a manager, they should be able to do so without delay.<sup>139</sup>

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<sup>134</sup> Ibid.

<sup>135</sup> CRA, *Resolving your dispute: Objection and appeal rights under the Income Tax Act* (3 June 2014) <<http://www.cra-arc.gc.ca>>.

<sup>136</sup> Canada Department of Justice, 'Tax Law Services Portfolio Office Audit' (July 2011) <<http://www.justice.gc.ca>>.

<sup>137</sup> CRA, *Annual Report to Parliament 2012-13* (2013) p 85.

<sup>138</sup> Revenue Commissioners (RC), *Revenue Complaint and Review Procedures* (February 2013) <[www.revenue.ie](http://www.revenue.ie)> p 3.

<sup>139</sup> Ibid, p 5.

2.159 If the issue cannot be resolved through the complaints process, taxpayers may avail themselves of the review procedure which comprises two stages.

- local review; and
- internal review or external review.<sup>140</sup>

2.160 Local reviews are usually conducted by the relevant Local District Manager. However, the RC recognises there may be instances in which the taxpayer may not want to raise their concerns with the Local Revenue Office. In these circumstances, they may request that their local review be carried out by the Principal Officer in the Regional or Divisional Office.<sup>141</sup>

2.161 If the taxpayer remains dissatisfied after the local review has been completed, they can request an internal review or an external review but not both. When either is requested, the matter is referred to the Review Secretariat. This Secretariat is responsible for acknowledging the request, checking that a local review has been completed, assigning the case to a reviewer, co-ordinating the documentation for the reviewer and communicating directly with the taxpayer on behalf of the reviewer.<sup>142</sup>

2.162 Internal Review is undertaken by a reviewer chosen from a panel of senior Revenue officials at Principal Officer Level. They cannot have had any operational or management function in the original decision.<sup>143</sup> External reviewers are chosen from an external panel of qualified experts with a minimum of 10 years relevant experience in law, accountancy and/or related academic fields. External reviewers are selected from an open competition which is not open to existing civil servants.<sup>144</sup>

2.163 Where a taxpayer submits additional information, the Review Secretariat will decide if the material warrants consideration. If so, the case will be referred back to the Local Reviewer, before referral for internal or external review.

2.164 Internal and external reviewers complete their review 'on the papers', in that reviewers usually have no direct contact with taxpayers or the original decision maker when reviewing the matter.

2.165 Local, internal or external reviewers may overturn an original decision generally on the basis of findings of fact. Where the dispute is in relation to the interpretation of a legislative provision, reviewers generally do not challenge the original decision maker's interpretation unless it is clearly wrong. The role of adjudicating on points of law lies with the Appeal Commissioners and the Courts.<sup>145</sup>

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<sup>140</sup> Ibid, p 3.

<sup>141</sup> Above n 138, p 7.

<sup>142</sup> Ibid, p 11.

<sup>143</sup> Ibid.

<sup>144</sup> Ibid, p 14.

<sup>145</sup> Ibid, p 4.



2.166 The RC is bound by the decision of its reviewers (local, internal or external) except in circumstances where the 'Revenue Board is of the view that the decision of the reviewers is not in accordance with the relevant legislation.'<sup>146</sup>

2.167 Separately from the RC review procedures, the taxpayer has a statutory right of appeal against the RC's assessments. The taxpayer has thirty days to appeal an assessment to the Appeal Commissioners, who are appointed by law and are external and independent of the RC. Taxpayers may still engage with the RC notwithstanding the lodgement of an appeal. It is open for the taxpayer and the RC to reach a settlement of an appeal prior to an appeal hearing by the Appeal Commissioners or the Courts.

2.168 An appeal by the taxpayer is made to the Appeal Commissioners, but currently this is done by notice in writing to the appropriate Revenue officer rather than to the Appeal Commissioners directly. Revenue officers process these appeal applications and may form an opinion that the taxpayer is not entitled to make an appeal to the Appeal Commissioners and refuse the application. Taxpayers can appeal such refusals directly to the Appeal Commissioners.<sup>147</sup>

2.169 The Appeal Commissioners are considered a Tribunal,<sup>148</sup> but it is not a tribunal of record.<sup>149</sup> Generally, appeals are heard in private. Appeal Commissioners decisions are 'based on findings of fact made from the evidence presented and interpretation of taxation law'.<sup>150</sup>

2.170 Appeal Commissioners are not members of the judiciary and only a small fraction of the cases decided have been published. Taxpayers may appeal decisions of the Appeal Commissioners to the Circuit Court for a full rehearing, where the Circuit Court exercises the same powers as the Appeal Commissioners,<sup>151</sup> or directly to the High Court on a point of law.<sup>152</sup> The RC may only further appeal a decision of the Appeal Commissioners to the High Court on a point of law, except in relation to Capital Acquisitions Tax appeals for which a rehearing request is available to the RC.<sup>153</sup>

2.171 In litigation before the Appeal Commissioners, the RC is usually represented by the relevant officers who were responsible for the original decision. However, where matters involve significant issues or proceed to the Circuit Court or High Court, the Appeals Committee within the RC will ordinarily approve the engagement of Counsel to represent the RC.

2.172 The position as outlined above in relation to appeals is currently under review. The Irish Government, following a public consultation process, is presently considering legislative reforms to the tax appeals system. Among the reforms under

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146 Ibid, p 13.

147 Office of the Appeal Commissioners, 'Guide to the Functions and Records of the Office' (undated) <<http://www.appealcommissioners.ie>>.

148 Irish Tax Institute, 'The Irish Appeals System - The Rules and Procedures Governing Irish Tax Appeals' (March 2008) p 53.

149 Above n 147.

150 Ibid.

151 *Taxes Consolidation Act 1997* (Ireland) s 942(3).

152 RC, *Tax and Duty Appeals Manual* (April 2014) p 54.

153 Ibid.

consideration is one from the RC to eliminate the Circuit Court stage and have appeals from Appeal Commissioners' decisions made direct to the High Court on a point of law.<sup>154</sup> This proposal arises from concerns raised by the RC that the option for a rehearing of an entire case, including findings of fact, by the Circuit Court creates incentives for taxpayers to not fully engage with the Appeal Commissioners process as well as contributing to delay in finalising appeals.<sup>155</sup>

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154 Michael Noonan, 'Reform of the Appeal System for Tax Matters' (Department of Finance, 16 October 2013).

155 RC, 'Submission to the Consultation on the Reform of the Appeal System for Tax Matters by the Office of the Revenue Commissioners' (undated) p 15.



## CHAPTER 3 — THE CURRENT SYSTEM AND THE CASE FOR REFORM

3.1 Generally, complexity in the tax system provides fertile ground for disputation<sup>156</sup> as it increases uncertainty and costs for both the taxpayer and the revenue authority. For example, unclear provisions in the legislation may lead to taxpayers and the revenue authority developing and maintaining different interpretations of those provisions that may only be resolved by having the matter litigated.<sup>157</sup>

3.2 The costs of disputes, for taxpayers, may manifest themselves at any stage of the tax disputes process and may take the form of financial, emotional and/or reputational costs. As such costs increase or take hold, taxpayers may become unable or unwilling to maintain a position they may rightfully believe is correct. Such an outcome can have a regressive effect with greater impact on small businesses and individuals. The community expects the ATO to minimise this regressive effect through a sustainable framework that provides robust checks and balances, including effective pre-assessment reviews, to prevent or expeditiously resolve disputes.

3.3 In submissions to this review, stakeholders have observed that in recent years, the ATO has made considerable improvement in their approach to early dispute resolution, mainly in the large business market.

3.4 Submissions, as well as those who testified at the Committee's public hearings, have also highlighted persisting concerns giving rise to unnecessary disputation, including those resulting from:

- unsustainable audit decisions due to a lack of auditor capability, engagement or inappropriate auditor conduct;
- limiting access to pre-assessment reviews (such as the IR process) to only the largest taxpayers and the ineffectiveness of some of these processes;
- the Compliance Group's ability to unduly influence objections officers, such that the process lacks sufficient independence and objectivity;
- inadequate management and independence of the litigation function, leading to unnecessarily litigated cases; and
- a lack of transparency and accountability in relation to settlements.

3.5 The IGT has previously conducted a number of reviews relating to tax disputes, the reports of which are noted in Chapter 2. The IGT has identified

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156 Victor Thuronyi and Isabel Espejo, 'How Can an Excessive Volume of Tax Disputes Be Dealt With?' (Tax Law Note, International Monetary Fund, December 2013) p 6.

157 IGT, *Review into Improving the Self Assessment System* (2012) p 125. See also: Ibid.

underlying themes that permeate many of the concerns raised in relation to those reviews. These themes relate to the ATO's governance and management structure, the key elements of which are outlined in the Tax Forum Submission.

3.6 In analysing the stakeholder concerns in this review, the IGT has also given due consideration to the key themes emerging from previous reviews having regard to the important nature of the Committee's overarching inquiry into tax disputes. The stakeholder concerns and related themes are each considered in turn below.

## AUDIT DECISIONS AND CONDUCT

3.7 ATO original decision making in compliance activities has continued to be a concern for taxpayers. This has been explored in a number of earlier IGT reviews including those that have examined the ATO's compliance approach to large businesses and HWIs.<sup>158</sup>

3.8 It is important that ATO original decisions in audits are robust and are based on a common understanding of each party's view of the facts, evidence and application of the relevant law. Whilst stakeholders have acknowledged recent improvements, the ATO statistics show a level of disputation that cannot be explained solely by taxpayer conduct or occasional ATO officer non-compliance with ATO procedures. This suggests a need for more focused engagement during audits.

3.9 Submissions to this review suggest a number of reasons for unsustainability of initial audit decisions. These include:

- lack of opportunities or willingness for ATO officers to engage;
- auditors lacking necessary commercial knowledge of the industries or entities they are examining;
- auditors lacking technical capability leading to unclear risk hypotheses;
- ATO requests for excessive information to be provided within short timeframes;
- allegations of tax avoidance pursuant to Part IVA of the *Income Tax Assessment Act 1936* (Part IVA), fraud and evasion are made without strong bases; and
- perceptions that auditors have adopted an overzealous approach to compliance with a 'guilty until proven innocent' mindset.

## Engaging with taxpayers

3.10 Stakeholders have acknowledged the recent support for better and earlier engagement and dispute resolution by ATO senior executives. A range of taxpayer experience has been shared in submissions to this review.

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<sup>158</sup> Above n 38, pp 24-25; Above n 37, p 127.

3.11 Stakeholders have cited some positive experiences, mainly in the large business market, which have highlighted the benefit of early and effective engagement, including the ability to refine and discuss risk hypotheses, request the correct information and thereby reduce the overall time taken to complete the audit and minimise the risk of disputes.

3.12 Other examples suggest that, at times, the engagements are overly adversarial and not conducive to effective dispute resolution. The issue may be further exacerbated in long-running cases where changes in personnel may create barriers for engagement due to a lack of familiarity with the history of the case, resulting in delays or unnecessary costs. Certain stakeholders have recounted instances where the ATO had not engaged meaningfully but rather sought to use the engagement to simply identify gaps in the audit case against the taxpayer rather than reconsidering its own position from an independent standpoint.

3.13 Instances where the ATO audit team did not seek to engage with the taxpayer have also been raised. Such instances have led to wide-ranging information requests and the use of formal ATO information gathering powers. The result has been considerable frustration and a rapid escalation of the dispute whereby the taxpayer through its advisers sought the assistance of senior ATO executives to intervene and assist in addressing the matter.

3.14 The above issue is particularly pronounced for non-HWI and small business taxpayers who may not have dedicated client relationship managers or senior ATO personnel contacts whose assistance may be sought. Where these taxpayers are unable to engage directly with the ATO and have few avenues to reach ATO senior staff, they have little choice but to seek external review by, for example, applications to the AAT as a means of bringing the matter to the ATO's attention.

3.15 The above highlights the importance of having a single dedicated area for all taxpayers to escalate potential disputes for expeditious and cost-effective resolution without the need to resort to personal contacts with senior ATO personnel.

3.16 The IGT has previously encouraged both the ATO and taxpayers to engage earlier during the compliance process to achieve a common understanding of the issues in dispute, including what information may assist to resolve these issues.<sup>159</sup> Both taxpayers and revenue authorities benefit from full disclosure of relevant facts and issues during the compliance stage, so that a sustainable original decision can be made.<sup>160</sup> The ATO has recently noted that there is incentive for both parties to get 'all the facts on the table together so you can both meaningfully look at them' to seek agreement.<sup>161</sup>

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159 Above n 38, recommendations 5.2 and 5.4; IGT, *Review of the Potential Revenue Bias in Private Binding Rulings Involving Large Complex Matters* (2008) recommendation 5.

160 Commonwealth, *Parliamentary Debates*, House of Representatives Standing Committee on Tax and Revenue (16 July 2014) p 10.

161 *Ibid*, p 12.

## Commercial knowledge

3.17 Stakeholders consider that ATO officers do not possess an appropriate understanding of commercial drivers of businesses which would help them to narrow the issues in dispute. It has been suggested that ATO officers need to appreciate that large businesses will routinely engage in tax planning that is permissible at law and that capable ATO officers are able to distinguish between legitimate tax planning activities and those which offend the law.

3.18 Stakeholders have observed that the lack of commercial understanding is evidenced by the ATO reasoning for some anti-avoidance claims. Examples in this regard include instances where the auditor's alternate postulate as presented to the General Anti-Avoidance Rule (GAAR) Panel was noted to be more expensive and inconvenient to the business and did not generate the commercial benefit of the actual transaction.

3.19 In the IGT *review into the ATO's management of transfer pricing matters* (the Transfer Pricing review),<sup>162</sup> senior ATO executives also acknowledged that, at times, their staff lacked awareness of commercial drivers underlying the transactions being reviewed.<sup>163</sup>

3.20 Similar concerns have been expressed in relation to ATO officers dealing with HWIs and their businesses. In these examples, the submissions had noted that the ATO officers' appreciation of the taxpayers' business had not substantially improved even after the taxpayers and their advisers provided presentations on the nature of their business.

3.21 Stakeholders have also identified a need to guard against auditors' selection bias particularly in relation to taxpayers with less resources and access to relevant tax expertise, such as small businesses and individuals. The issue is that auditors may assume that simply because a taxpayer has been selected for audit, there must be something awry,<sup>164</sup> i.e. they adopt an overzealous 'guilty until proven innocent' approach.

## Technical capability and risk hypotheses

3.22 Technical capability is a common theme in both this review and other IGT reviews which have specifically examined large business and HWI compliance approaches as well as transfer pricing.<sup>165</sup> More recently, the ATO has also acknowledged to the Committee that within a large organisation, capability may vary between officers:<sup>166</sup>

When you have a large workforce—and we do have a large auditing workforce in our organisations, many thousands of officers that do that kind of work—then, as with

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162 IGT, *Review into the ATO's management of transfer pricing matters* (2014).

163 Ibid, pp 175-200.

164 Commonwealth, *Parliamentary Debates*, House of Representatives Standing Committee on Tax and Revenue (29 October 2014) p 1.

165 Above n 162; Above n 37; Above n 38.

166 Above n 75, p 2.

any large system, you do from time to time get variances in performance. That is not to excuse them. It is just an acknowledgement that is a reality when you are dealing with big systems.

3.23 While there is an appreciation that officers may need to be trained to develop necessary skills and expertise, stakeholders are concerned that where developing officers are inadequately supervised in compliance activities, their lack of knowledge leads to protracted audits and disputes which are costly and time consuming.

3.24 An example raised with the IGT outlined instances in which the ATO undertook two separate audits against different entities within the one taxpayer group on the same issue. Whilst the taxpayer believed that the ATO was seeking to apply a particularly ATO precedential view to the matter, the ATO was not transparent in relation to its risk hypothesis and therefore did not request the correct information. During the objection, the ATO officer agreed with the taxpayer that the audit had failed to request the correct information to truly examine the issue. Moreover, the conduct of two separate audits for essentially the same issue resulted in substantially more costs than if the ATO had sought to clarify its position in respect of one case and then applied it to the other case. Although the taxpayer was eventually able to engage directly with senior ATO officers for a more pragmatic approach to managing the audits, this had only occurred after considerable time and expense had been incurred by both parties.

3.25 In another example, the taxpayer contended that the ATO presented three different risk hypotheses concerning transfers of shares, a restructure of share capital and a demerger. The taxpayer considered that the three hypotheses were inconsistent with each other such that if the transfers of shares occurred then the demerger argument could not be sustained. However, the ATO's insistence on presenting all three hypotheses and progressing on this basis resulted in considerable time, cost and stress for the taxpayer, his wife and their business. Taxpayer costs in this matter have thus far exceeded \$1 million over a number of years and the taxpayer has been unable to directly engage with senior ATO officials.

## Information requests

3.26 The lack of commercial appreciation and ATO staff capability issues has led to a number of concerns in relation to the ATO's information requests.

3.27 The ATO's approach to information gathering, particularly through its statutory information gathering powers under section 264 of the *Income Tax Assessment Act 1936*, has been an area of particular concern for large businesses. The IGT had previously considered the ATO's approach to information gathering in the ADR Review,<sup>167</sup> the Large Business Review<sup>168</sup> and the SME/HWI Review.<sup>169</sup> It was also raised as a potential area of review during consultation on the most recent IGT work program. However, having regard to the ATO's more recent updates to its approach to

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<sup>167</sup> Above n 42, p 28.

<sup>168</sup> Above n 37, p 87.

<sup>169</sup> Above n 38, p 93.

information gathering,<sup>170</sup> the IGT considered that there would be greater benefit in allowing the ATO's new approach to be implemented and assess its effectiveness at a later date.

3.28 Nevertheless, information gathering approaches of the ATO remain a significant concern. Submissions made to this review outlined a number of concerns with the ATO's information gathering approach.

3.29 Firstly, stakeholders were concerned that the ATO was inappropriately using section 264 to gather information which did not relate to the taxpayer's taxation affairs, such as information held overseas by the taxpayer's parent company and which was not the subject of the ATO's inquiries.

3.30 Secondly, examples provided to the IGT illustrate that, where audits extended over long periods of time, the ATO's use of information requests were excessive creating additional costs for taxpayers.

3.31 Thirdly, the timeframes allowed for the provision of information are not reasonable and appeared to be based on internal timeframes rather than based on consideration of the complexity and volume of material requested. In some instances, stakeholders have noted that even where extensions have been granted, the ATO has threatened taxpayers with criminal proceedings for non-compliance.

3.32 Fourthly, information requests issued to HWIs can be particularly burdensome with some stakeholders observing that such taxpayers are often issued with requests for the same amount of information as large businesses without the ATO appreciating the time and resources required to respond to these requests and the impact it has on these taxpayers. In one case, the ATO requested receipts for removalist expenses going back 10 years to evidence the taxpayer's principal place of residence.

3.33 Finally, excessive information requests are not confined to large businesses and HWIs and may have particularly adverse effects on individuals and small businesses. As will be discussed in the next section, information requests may be particularly burdensome for individual taxpayers, especially where the ATO does not sufficiently engage with those taxpayers on the scope and reasons for the requested information.

3.34 As stated earlier, the IGT had previously sought to minimise the instances of disputes arising as a result of information requests by recommending that the ATO engage with taxpayers to discuss relevant tax risk hypotheses, the appropriate information to address those hypotheses and identify appropriate sources of information where the documents initially requested may not be available or unduly burdensome to obtain.<sup>171</sup>

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170 ATO, 'Our Approach to Information Gathering' (November 2013) <[www.ato.gov.au](http://www.ato.gov.au)>.

171 Above n 42, recommendation 3.2; Above n 37, recommendation 7.2; Above n 38, recommendation 5.2.



## Part IVA, fraud and evasion

3.35 A particular area of concern for stakeholders was the ATO's approach to allegations of fraud and evasion as well as Part IVA, the general anti-avoidance provision. Notwithstanding that the ATO requires its senior officers to review such allegations before they are formally made, stakeholder submissions have outlined a number of issues which are set out below.

3.36 Firstly, stakeholders perceive that the above allegations are made without strong evidentiary bases, are not properly reviewed and are used as a means of extending the periods for amendment, notwithstanding that the ATO has issued a practice statement to guard against such inappropriate behaviour.

3.37 The frequency with which fraud and evasion allegations are made against HWIs has also been a cause for concern with stakeholders. A case was highlighted to the IGT in which the ATO alleged that a HWI taxpayer was seeking to evade taxes by reason of a clerical error made in his tax return.

3.38 Fraud and evasion allegations are extremely serious, due to their criminal connotations, and are difficult for taxpayers to disprove, especially those who are self-represented.<sup>172</sup> The IGT previously considered the issue in the SME/HWI Review and made a recommendation that any suggestions of evasion should be internally reviewed by a senior ATO officer and the taxpayer provided with a base level of documentation and evidence which sets out the ATO's reasoning.<sup>173</sup> The IGT also recommended that where evasion is considered to be a risk by the senior officer, the matter be referred to the SME technical panel for further action and the taxpayer be notified of the referral to the panel.<sup>174</sup>

3.39 Secondly, stakeholders remain concerned with the ATO's application of Part IVA to ordinary commercial transactions rather than arrangements which are blatant, artificial or contrived. Such allegations are particularly difficult for taxpayers as they still bear the onus of adducing evidence to argue against the ATO's alternate postulate on matters which may or may not have occurred.

3.40 Thirdly, stakeholders consider that ATO officers are not bringing an independent and objective mind to bear on potential determinations under Part IVA. In one example, the taxpayer highlighted concerns with potential conflicts of interest on the GAAR Panel owing to prior involvement which led to two members of the Panel recusing themselves from consideration of the matter. However, another person involved with the process, an ATO Assistant Commissioner refused the request for a recusal leading to concerns that he was invested in his view and did not objectively consider the taxpayer's arguments.

3.41 In the past, stakeholders have also raised other concerns including the GAAR Panel having no decision making role, the extent to which the ATO decision makers

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172 Commonwealth, *Parliamentary Debates*, House of Representatives Standing Committee on Tax and Revenue (16 October 2014) p 21.

173 Above n 38, recommendation 3.3, p 58.

174 Ibid.

may disregard the Panel's recommendations and the taxpayer and their advisers not being present when the ATO makes its submissions to the Panel.

3.42 The IGT to date has not specifically reviewed the ATO's administration of Part IVA (including the operation of the GAAR panel) although it had been raised as a potential review topic during consultation on IGT's most recent work program. However, given the relatively recent legislative amendments to Part IVA, stakeholders have generally acknowledged that it would be more beneficial to await any resultant changes in ATO administrative practices before the IGT undertook such a review. Accordingly, the IGT may review this area in the future.

## OBJECTIONS PROCESS

3.43 Submissions to the IGT characterise the objections process as a 'frustrating step to the doors of the Court.' This is particularly highlighted by the high rates of litigation being conceded or otherwise withdrawn prior to hearing. In the ADR report, the IGT observed that over 90 per cent of matters filed in the AAT are resolved without hearing.<sup>175</sup> Similar statistics were also reported in the ATO's annual report for 2013-14.<sup>176</sup>

3.44 In particular, these stakeholders were concerned with the lack of independence between the objections function and the original decision makers. Examples raised in submissions suggested instances where the taxpayer perceived that the officer deciding the objection was the same officer who made the original decision or was located within the same team.

3.45 Stakeholders also consider that the ATO's objections function has lacked the necessary level of independence since the dissolution of the ARG in 1994. The IGT has also previously examined the co-location of the compliance and objection functions within the HWI area. One outcome of the merger in this area was an increase in the backlog of objections because the resourcing of compliance activities took priority.<sup>177</sup> The risk of such under-resourcing of objection function exists throughout the ATO except where the objection function has been moved out of the Compliance Group.

3.46 The absence of a separate objections area with independent leadership domestically has been compared unfavourably by stakeholders with other jurisdictions possessing these features as part of their internal structure. Specifically, the IRS (United States) and CRA (Canada) both have an appeals branch with their own dedicated direct report to the agency head. Under such arrangements, it is much more difficult to assert that the appeal officers are acting under the direction of the original decision makers.

3.47 Similarly, New Zealand's IRD has a specialist Dispute Resolution Unit (DRU), headed by a direct report to the agency head, the Chief Tax Counsel, who also administers the advisory functions of the IRD. Unlike the ATO, all internal reviews are undertaken by this unit.

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<sup>175</sup> Above n 42, p 39.

<sup>176</sup> Above n 4, p 75.

<sup>177</sup> Above n 38, p 77.



3.48 The UK's HMRC does not have a dedicated separate appeals area, however, it has a dedicated Assurance Commissioner who reports directly to the agency head and is responsible for overseeing HMRC's adherence to its litigation and settlement strategy. This direct report is the Tax Assurance Commissioner who also issues a separate annual report on the HMRC's approach to dispute management and settlements. This arguably represents a higher degree of internal oversight and assurance especially as the larger more complex cases are reviewed by this Commissioner along with two other Commissioners.

3.49 Stakeholders also observe that, until recently, all objection decisions were made in the same compliance business line that made the original decision in dispute. As noted earlier, objections for taxpayers with turnovers over \$100 million are now undertaken in the RDR business line, which belongs to the LD&P Group instead of the Compliance Group. Despite this separation, there is some concern that the RDR objections function is not sufficiently independent, as the LD&P Group also contains the TCN.

3.50 In this respect, stakeholders have raised concerns that objections officers seeking technical advice from TCN may receive the same advice that underlies the original decisions by compliance teams. TCN is a source of technical advice for the ATO, including the Compliance Group. Structurally, TCN and RDR are ultimately headed by the same direct report to the Commissioner, being the Second Commissioner LD&P Group.

3.51 Examples were raised with the IGT of instances where TCN officers who had provided advice in the original audit were also called upon to advise officers considering the objection, effectively leading to the same outcome. As the ATO is increasingly allocating technical staff, such as LD&P's TCN, to assist the compliance teams with specific taxpayers, particularly in the PGI business line, such occurrences may become more frequent. The ATO has publicly indicated that this should not occur and that TCN officers involved in the audit stage are effectively excluded from involvement in the subsequent stages of the objection.<sup>178</sup>

3.52 In another case, the taxpayer noted that the Assistant Commissioner who was leading the audit was subsequently transferred to the TCN whereupon they were asked to provide technical advice on the same case.

3.53 Stakeholders have commented that this lack of independence and separation, rather than being a process to determine the correctness of the original decision or the taxpayer's objection, leads to a perception that the objection process is being conducted for the broader corporate purposes of the ATO, such as strengthening the ATO position for subsequent litigation.<sup>179</sup> Internal ATO reporting had previously raised concerns that objections officers were re-auditing cases.<sup>180</sup>

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<sup>178</sup> Above n 75, p 12.

<sup>179</sup> John Hyde Page, Submission 22 to the House of Representatives Standing Committee on Tax and Revenue, *Inquiry into Tax Disputes*, 25 July 2014, p 4.

<sup>180</sup> 'Review of interpretative advice as part of the SM&E pipeline', a report commissioned by and prepared for the ATO's SME Executive, June 2011, pp 15–19 as cited in Above n 38, pp54–56.

3.54 Concerns in relation to the independence of the ATO's objections function were previously examined by the IGT in his 2009 *Review into the underlying causes and management of objections to Tax Office decisions* (Objections Review)<sup>181</sup> and reiterated again in the ADR Review.<sup>182</sup>

3.55 The lack of independence and community confidence in the objection process has diminished the latter's role as a key dispute resolution channel for taxpayers as envisaged in the IGT's objections report.<sup>183</sup> Notwithstanding this, some stakeholder submissions have highlighted recent positive examples of the effectiveness of the objections process in the large business market. In one such example, the taxpayer noted that it was able to engage meaningfully with the objections officer to identify that the dispute turned on a single technical issue which could benefit from early neutral evaluation (ENE). Following the parties' participation in the ENE process, the ATO accepted the neutral evaluator's advice and allowed the taxpayer's objection in full.

3.56 The IGT considers that the positive examples of how effective the objections process can be in resolving disputes reinforces the importance of ensuring that the process is robust, objective and independent and perceived to be so.

### Intra-agency communication

3.57 Stakeholders have observed that there is a lack of robust protocols governing communication between the original decision maker and objections officers. There are no restrictions on objections officers obtaining technical advice from a senior tax counsel within TCN even where that same senior tax counsel gave advice to the audit team which made the original decision in dispute.

3.58 The lack of strong communication protocols has exacerbated stakeholder concerns in relation to the independence of the objection function from the audit area, especially when compared to other jurisdictions where prohibitions against *ex parte* communication exist. Notably, the IRS has an *ex parte* rule governing communications between the original decision maker and the appeals branch. The principle of the *ex parte* rule is enshrined in legislation.

3.59 Whilst the CRA does not have the same explicit *ex parte* rule, protocols require any communication between the original decision maker and the appeals branch to be 'fair, open and transparent' by ensuring that appeals officers keep taxpayers informed of any discussions with auditors.

3.60 The IRD (New Zealand) has communication protocols in place that prevent other parties, such as taxpayers or the original decision maker, from making direct contact with DRU officers. Communication to and from DRU officers are routed through a liaison office that also ensures copies are provided to the other party.<sup>184</sup> The

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181 Above n 39.

182 Above n 42, p 100

183 Above n 39, pp 86, 119-120.

184 IRD, 'Managing communications associated with a dispute referred to the Adjudication Unit' (10 February 2006) <[www.ird.govt.nz](http://www.ird.govt.nz)>.

communication protocols are guided by the two principles of ‘openness and transparency’ and ‘maintaining the independence of the [Disputes Review] Unit so that the impartiality of the team considering a disputed matter is not compromised.’<sup>185</sup>

3.61 While the ATO does issue internal guidance to its staff on the importance of maintaining independence and the perception of independence, this is not accompanied by robust communication protocols or processes. Rather, the ATO has elected to allow its officers to exercise judgment in relation to their conduct and how independence may be maintained and managed. Specifically, it states:

Independence during the review process ensures that tax officers act in an objective and impartial manner, free from any conflict of interest, inherent bias or undue influence. Independence promotes fairness and perceptions of fairness, and minimises the potential for taxpayer dissatisfaction and complaints.

In some circumstances there may be a trade-off between maintaining independence during the review process and the nature and extent to which the reviewer seeks input from the original decision maker. Ultimately, it will be an exercise of judgment on the part of the reviewer.

Contact between the reviewer and the original decision maker provides a degree of continuity and subsequently a better taxpayer experience. Our aim is that taxpayers experience an integrated approach to resolving their dispute. However, this must be balanced with the need to ensure the merits of the dispute are properly re-examined without bias or influence.<sup>186</sup>

3.62 The absence of strong protocols has given rise to both concerns regarding the lack of independence and the objection process being used for an improper purpose, such as to gather evidence to bolster the ATO position. In *Binetter v Commissioner of Taxation (No 3)*,<sup>187</sup> the taxpayer tendered evidence of correspondence passing between ATO officers which suggested that the ATO was using the objection process to gather evidence in anticipation of litigation. Specifically, the correspondence noted:

However, I think that the perception that the matter will proceed to litigation is clearly correct... With this in mind, we need to consider how best to utilise the objection stage to assist with the finalisation of the matter overall.

It has been a typical pattern for this group of cases to refuse to provide information, and then flood the Commissioner with material at the late stages of litigation. The late receipt of the material is the most disadvantageous to the Commissioner. I would therefore recommend that we use the objection stage fully to try to compel additional evidence from the taxpayer at this early stage.<sup>188</sup>

3.63 While the judge in that case did not find that the information requests were used for an improper purpose, the matter illustrates that there is at least a perception issue, i.e. communication between ATO officers in these different functions can give

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<sup>185</sup> Ibid.

<sup>186</sup> Above n 72; ATO, *The Online Resource Centre for Law Administration*, PS LA 2003/9, 28 August 2013.

<sup>187</sup> *Binetter v Commissioner of Taxation (No 3)* [2012] FCA 704.

<sup>188</sup> *Binetter v Commissioner of Taxation (No 3)* [2012] FCA 704 at [93].

rise to perceptions of bias or lack of independence or objectivity and, therefore, there is a need for strong protocols governing such communication.

### Challenging the ATO precedential view

3.64 Stakeholder submissions to the IGT note that objections officers' independence is further reduced due to the ATO policy that all ATO officers, including objections officers are bound to follow the ATO precedential view of the law. For example, the ATO's interpretation of a particular legislative provision may be established in a public ruling.<sup>189</sup> Where the original compliance decision hinges on the ATO's interpretation and the taxpayer's dispute primarily relates to such interpretation, the objection outcome is unlikely to be different since objection officers are bound to follow it. In these circumstances 'the lodgment of an objection is necessarily futile if the reviewing officer is also necessarily bound by the same public ruling.'<sup>190</sup>

3.65 The IGT has previously stated in his Objections Review that:

...objection officers should [not] be able to unilaterally re-examine or redetermine the Tax Office view as this will lead to potential inconsistent treatment of taxpayers. Rather, it is appropriate that where challenges are made to the correctness of a Tax Office view, then these issues are promptly escalated to either the Tax Counsel Network or the Centres of Expertise for timely reconsideration.<sup>191</sup>

3.66 Notwithstanding the existence of an escalation process, submissions made to the IGT during this review have expressed concern that ATO objections officers are not effectively exercising this process to challenge or reconsider ATO precedential views which are incorrect or an exception should exist in the particular case before them. Stakeholders have observed that this can be especially true where officers considering the objections are more junior than the original auditors or the technical officers on whose advice the audit had proceeded.

3.67 Moreover, submissions have also expressed concern that some audit teams have exploited this approach. In support of these claims, one stakeholder has advised that documents obtained by them, under the freedom of information law, suggested that the ATO audit team had facilitated the issue of an ATO Interpretative Decision to effectively bind the objections officer to an ATO precedential view.

3.68 More recently, the IGT's *follow up review into delayed or changed ATO views on significant issues*<sup>192</sup> identified further concerns which may arise where the ATO view of the law is not clearly communicated. In that report, the IGT examined a case study concerning taxpayers' treatment of Offshore Banking Unit general expenses and the ATO's purported application of a changed view retrospectively notwithstanding

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189 Above n 77, para [5].

190 Law Institute of Victoria, Submission 8 to the House of Representatives Standing Committee on Tax and Revenue, *Inquiry into Tax Disputes* (4 July 2014) p 20.

191 Above n 39, p 12.

192 IGT, *Follow up review into delayed or changed ATO views on significant issues* (2014).

evidence raised by taxpayers of prior inconsistent treatment and internal ATO reports noting the inconsistency and prior ATO tacit approval.<sup>193</sup>

3.69 The matter also became subject of Federal Court litigation,<sup>194</sup> which highlighted the limitations of taxpayers' ability to enforce internal ATO administrative processes. This has emphasised the need for the ATO to be clear and transparent in its view of the law and to have robust processes in place to consider the appropriateness of the application of the law to a particular taxpayer's circumstances.

3.70 Submissions have also indicated that even during IR processes, some IR officers have demonstrated a preference to accord with the ATO precedential view (where one existed) and did not appear to consider whether that view properly applied to their specific facts.

3.71 These perceptions have given rise to the view that taxpayers cannot have a fully objective and independent review outside of the AAT or the Federal Court that require resources not within the reach of many taxpayers. This is particularly highlighted by the high rates of ATO decisions which are varied by the AAT or the Federal Court in litigation. As set out earlier in Tables 1 and 2, over a seven year period, the ATO's decision was varied by the AAT or the Federal Court in 75 per cent of all cases which were finalised.

### **Protection and certainty in the objection process**

3.72 The objections process is a mandatory and critical step in the formal Australian tax disputes process. However, in certain cases it may yield no protection or certainty for taxpayers.

3.73 In a particular case raised concerning an audit of a HWI, the ATO issued an amended assessment which adjusted the level of the taxpayer's carried forward losses but did not result in a liability payable for that year.

3.74 The taxpayer lodged an objection against the amended assessment but was advised by the objection team that there were no grounds to object as the amendments did not involve an increase in tax payable. The objections officer noted that they could review the original decision audit material but no binding decision could be issued in respect of the taxpayer's objection. The taxpayer was advised by the objections officer that it could nonetheless claim the loss as a deduction in a later year and that the ATO could revisit the deduction claim in a fresh audit.

3.75 The taxpayer noted that in addition to the lengthy audit, the additional time and costs of pursuing what was ultimately an invalid objection added to the expense of their interactions with the ATO.

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<sup>193</sup> Ibid, pp 16-21.

<sup>194</sup> *Macquarie Bank Limited v Commissioner of Taxation* [2013] FCA 887; *Macquarie Bank Limited v Commissioner of Taxation* [2013] FCAFC 119.

## By-passing mandatory objections

3.76 Unlike the US and the UK (and to an extent, New Zealand), in Australia, taxpayers require an objection decision to be made (or deemed to have been made) before external review rights in the AAT or Federal Court are enlivened. In the US and UK, taxpayers may by-pass the internal processes and have their matter externally reviewed directly. In New Zealand, taxpayers can seek external review directly from an assessment decision, as formal internal review takes place before the assessment decision.<sup>195</sup>

3.77 Stakeholders considered that there should be a mechanism whereby the taxpayer could by-pass or 'opt-out' of the ATO review process in order to expeditiously access external review from the AAT or Federal Court. The IGT has previously made recommendations for the ATO to fast-track certain objections where the dispute is in relation to the ATO view of the law and the facts are agreed.<sup>196</sup>

3.78 Furthermore, in his ADR Review, the IGT recommended that the ATO consult on making use of declaratory proceedings as way of seeking clarification from the Court on a point of law to avoid the associated costs and delay of the Part IVC objections process.<sup>197</sup>

3.79 During the IGT's Large Business Review, stakeholders raised concerns that the ATO was issuing amended assessments near the end of a self-imposed two year time limit, leaving little time for taxpayers to respond to SOAPs or for the ATO to consider taxpayer responses before issuing the amended assessment.<sup>198</sup> As a result, taxpayers submitted that it forced them to use the objection process to 'protect their position' notwithstanding that the ATO's position had not been finalised. This also required the taxpayer to incur additional costs by having to respond to the position paper (SOAP) and prepare the grounds for objection.<sup>199</sup>

## ACCESS TO THE PRE-ASSESSMENT PROCESS

3.80 Taxpayers cannot make an objection until an assessment has been issued to them. However, the issuing of an assessment, as evidenced in the NOA, crystallises a debt due and payable to the Commonwealth which can have significant implications for the taxpayer. These include:

- NOA is conclusive evidence of the due making of the assessment and all of the information contained therein and the taxpayer cannot challenge the assessment save through proceedings under Part IVC of the TAA 1953;<sup>200</sup>

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<sup>195</sup> Tax practitioners in New Zealand have also expressed concerns about the inability of taxpayers to unilaterally opt-out from the legislated pre-assessment dispute procedures. See: New Zealand Law Society and New Zealand Institute of Chartered Accountants, Joint Submission to Inland Revenue, *Disputes: A Review – an Officials' Issues Paper*, July 2010 (Wellington, 3 September 2010) p 24.

<sup>196</sup> Above n 39, recommendation 3.

<sup>197</sup> Above n 42, recommendation 4.3.

<sup>198</sup> Above n 37, p 125.

<sup>199</sup> Ibid.

<sup>200</sup> *Income Tax Assessment Act 1936* s 177; *Taxation Administration Act 1953* Sch 1 s 350-10.



- NOA will render any other proceedings launched by the taxpayer, such as declaratory proceedings, nugatory and confine them to the statutory regime set out in Part IVC;<sup>201</sup>
- the Commissioner can pursue debt collection activity notwithstanding a dispute may be on foot<sup>202</sup> which in itself may have implications for taxpayers seeking to effectively challenge the assessments;<sup>203</sup>
- efforts to stay payment of the full debt, such as 50/50 arrangements,<sup>204</sup> may still require taxpayers to liquidate assets to make such payments, potentially realising losses for the taxpayer;
- the ATO may apply credits for other taxes against the liability, which may otherwise have been refunded to the taxpayer;<sup>205</sup>
- the taxpayer begins accruing interest at the GIC rate from the due date for payment on the amended assessment until the debt is paid;<sup>206</sup>
- such adjustments may lead to taxpayers inadvertently exposing themselves to insolvent trading claims when trying to manage their business and challenging existing ATO liabilities at the same time;
- such adjustments may trigger default clauses in loan and funding agreements with financiers; and
- obligations for certain entities, especially large publicly listed companies, to disclose the tax liability to the market may be triggered,<sup>207</sup> which may adversely affect share prices, existing commercial transactions or financing arrangements.

3.81 Implications such as these led the Ralph Review to observe that ‘satisfactory resolution of the subsequent dispute offers little comfort for taxpayers faced with these potential impacts on issue of the assessment.’<sup>208</sup>

3.82 In one example the ATO had unilaterally offset refunds due to the taxpayer against disputed tax debts, leading to the taxpayer not receiving the expected refund notwithstanding that the taxpayer had sought to pay 50 per cent of the disputed debt pending the determination of an objection. Similarly, submissions have expressed concerns against the use of garnishee notices during tax disputes, especially where these were issued against taxpayers’ business accounts, effectively hampering business as usual and denying access to necessary funds to challenge ATO decisions.

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201 *Platypus Leasing Inc & v Commissioner of Taxation* [2005] NSWCA 399.

202 *Taxation Administration Act 1953* ss 14ZZM and 14ZZR.

203 See for example: *Denlay v Commissioner of Taxation* [2013] FCA 307 at [77].

204 See ATO, *Collection and recovery of disputed debts*, PS LA 2011/4 (December 2014) para [26].

205 ATO, *Offsetting of refunds and credits against taxation and other debts*, PS LA 2011/21, 1 April 2011, para [9].

206 ATO, *Remission of shortfall interest charge and general interest charge for shortfall periods*, PS LA 2006/8 (28 August 2014) para [148].

207 See for example: *Corporations Act 2001* s 674.

208 Above n 31, p 120.

3.83 Having regard to the manner in which the ATO may approach collateral debt collection action, stakeholders have advocated for an effective pre-assessment dispute resolution process for all taxpayers. These stakeholders point to the processes in the US, where disputes may be reviewed by the Office of Appeals before assessments are issued. In the case of New Zealand, the NOPA process is a legislated pre-assessment process which seeks to resolve the substantive tax dispute before the liability is crystallised. Similarly, Ireland's statutory prohibition against debt recovery of disputed liabilities assists to ensure that taxpayers are not denied the opportunity to effectively challenge the accuracy of the assessment.

3.84 A submission to the IGT indicated that a taxpayer had not progressed matters to either the AAT or the Federal Court because demands from the ATO for the payment of 50 per cent of the disputed debt were prohibitive. Other submissions indicated that the 50 per cent requirement may be particularly onerous where the ATO had issued protective assessments (i.e., those assessments which inflate the amount of tax liability to protect the ATO's position).

3.85 The above international comparisons as well as difficulties faced by taxpayers in Australia, highlight the need for an effective review of the ATO's original audit decisions before assessments are issued. Although the ATO provides such a review for the very large taxpayers, through the IR process, the IGT believes that such pre-assessment reviews should be available to all taxpayers. In fact, small business and individual taxpayers are in greater need of such reviews as they are the least likely to be in a position to take the matter to the next stage and ultimately to the AAT and the courts.

3.86 It should be noted that the IGT has already addressed some related issues in recent reviews. In particular, in the *Review into the ATO's administration of penalties* (Penalties Review),<sup>209</sup> to mitigate the impact of paying 50 per cent of disputed debts (including associated penalties) when seeking to challenge ATO assessments, the IGT recommended and the ATO agreed not to require taxpayers to pay penalty amounts until the dispute on the primary tax is resolved.<sup>210</sup>

3.87 The IGT is also currently undertaking a broad review of the ATO's approach to debt collection which, amongst other things, will examine the ATO's processes in relation to the collection of disputed debts.<sup>211</sup>

## The ATO's IR process

3.88 Stakeholders who participated in the ATO's IR process were generally supportive of it. The IGT team engaged directly with those taxpayers and advisers who had participated in the IR process to better understand their experience and seek ideas on potential improvements. Some stakeholders considered that such reviews should be built into the audit process as a form of quality control for the audit rather than as a dispute procedure.

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209 IGT, *Review into the ATO's administration of penalties* (2014).

210 Ibid, recommendation 2.2(a).

211 IGT, *Review into the ATO's approach to debt collection* (2014, in progress).



3.89 It is important to appreciate that the IR process has been limited to only twenty large market cases to date and, therefore, it is not possible to ascertain a broad market segment view of the process. However, some stakeholders who participated in the IR process have identified a number of areas for improvement, including:

- the independence of the IR officers;
- the inability to introduce new facts and evidence for consideration;
- the appropriateness of the IR process to resolve disputes that involve such specialised topics as transfer pricing or valuations;
- a lack of clarity about how the ATO deals with internal disagreement and escalations to the Chief Tax Counsel on critical questions of law including, but not limited to, those with strategic or systemic implications;<sup>212</sup>
- the inability of taxpayers to invite new counsel or advisers to assist in the process where it was suggested that existing advisers may have contributed to the dispute; and
- the weight given to the IR officer's decision with stakeholders being of the view that the process was ineffective where the review's decision is not binding on the ATO.

3.90 Comparisons have been drawn between the above IR process and those of the US Appeals Office, New Zealand's DRU and the Republic of Ireland's internal/external review processes, all of which can issue decisions which bind the respective revenue authorities with few exceptions.

3.91 During the course of this review, the ATO updated its guidance on the IR process to provide clarification on some of the points raised above, such as the instances in which the IR officer may receive new information.<sup>213</sup>

3.92 Certain stakeholders have raised a more fundamental concern regarding the fairness of the IR process being made available only to approximately 1,250 large businesses with annual turnover exceeding \$250 million out of the total taxpayer population of more than 16 million including individuals, small businesses, trusts and self-managed superannuation funds.<sup>214</sup>

3.93 As a fundamental matter of fairness and equity, effective dispute resolution should be available to all taxpayers regardless of resources. The ATO may justifiably devote more resources to ensure that large taxpayers comply with their tax obligations as the risk to Government revenue is generally significant. However, devoting more resources to the objection process or pre-assessment reviews for large businesses than those for small businesses and individuals is more problematic. The reason is that at such stages, whilst risk to revenue remains an issue, a major goal should be to ensure that taxpayers are treated equitably and a fair outcome is achieved.

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212 ATO communication with the IGT, 12 November 2014.

213 Above n 66.

214 Above n 4, p v.

3.94 Furthermore, as the ATO's statistics indicate, 96.8 per cent (21,756 out of 22,455) of all objections arising from audits are attributable to small businesses and individual taxpayers.<sup>215</sup> Given the significant proportion of disputes attributable to small businesses and individuals, it is imperative that the ATO provides at least the same level of dispute prevention and resolution mechanisms to these market segments including providing access to effective and efficient pre-assessment reviews.

3.95 The IGT notes that certain processes with elements of pre-assessment review are available to individual and small business taxpayers, such as the administrative reversals process for data matching and income integrity cases and in-house facilitation for less complex disputes. However, these processes do not occur prior to NOAs issuing and do not involve a reconsideration of the merits of the case by a person outside of the Compliance Group. For these taxpayers, an early reconsideration of their matter with 'fresh eyes' is critical.

3.96 This is highlighted in a number of highly publicised individual taxpayer disputes. In one case, the ATO had raised a large tax liability against which the taxpayer was unable to have reconsidered afresh by an ATO officer until he inadvertently managed to speak directly with the Commissioner. Following that discussion, a senior ATO officer was appointed to review the matter which led to a significant reduction in his assessment. However, this only occurred after many years of seeking to deal with the ATO and incurring significant costs in the process.

3.97 Moreover, the availability of the above processes would assist to address the risk of some individual and small business taxpayers being reluctant to raise issues or disputes with the ATO. As will be discussed in the next section, whilst cost is a factor in taxpayer decisions concerning dispute resolution, there may be other issues such as fear of being targeted by the ATO in the future.<sup>216</sup>

## **BARRIERS TO ACCESS TO JUSTICE**

### **Costs**

3.98 The AAT and the Federal Court offer avenues for external and independent reconsideration of decisions made by the ATO. As discussed earlier, the AAT is empowered to 'stand in the Commissioner's shoes' and substitute its own decision for that of the Commissioner, whilst the Federal Court may judicially review the legal correctness of the decision that was made.

3.99 However, access to these external avenues is constrained due to the time and costs associated with such challenges. The issue was most recently examined by the Productivity Commission in its *Access to Justice Arrangements* report which identified that the high costs of litigation may prevent people, particularly small businesses and individuals, from seeking legal remedies, discourage them from seeking legal advice or

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215 ATO, Submission 10 to the House of Representatives Standing Committee on Tax and Revenue, *Inquiry into Tax Disputes* (4 July 2014) p 40.

216 Above n 164, p 5.

lead them to settle or withdraw their claims.<sup>217</sup> It should also be noted that whilst large businesses and HWIs may have access to more resources than other taxpayers, their disputes typically involve complex issues which often require highly specialised and costly financial and legal advice. Therefore, costs may be proportionally higher and may also act as a barrier for these taxpayers.

3.100 Tax disputes involve significant direct financial and opportunity costs which are incurred both upfront and progressively throughout the dispute. Taxpayers may also be obliged to expend resources to engage tax practitioners and other advisers to work with the ATO on initial risk reviews and audits. Further expenses may be incurred through pre-assessment engagement, objections and ultimately litigation. While it is not possible to precisely assess all the costs incurred by every taxpayer, examples which have been raised with the IGT indicate that these costs may range from hundreds to thousands to millions of dollars, even before the litigation stage.

3.101 Stakeholders have also noted that the cost of litigation may be prohibitive, especially for smaller taxpayers.<sup>218</sup> Submissions have also indicated that, in certain cases, the costs of disputes are such that they may be ruinous to the taxpayers who have to bear them. One example highlighted a case in which the costs already incurred, prospects of further costs of challenging the ATO together with the adverse negative health impacts have led the taxpayer to offer settlement with the ATO notwithstanding that they disagree with the ATO's position.

3.102 In the AAT, litigants bear their own costs and cannot recover them from the other party. A 2012 study estimated that personal costs incurred by represented taxpayers in the AAT were between \$5,634 and \$6,684 in the Taxation Appeals Division. For represented taxpayers using the Small Taxation Claims Tribunal (STCT), the costs were more likely to be between \$4,094 and \$4,794.<sup>219</sup> As the limit for the amount of tax in dispute to access the STCT is \$5,000, taxpayers who wish to use the STCT may find it uneconomical to do so if they also wish to obtain professional advice.

3.103 In the Federal Court, successful litigants are unlikely to be awarded the full extent of costs expended. The successful party is usually awarded costs on a party-party basis which generally accounts for only 60-75 per cent of the actual costs.<sup>220</sup>

3.104 As discussed earlier, costs are further compounded by the ability of the ATO to undertake debt recovery action while matters remain in dispute<sup>221</sup> or demand payment of 50 per cent of the disputed debt before recovery action is suspended. This power gives the ATO considerable leverage over taxpayers and has resulted in some instances where the taxpayer was unable to pursue the appeal due to a lack of resources.<sup>222</sup>

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217 Productivity Commission, *Access to Justice Arrangements* (2014) pp 123-124.

218 Binh Tran-Nam and Michael Walpole, 'Access to tax justice: How costs influence dispute resolution choices,' (2012) 22 *Journal of Judicial Administration* 3, p 3

219 Ibid, p 26. The study estimated the costs of an unrepresented litigant to be \$2,484 in the AAT and \$1,994 in the STCT.

220 Above n 217, p 455.

221 *Taxation Administration Act 1953* ss 14ZZM and 14ZZR.

222 *Denlay v Commissioner of Taxation* [2013] FCA 307.

## Other barriers

3.105 In addition to the time and cost factors, it is important to recognise that there are other barriers which prevent access to these external forums.

3.106 Firstly, there may be an imbalance of bargaining power and experience. As the Productivity Commission has observed:

The effectiveness of the adversarial system is premised on parties being on an equal footing, but this is not always the case. Differences in the bargaining power of litigants are most evident when comparing the two extremes – self-represented litigants and well resourced, repeat users of the system, such as governments and big businesses.<sup>223</sup>

3.107 The ATO is one of the largest Government agencies which, by necessity, has monopoly power and significant resources. Accordingly, it is considered to have considerable advantage over the vast majority of taxpayers, particularly small businesses and individuals, when dealing with legal disputes.

3.108 Secondly, the taxation and superannuation system is extremely complex and may operate as a barrier to access justice. This is especially true of taxpayers who are self-represented and who may not be able to articulate their positions to sufficiently raise concerns in relation to ATO decisions.

3.109 Thirdly, there is a concern that taxpayers who challenge ATO decisions feel that they will be targeted and may therefore be the focus of more intensive action in the future.<sup>224</sup>

3.110 Finally, there are reputational issues associated with litigation which often play out in a public forum. For many HWIs and large businesses, the potential for adverse reputation risks will have a direct bearing on decisions in relation to tax risk positions being adopted.<sup>225</sup>

3.111 Thus, while some taxpayers may appear to have the option of seeking legal redress against ATO decisions in external forums, they may feel that they are not in a position to do so. Accordingly, it is particularly important in such cases that there are appropriate internal mechanisms to have the decisions independently and objectively reconsidered.

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<sup>223</sup> Above n 217, p 17.

<sup>224</sup> Above n 164, p 5.

<sup>225</sup> Catriona Lavermicocca and Jenny Buchan, 'Role of reputational risk in tax decision making by large companies' (Working paper delivered 11th International Conference on Tax Administration, 5 April 2014).

## MANAGEMENT OF LITIGATION

### Reducing litigation levels

3.112 Efficient dispute management is generally typified by early engagement and timely use of ADR. A lack of these two elements usually results in protracted disputes, unnecessary litigation, mounting costs and frustrations.

3.113 Following the implementation of IGT recommendations relating to settlements and dispute resolution, the ATO has reported both a general increase (with the exception of a decline in 2011–12) in the number of settlements across all market segments as well as an increase in the number of pre-litigation settlements. These statistics are set out in Table 5 below.

**Table 5: Stage at which settlements (across all market segments) occurred**

| Settlement stage | 2010–11    | 2011–12    | 2012–13    | 2013–14    |
|------------------|------------|------------|------------|------------|
| Pre-audit        | 10         | 15         | 23         | 21         |
| Audit            | 86         | 88         | 144        | 166        |
| Objection        | 65         | 62         | 77         | 114        |
| AAT              | 131        | 53         | 82         | 72         |
| Federal Court    | 12         | 38         | 13         | 20         |
| Other            |            | 3          |            |            |
| <b>TOTAL</b>     | <b>304</b> | <b>256</b> | <b>339</b> | <b>393</b> |

Source: ATO website; Commissioner of Taxation Annual Report 2013–14.

3.114 As Table 5 indicates, the proportion of settlements occurring before litigation has increased from 53 per cent in 2010–11 to 64 per cent, 72 per cent and 77 per cent in the three years which followed. These increases suggest that the ATO is becoming better at early engagement and the use of ADR, leading to more efficient and effective resolution of disputes.

3.115 However, during this review, examples have again been raised with the IGT which suggested that cases were unnecessarily progressing to litigation where simple factual matters were eventually unearthed which resolved the matter. In one case, involving luxury car tax, the question of whether the taxpayer had appropriately quoted its Australian Business Number at the time of importing (and therefore, whether the taxpayer was in fact liable for the tax) was not discussed until the Federal Court Scheduling Conference whereupon the matter was withdrawn.

3.116 Statistics published by the AAT and the Federal Court,<sup>226</sup> in Table 6 below, also suggest that cases are still progressing to litigation where a dispute should not have arisen or should have been resolved at an earlier stage. Table 6 shows that the numbers of filings in the AAT (excluding the STCT) have increased over the past five years. In the STCT, the filing of small claims (less than \$5,000 or reviews of

<sup>226</sup> Federal Court of Australia, *Annual Report 2013–14*, p 152; Administrative Appeals Tribunal, *Annual Report 2013–14*, p 28; Administrative Appeals Tribunal, *Annual Report 2012–13*, pp 30–31; Administrative Appeals Tribunal, *Annual Report 2011–12*, p 26.

decisions not to release taxpayers from tax debts) increased dramatically between 2010–11 and 2011–12. While there has been a decrease in the past two years, filings in the STCT remain above 200.

3.117 In the Federal Court, Table 6 shows that the numbers of filings have fallen from 171 in 2009–10 and 235 in 2010–11. However, over the past three years, there appears to be a year-on-year increase in the number of filings with 130, 140 and 160 being filed in 2011–12, 2012–13 and 2013–14, respectively.

**Table 6: Taxation matters commenced in the Federal Court of Australia and Administrative Appeals Tribunal**

| Financial Year | Number of tax matters filed in the Federal Court | Number of tax matters filed in the AAT (excl STCT) | Number of tax matters filed in the STCT |
|----------------|--|--|---|
| 2013–14        | 160  | 1798   | 219                                     |
| 2012–13        | 140  | 1471   | 207                                     |
| 2011–12        | 130  | 1438   | 274                                     |
| 2010–11        | 235  | 1103   | 73                                      |
| 2009–10        | 171  | 994  | 59                                      |

Data source: Federal Court of Australia and the Administrative Appeals Tribunal

3.118 Notwithstanding that the numbers of filed litigation cases has generally increased, statistics also indicate that the majority of these matters were finalised without hearing. In the AAT, for example, the ATO reports that 85 per cent of matters were finalised without hearing in 2013–14.<sup>227</sup>

3.119 Whilst it is not possible to reconcile the numbers of matters resolved before hearing and litigation cases filed (owing to differences in the way disputed cases are reported by the ATO, AAT and Federal Court and the long-running nature of some litigated disputes), the combination of increased filings in the AAT and Federal Court and higher incidence of matters resolving without formal hearings suggest that there is room for improvement in terms of early engagement and resolution. This aligns with the stakeholder concerns discussed earlier that some ATO officers remain reluctant to engage and taxpayers have ongoing difficulties in identifying appropriate senior technical personnel to discuss more complex issues until taxpayers bring the matter to litigation.

3.120 A more defined framework for the management of disputes, including through appropriate escalation channels for taxpayers, who are unable to engage with ATO audit officers, would greatly assist to improve efficiency with which the ATO resolved disputes and avoid matters proceeding to litigation unnecessarily.

## Independence of the litigation function

3.121 Submissions to the IGT's review also commented that the ATO should outsource its instructing solicitor function to the private sector. Stakeholders have

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<sup>227</sup> Above n 4, p 75.



commented that it is ideal for there to be a separation between the client and the solicitor, as the solicitor can provide impartial advice and appropriately brief Counsel.

3.122 Concerns regarding the necessary degree of independence of the ATO's in-house solicitors has been raised previously in the Federal Court:<sup>228</sup>

It is a matter of concern to me in this case that the objective detachment which is an incident of a truly independent solicitor acting for the Commissioner has not been apparent. That is not in any way to criticise counsel but, rather, to emphasize the singular importance of an independent solicitor acting for a client. That role is to act as something of a reality check for a client. Where a solicitor is in house, and [the Australian Taxation Office Solicitor] has that status, there is a risk which must constantly be guarded against of client capture. I was left to wonder on the hearing of this application, having regard to the material before me, whether that particular phenomenon had occurred here.

3.123 Similar concerns have also been expressed in submission to this review, noting that ATO litigation officers representing the Commissioner at the AAT or the Federal Court often had to revert to the business line before decisions could be made on the progress of litigation. The influence of the compliance business lines has given rise to further concerns that the ATO's litigation is not empowered or able to bring an independent mind to bear on the merits of a litigation case.

3.124 The influence of the compliance business line over the appeals process has also been raised with the Committee in its public hearings with a tax practitioner witness noting:

More particularly – and more close to heart for me in attending to the appeals in the tribunal – the business line should have zero input to the appeal process. They are not witnesses to anything. They bring nothing to the factual matrix, and they should not be part of that process at all. But they seem to dictate the appeal process and appeal decisions in the tribunal, in terms of what the appeals officer does, and I think that is just plainly wrong.<sup>229</sup>

3.125 During this review, a case example has been brought to the IGT's attention which illustrated the influence of the ATO's business line over the litigation function resulting in an appeal being lodged against Counsel's advice that the prospects of success were poor. In addition, the case also highlights a potential breach of the *Legal Services Directions 2005*. Further discussion of this is set out in Chapter 5.

3.126 Stakeholders also commented that the ATO appears to lack a key senior decision maker who is responsible for all litigation in the ATO. It has been suggested that the absence of ownership of litigation decisions by a senior officer within the ATO makes it easier for the Compliance Group to exercise control over the process.

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<sup>228</sup> *Deputy Commissioner of Taxation v Prentice (Trustee)* [2011] FCA 1535 at [26].

<sup>229</sup> Above n 164, p 2.

## ATO costs

3.127 In addition to costs incurred by taxpayers discussed above, the early resolution of disputes and the ATO's management of litigation also has a direct bearing on its own legal expenditure which can be very significant.

3.128 The ATO has reported that in 2013-14 it incurred \$100,508,314 in legal expenditure.<sup>230</sup> This amount represents a decrease from the prior year total of \$106,147,281 but is higher than the \$96,323,087 reported in 2011-12, respectively.<sup>231</sup> In each of 2011-12, 2012-13 and 2013-14 financial years, the ATO reported that Part IVC litigation expenditure was \$43,864,684 (45.5 per cent of total legal expenditure), \$44,346,431 (41.7 per cent of total legal expenditure) and \$38,744,755 (38.5 per cent of total legal expenditure) respectively.

3.129 Having regard to the high levels of costs and the significant impacts on taxpayers, it is essential that litigation is appropriately managed and resolution is effected as early as possible to ensure that the parties are not exposed to the unnecessary expense. To an extent, the Federal Court's Tax List Directions introduced in April 2008, and subsequently re-issued as Practice Note TAX1, seeks to reduce unnecessary expenses by ensuring the parties clearly articulate the reasons for litigation and the questions needing to be put to the Court.<sup>232</sup>

3.130 In the ADR Review, the IGT sought to ensure that the ATO and taxpayers adopted this collaborative mindset early in the process to consider appropriate options and channels to resolve the dispute and minimise the cost exposure in litigation through achieving a common understanding of the areas of disagreement and exploring alternatives, such as declaratory proceedings.<sup>233</sup>

## Test case litigation and law clarification

3.131 Concerns have also been raised with the ATO's administration of the test case litigation funding program. In particular, stakeholder submissions have raised concern regarding the apparent inconsistency with which such decisions are made, including denying well-resourced taxpayers access to funding notwithstanding that those cases were intended to clarify the law for the benefit of the broader community. While it is acknowledged that the ATO does provide funding on a number of cases each year where there is a public benefit in testing the issue, submissions to the IGT on this and earlier reviews have indicated difficulty accessing such funding and inconsistencies in the ATO's decisions in this regard.

3.132 The issue was explored in the IGT's ADR Review<sup>234</sup> in which the IGT outlined concerns regarding the cost implications to taxpayers whose cases are used for law clarification without funding. Those concerns remain relevant for this review.

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<sup>230</sup> Above n 4, p 114.

<sup>231</sup> Commissioner of Taxation, *Annual Report 2011-12* (2012) p 102; Commissioner of Taxation, *Annual Report 2012-13* (2013) p 156.

<sup>232</sup> Federal Court of Australia, 'Practice Note TAX1' (1 August 2011) <[www.fedcourt.gov.au](http://www.fedcourt.gov.au)>.

<sup>233</sup> Above n 42, pp 37-38 and 61.

<sup>234</sup> Above n 42, pp 51-59.



3.133 Following publication of the ADR report, further concerns were raised with respect to the ATO's approach to test cases. In particular, concern was raised in instances where the ATO obtained its desired outcome and ceased to further fund appeals which the taxpayer may lodge.<sup>235</sup> The IGT had previously expressed the view that funding should be provided to ensure that the highest level of judicial clarification may be sought on ambiguous technical issues. To do otherwise would not deliver the full benefit of judicial clarification from a taxpayer perspective. Indeed, it would serve as a further example of the power imbalance in the ATO's favour and a barrier for taxpayers accessing the justice system.

3.134 The ATO is presently undertaking consultations to update its test case litigation program and the criteria for funding. This was recommended by the IGT in his ADR Review.<sup>236</sup> As at the date of this report, that consultation is still in its early stages and no material is yet available for review.

## TRANSPARENCY AND ACCOUNTABILITY OF SETTLEMENTS

3.135 The IGT had previously reviewed aspects of the ATO's approach to settlements and made a number of recommendations to improve, amongst other things, the ATO's approach and conduct, decision making and reporting on settlements.<sup>237</sup> During the course of the review, the ATO also released its refreshed Code of Settlement and accompanying practical guide<sup>238</sup> which seeks to provide more streamlined advice and guidance on the ATO's settlement approach.

3.136 Stakeholder submissions to this review have acknowledged that in recent years, the ATO has adopted a less rigid and more commercial approach to settlement of tax disputes which has been largely welcomed by taxpayers, including large businesses. However, whilst the ATO's increased willingness to enter into settlements has been welcomed by stakeholders, it has also given rise to some concerns.

3.137 Firstly, stakeholders have expressed concern that increased settlements may lead to fewer cases being litigated and therefore a lack of certainty may emerge in the long term with fewer instances of judicial clarification, resulting in ATO-issued guidance and advice becoming the predominant source of interpretation of tax law.

3.138 Secondly, it has been suggested that a certain degree of tension between taxpayers and revenue authorities supports the health of the system by ensuring that contentious issues are challenged and judicially tested. Where this does not occur, it may give rise to a 'pendulum' effect in which higher levels of settlements may lead to taxpayers adopting riskier positions which are ultimately sought to be clawed back through more intensive compliance activity and litigation.

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235 *Commissioner of Taxation v Greenhatch* [2012] FCAFC 84; *Greenhatch v Commissioner of Taxation of the Commonwealth of Australia* [2013] HCATrans 104.

236 Above n 42, recommendation 4.2.

237 Above n 40, p 2.

238 ATO, *Code of Settlement*, PS LA 2015/1 (15 January 2015); ATO, 'Code of Settlement' (15 October 2014) <[www.ato.gov.au](http://www.ato.gov.au)>; ATO, 'A practice guide to the ATO Code of Settlement' (15 October 2014) <[www.ato.gov.au](http://www.ato.gov.au)>.

3.139 Thirdly, there are some stakeholder concerns that a lack of transparency and monitoring of ATO settlement decisions may give rise to perceptions that the ATO's approach has been more of a 'horse trade' and not based on cogent legal advice on technical merits and risk of litigation. Stakeholders have also suggested that perceptions of favouritism or inconsistency may also emerge as was the case in the UK.<sup>239</sup> However, stakeholders have also noted that the proper management of settlements should not be overly bureaucratic or unnecessarily hamper the settlement process.

3.140 Finally, where settlements are not adequately overseen, the settlement process may be improperly used by some ATO officers to achieve outcomes which are inconsistent with settlement principles and the ATO's approach to early resolution of disputes. For example, in the *Review into aspects of the Tax Office's settlement of active compliance activities* (Settlements Review),<sup>240</sup> the IGT observed that settlement offers were made which were inconsistent with the ATO view being developed simultaneously.

3.141 Another example which was contained in a submission to this review involved a taxpayer lodging an objection during which the objections officer acknowledged that the legacy issues were complex and had no further application on future transactions. Accordingly, the objections officer and the taxpayer entered settlement negotiations to resolve the matter. While an 'in principle' agreement was reached, the taxpayer received a call from a senior audit officer who had sought to intervene and withdraw the negotiated settlement. The matter was ultimately resolved but only after the taxpayer escalated the matter to the highest levels within the ATO.

3.142 In another case, the taxpayer submission noted that the ATO had sought to use suspensions of debt collection as leverage for the settlement negotiation process and that following the taxpayer's rejection of a proposed settlement, the ATO commenced recovery proceedings of the disputed debt.

## THE NEED FOR REFORM

3.143 As noted earlier, the ATO, by necessity, is a monopoly service provider with considerable power. These powers need appropriate checks and balances.<sup>241</sup> This is reflected in the stakeholder concerns raised in relation to the increasing centralisation of functions within the ATO, in comparison with other overseas jurisdictions. Addressing such concerns and ensuring there are appropriate checks and balances requires the establishment of a strong and sustainable governance framework.

3.144 The IGT had previously noted, in the Tax Forum Submission, that governance is a key lynchpin in any tax system as 'the approach of tax administrators has a direct bearing on policy implementation and taxpayer confidence through application of fairness, certainty, transparency, minimisation of compliance costs and reduction in

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239 National Audit Office (UK) *Settling large tax disputes* (2012) p 12.

240 Above n 40, pp 25-26.

241 House of Representatives Standing Committee on Tax and Revenue, *2013 Annual Report of the Australian Taxation Office* (March 2014), pp 32-33.

unnecessary complexity.’<sup>242</sup> The IGT also set out an integrated package of options to develop a more effective and comprehensive set of governance arrangements for the ATO, including:<sup>243</sup>

- (1) Establishment of a management board (such as those of an advisory or supervisory nature) to bring into the ATO a diverse mix of expertise and experience including information technology, human resources, finance and communication.<sup>244</sup>
- (2) Appointment of additional Second Commissioners from the private sector to diversify the ATO Executive Committee, inject a wider range of experiences and perspectives and also provide intelligence on trends in corporate governance and taxation risks. These additional Second Commissioners to be appointed to lead the more contentious areas of the ATO, including one as head of a separate appeals area.
- (3) Enhancement and centralisation of the ATO scrutineer function to provide a single port-of-call for taxpayer grievances with tax administration, be they specific disputes or systemic issues. A more co-ordinated approach to ATO scrutiny would also minimise duplication and the cost of external scrutiny.

3.145 Since that submission was made, the Government has announced that it would transfer the current tax complaints handling function from the Commonwealth Ombudsman to the IGT.<sup>245</sup> Moreover, some of the most senior ATO executives have been appointed from the private sector, including the current Commissioner who has ‘promised to change the culture of the ATO’ and has embarked on initiatives towards that end.<sup>246</sup>

3.146 The preceding discussion in this chapter has highlighted a number of major issues permeating all stages of the tax disputes process and reaffirmed the importance of robust governance and oversight. Whilst recognising that there have been substantial improvements made in more recent years, stakeholders have also observed that the present system is too dependent on the views and ideals of ATO senior executives of the day.<sup>247</sup>

3.147 The extent of the influence of a few individuals on the ATO approach and culture has been likened to a benevolent dictatorship whereby such individuals are afforded discretion to act in the best interests of the community. However, such an approach is untenable in the long term as there is no safeguard or framework within which desirable approaches and processes may be embedded. The views of the current senior executives may change or they may be replaced by others with different views.

3.148 Accordingly, the majority of submissions made to the IGT, in this review, have advocated structural reform to the management of tax disputes such that

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242 Above n 33, p 1.

243 Ibid.

244 See also: *Competition Policy Review* (Ian Harper, Chairman) (Draft Report, 2014) pp 62-63; Organisation for Economic Cooperation and Development (OECD), *The Governance of Regulators* (2014) p 69.

245 Australian Government, *Budget 2014–15 Budget Paper No 2* (2014) p 217. See also: Tax and Superannuation Laws Amendment (2014 Measures No. 7) Bill 2014 sch 2.

246 Chris Jordan, ‘Reinventing the ATO – building trust in Australia’s tax administration’ (speech delivered to the 11th International Tax Administration Conference, 14 April 2014).

247 See for example: Above n 172, p 16.

enduring benefits are realised and there is less dependence on the views and ideals of the ATO leadership team of the day. As previously noted, the IGT has had the benefit of collective experience drawn from a range of his earlier reviews as well as this review. Based on this experience, the IGT supports the need for structural reform and a key governance framework. Such a framework needs to have built in accountability such that key performance indicators and management outcomes are measured against delivery.

3.149 The options for reform are explored in the next chapter.

## CHAPTER 4 — OPTIONS FOR REFORM

4.1 As mentioned in the previous chapter, the majority of the submissions to this review have advocated for structural reform to address the underlying causes of the concerns raised. Three main options have been put forward:

- one submission has suggested maintaining the status quo and focusing efforts on improving better dispute resolution and management practices throughout the ATO;
- a small number of submissions suggested establishing an agency separate from the ATO to manage and resolve tax disputes, including litigation, between the ATO and taxpayers; and
- the majority called for the creation of a separate area within the ATO to facilitate and manage the resolution of tax disputes – some have publicly voiced these views.<sup>248</sup>

### MAINTAINING THE STATUS QUO

4.2 One stakeholder expressed the view that due to the positive changes which have been implemented by the ATO over the past 18 months, structural changes may not be necessary as yet. However, it was noted that it is critical for the ATO to ensure that appropriate time and resources are devoted to maintaining the independence and effectiveness of the pre-assessment review processes within the current administrative framework.

4.3 Notwithstanding the positive reception of the ATO's more recent changes, it is also necessary to note that these positive initiatives have been introduced in the pilot stage at the discretion of its senior executives, are available to a limited number of taxpayers and are administrative in nature.

4.4 Moreover, it is important to note that these changes, including the removal of objections from the Compliance Group to the Law Group for the taxpayers with turnover of more than \$100 million<sup>249</sup> and the introduction of the IR process for taxpayers with turnover of \$250 million or more,<sup>250</sup> have largely been applied towards the resolution of older cases which had been managed or overseen by senior staff who are no longer with the ATO. It is less clear how effective these processes will be when existing senior leadership within the ATO play a greater role in formulating or approving initial decisions which are subsequently the subject of an IR or objection.

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<sup>248</sup> Robert Jeremenko, 'Tax disputes and the ATO – change on the way?' *Taxation in Australia* Vol 49(4) p 189.

<sup>249</sup> Above n 58.

<sup>250</sup> Above n 66.

4.5 The IGT considers that the present system is too dependent on administrative discretion which could be substantially altered at any time and is available to a relatively small number of taxpayers. Accordingly, and having regard to the matters set out in the previous chapter, the IGT is of the view that merely maintaining the status quo, notwithstanding that further resources may be directed to improving processes, would not provide longer term certainty and enduring benefits for the community.

## **A SEPARATE AGENCY TO MANAGE TAX DISPUTES**

4.6 The need for independent and objective management and resolution of disputes, for all taxpayers, is critical to maintaining community confidence with the ATO's pre-assessment review and objection processes and the ATO as administrator. However, it has been noted that by definition, internal reviews (such as objections) can never be completely independent of the original decision maker as, ultimately, all decision makers are accountable to the same agency head.<sup>251</sup>

4.7 The purest and most definitive form of independence as regards ATO decisions would be the creation of a separate agency to manage tax disputes. Like the AAT and the judiciary, a separate agency would not be subject to direction from the Commissioner and would not be beholden to ATO culture, policies or internal decisions. Moreover, it would have no financial dependency on the ATO and would have minimal or no conflicts of interest.

4.8 Some stakeholders, in their submissions to the IGT, have advocated for the creation of such an agency. They have contended that such an agency would yield a number of benefits for taxpayers and for the tax administration landscape more generally as a result of the actual and perceived independence from the ATO. Such an agency would also improve the transparency and accountability of the management of tax disputes as it would report directly to the Government on these issues. More importantly, a separate agency would be able to recruit and retain new staff who, over the longer term, would be less likely to have been affected by any cultural bias or management priorities from within the ATO. It would be able to challenge existing ATO views and assess the merits of litigating cases without any undue influence from the original decision makers.

4.9 It was also noted that if the ATO was already taking steps to separate certain functions, as evidenced by the transfer of certain objections from the Compliance Group to the LD&P Group, then an agency separation would only require a small step beyond what the ATO is already undertaking.

4.10 The Commissioner has, however, publicly rejected such a proposal and provided his view on the matter as follows:

Turning to the appeal process generally, the ATO is not aware of any jurisdiction where the appeals function is conducted by a separate agency from the revenue authority. We do not believe this would be an effective way to conduct a tax review or

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251 ARC, *Better Decisions: Review of Commonwealth Merits Review Tribunals* (1995) p 122.

appeals function. It would add considerable delay and cost to the dispute-resolution process and would not be conducive to promoting a productive relationship between the revenue authority and taxpayers. It would also be inefficient to place a separate function between the revenue authority and the courts as a substitute to an appeals function within the revenue authority.<sup>252</sup>

4.11 Representatives of the Treasury have also indicated that there is little merit in the establishment of a separate agency provided there is appropriate separation within the agency.<sup>253</sup>

4.12 The IGT considers that the creation of a separate agency represents the highest possible level of independence (and the perception of independence) in the management and resolution of tax disputes. However, the IGT also recognises that the creation of a new agency presents certain challenges.

4.13 Firstly, the creation of a separate agency would increase the costs for the Government over and above the other options raised, such as the creation of a separate appeals area within the ATO. These costs relate to securing accommodation, corporate services and staff recruitment and may be too high a price for such levels of independence.

4.14 Secondly, where the new agency is largely staffed by transferring relevant personnel from the ATO, there is a risk that the cultural biases and concerns regarding independence may persist. Alternatively if staff are recruited from outside the ATO, it may take time for these new recruits to develop within the new agency and this may lead to delays in the resolution of disputes.

4.15 Thirdly, a separate agency which is empowered to re-examine cases and substitute its own decision for the ATO's decision may overlap with the existing functions of the AAT which currently undertakes merits reviews of ATO decisions. Consequently, taxpayers will effectively have two administrative review forums.

4.16 Finally, it has been suggested that a separate agency would hamper the development of effective feedback loops to improve original ATO audit decisions and that feedback would be more effective where the functions were maintained within the same organisation. This issue is further discussed later in this chapter.

4.17 While there may be challenges to the creation of a separate agency, the IGT does not believe that the suggestion should be immediately discounted. This option should remain open to the Government, to be considered if significant issues persist following full implementation of the ATO's current initiatives as enhanced by the findings of this report, the report of the House of Representatives Standing Committee on Tax and Revenue's Inquiry into Tax Disputes and the Government's White Paper on the Reform of Australia's Tax System.

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252 Above n 160, p 2.

253 Ibid, p 3.



## A SEPARATE APPEALS AREA WITHIN THE ATO

4.18 The majority of submissions made to the IGT favoured the creation of a separate group under independent leadership within the ATO to manage tax disputes.

4.19 Current practices and structures in a number of international revenue jurisdictions demonstrate a preference for a separation of the appeals and primary decision making functions.

4.20 As set out in detail earlier in the report, the US's IRS Office of Appeals is responsible for the internal appeals function and is 'an independent organization within the IRS whose mission is to help taxpayers and the government resolve tax disagreements'<sup>254</sup> quite distinct from the compliance function. It also offers a mediation service to assist the taxpayer resolve any disputes at the earliest possible point during the audit or collection process.<sup>255</sup> Similarly, the CRA also has a dedicated and separate Appeals Branch which also reports directly to the head of the agency.

4.21 New Zealand's IRD manages tax disputes through its DRU which is structurally separate from the audit team.<sup>256</sup> It should be noted that although the UK's HMRC does not have a functionally separate internal appeals area, as these are subsumed into the compliance areas, oversight on its settlement and dispute resolution processes is provided by the Tax Assurance Commissioner who reports directly to the Chief Executive of HMRC.<sup>257</sup> Such arrangements provide increased public assurance and transparency on the independence of review decision making.

4.22 As discussed in Chapter 2, the ATO historically had an internal structural separation between its primary decision makers and its internal reviewers in the form of the ARG<sup>258</sup> until it was subsumed into the different compliance business lines in the 1990s.<sup>259</sup>

4.23 In a similar vein, the IGT has previously called for the creation of an internal appeals and review group which is separate from the rest of the ATO and reports directly to the Commissioner. In his ADR Review,<sup>260</sup> the IGT noted that such a structure would enhance both the actual and perceived independence of officers conducting reviews of primary decisions and, thereby, instil greater public confidence in the ATO as an administrator.

4.24 The need for a separate and distinct internal separation was considered by the Administrative Review Council (ARC) who have stated:

...perceptions that internal review officers are not sufficiently independent of agency decision makers can arise from their physical proximity. Further, if internal review officers have close links with the decision makers whose decisions they review, there

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254 IRS, 'Appeals' (6 October 2014) <[www.irs.gov](http://www.irs.gov)>.

255 Ibid.

256 Above n 119.

257 HMRC, 'Message from Edward Troup, HMRC's Tax Assurance Commissioner' (undated) <<http://www.hmrc.gov.uk/adr/edward-troup-message.htm>>.

258 Above n 6, pp 166-167.

259 Commissioner of Taxation, *Annual Report 1993-94* (1994) pp 10 and 11.

260 Above n 42.

is a danger that those internal review officers will lose the objectivity required for undertaking internal review effectively.<sup>261</sup>

4.25 The IGT continues to be of the view that a distinct group within the ATO should be responsible for the management of tax disputes. The majority of the submissions to this review have also advocated the creation of such a group. The IGT's view and observations regarding the need for such a group and how it can address the concerns raised in the previous chapter are explored further below. For the purposes of the discussion, this group will be referred to as the Appeals Group.

## **Improving availability and effectiveness of pre-assessment review of ATO decisions**

4.26 Having regard to the matters previously discussed on the impact of assessments issuing, including for some large businesses who may need to publicly disclose such matters, it is important to have clear and independent processes to reconsider proposed ATO decisions prior to finalisation and assessments being issued. The key benefits of an effective pre-assessment review are:

- an independent and 'fresh set of eyes' over the initial decision as a form of quality assurance before the dispute escalates;
- a circuit breaker between auditors and taxpayers where the parties' positions become intractable;
- engagement with taxpayers to achieve a common understanding of the issues in dispute and identify strategies to address those;<sup>262</sup> and
- to improve fairness, access to justice and address any power imbalances.

4.27 As discussed earlier, the ATO has implemented some procedures to informally review ATO decisions and resolve disputes as early as possible without resort to the objections process or litigation. Some of these informal processes occur prior to the issue of an NOA, such as through direct early engagement between the taxpayer and the ATO audit officers or the IR process<sup>263</sup> while others may be applied at any time during the audit and objection processes, such as in-house facilitation<sup>264</sup> or the use of different types of ADR.<sup>265</sup> Some of the ATO's processes are only used after an NOA has issued but before the period to lodge an objection has expired, such as the administrative reversals process used in relation to data matching and income integrity cases.<sup>266</sup>

4.28 In addition to examining the purely technical aspects of a case, it has been suggested that considerations of appropriate procedure and conduct, issues of fairness

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<sup>261</sup> Above n 251, p 122.

<sup>262</sup> Above n 218, p 3.

<sup>263</sup> Above n 66.

<sup>264</sup> ATO, 'Facilitation Process' (14 October 2014) <[www.ato.gov.au](http://www.ato.gov.au)>; Above n 42, p 44.

<sup>265</sup> ATO, 'Alternative dispute resolution – an overview' (27 May 2014) <[www.ato.gov.au](http://www.ato.gov.au)>.

<sup>266</sup> IGT, *Review into the ATO's compliance approach to individual taxpayers – income tax refund integrity program* (2014) p 82; IGT, *Review into the ATO's compliance approach to individual taxpayers – use of data matching* (2014) p 75.

and adherence to the *Taxpayers' Charter* and other guiding material could also be addressed. The learnings and outcomes from the HMRC experience in recently adopting a statutory internal review function and piloting a facilitation service have indicated that review of cases need not be strictly confined to technical aspects.

4.29 The IGT notes that the availability of pre-assessment review processes accords with current practice adopted in the US where IRS appeals officers also act as mediators in disputes between IRS compliance officers and taxpayers in order to resolve matters before they become 'appeals'.<sup>267</sup> Similarly, in Canada, CRA compliance officers and taxpayers are able to escalate matters to the CRA headquarters to assist in resolving any impasse. The New Zealand process moves one step further by legislating the requirements for the IRD and taxpayers to engage and resolve disputes before assessments are issued.<sup>268</sup> The process also promotes full and frank disclosure by excluding any evidence not previously raised in subsequent challenges.<sup>269</sup>

4.30 Stakeholders have expressed concern that, in Australia, the barriers to access certain pre-assessment reviews operate to prevent taxpayers resolving disputes in the most cost-effective and timely manner. Other stakeholders have indicated that dividing cases along monetary lines and applying treatments on purely that basis is unacceptable as cases with low disputed amounts may nonetheless yield significant and complex issues of law and vice versa.

4.31 In the IGT's view, as a matter of fairness and equity, there should be sufficient access to justice for all taxpayers through robust pre-objection mechanisms. This is particularly important for taxpayers who are least able to progress disputes through more formal channels (such as individuals and small businesses). However, there are resource implications for the ATO in extending all available processes to all taxpayers. There is also a potential for taxpayers to use such processes to delay ultimate resolution and assessment of their liabilities.

4.32 The IGT, therefore, considers that the ATO's intended dispute resolution culture should aim at ensuring that its officers are open and responsive to taxpayer requests for engagement. The ATO should work collaboratively with taxpayers to achieve a common understanding of the issues and identify the most appropriate resolution option. Thus, the full range of options should be available to all taxpayers (without arbitrary distinctions) while ensuring that discussions between ATO officers and taxpayers are directed towards selecting the best avenue for resolving a dispute.

4.33 By consolidating all dispute resolution functions within a single, dedicated group, i.e. the Appeals Group, officers would be able to apply the dispute resolution option which is most appropriate having regard to the needs of the case. For example, the IR process may be applied to complex technical legal issues while in-house facilitation may be best used in less complex matters where there may just be a misunderstanding of the positions of each party. By reducing financial barriers and focusing on the issues in dispute, the ATO would be better able to address perceptions of inequity and inconsistency in its dispute resolution approach.

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<sup>267</sup> IRS, 'Appeals Mediation Programs' (11 June 2014) <[www.irs.gov](http://www.irs.gov)>.

<sup>268</sup> Above n 119.

<sup>269</sup> New Zealand Inland Revenue Department, *Disputing a Notice of Proposed Adjustment* (2012) p 9.

4.34 In addition to the issues of access to these processes, stakeholders have also suggested that the utility of such early intervention and dispute resolution may be enhanced if decisions of the Appeals officers were binding on the compliance team.

### **Improving actual and perceived independence of the objection process**

4.35 As outlined in Chapter 3, since 1 July 2013, objections for large businesses have been dealt with by the RDR business line in the LD&P Group. This arrangement was extended to include taxpayers with annual turnover of \$100 million or more on 1 July 2014. All other objections remain within the compliance business line where the original audit decisions are made. This further differential treatment between groups of taxpayers gives rise to concerns that there is unequal and inconsistent treatment.

4.36 The IGT considers that transferring the responsibility for dealing with all objections to the Appeals Group would not only enhance both actual and perceived independence of the objection process but would also ensure equal treatment for all taxpayers. A dedicated network of officers and centralised set of procedures and guidance would need to be developed to deal with objection cases consistently and reduce the risk of arbitrary outcomes irrespective of the category of taxpayers.

### **Internal tensions between the Appeals Group and other areas of the ATO**

4.37 It has been suggested that a structural separation may present some risk of tension between different sections of the ATO. In this respect, the IGT has previously stated that there are benefits arising from such tension:

...a separate appeals and review area may on occasions give rise to internal tensions within the ATO such as auditors' perceptions that 'cases are given away' and reviewers' perceptions that auditors' decisions are not technically robust. The IGT considers that tensions of this nature are not necessarily undesirable in ensuring robust and tested outcomes are achieved, thereby reducing the overall level of taxpayer disputes and the cost to the broader tax system.<sup>270</sup>

4.38 The IGT remains of the above view. Such tensions when appropriately managed would assist the ATO to build community confidence and address any remaining perceptions of bias by reason of the function remaining within the ATO and not in a separate agency.

4.39 The ATO has also raised concerns that the creation of the Appeals Group under separate leadership would lead to tensions at the most senior levels which would require intervention by the Commissioner. These concerns are addressed later in this chapter.

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<sup>270</sup> Above n 42, p 106.

## By-passing the objections process

4.40 The concerns regarding the lack of independence of the objections process have led some stakeholders to consider that it would not yield useful outcomes in all situations and that the parties should have the option to proceed directly to an independent tribunal or court. As described by the ARC:

Opponents of mandatory internal review criticise it as a barrier to access to external review rights. The additional number of steps the applicant must proceed through in order to reach finally external review may mean that persons with meritorious cases will fall victim to 'appeal fatigue'.<sup>271</sup>

4.41 The suggestion to by-pass the objections process is not novel. It was also previously raised in the Ralph Review<sup>272</sup> and such a bypass mechanism aligns with the current processes in the US and the UK.<sup>273</sup> The Australian system, like Canada, does not presently permit taxpayers to apply directly to the AAT or the Federal Court.<sup>274</sup> As noted earlier, New Zealand has a statutory opt-out of the NOPA process with consent of the IRD.

4.42 It is important to recognise the different purposes of the statutory objections process and pre-assessment processes instituted by the ATO. The objection is a full review and investigation of facts and evidence. Pre-assessment processes are reviews based on existing information only to filter out unsustainable cases which would otherwise proceed to objection. Taxpayers who do not receive a satisfactory outcome during a pre-assessment review process retain the option to object to the ATO decision.

4.43 The IGT considers that, where the pre-assessment review and objection processes offer an effective and independent review of the audit decision, there may only be a limited number of cases where the taxpayer should be able to directly apply to the tribunal or the court for determination. In such rare cases both parties should have agreed or agreed to disagree the facts of the case<sup>275</sup> and there should be a fundamental disagreement as to the operation of the law.<sup>276</sup>

4.44 In order to achieve agreement (or agreement to disagree) on the facts and whether the case genuinely turns on a fundamental disagreement of the law, some degree of engagement between the parties following issuance of the audit decision is necessary. Therefore, as initially recommended in his Objections Review, the IGT is of the view, that once these matters are established, the objection process should be expedited and fast-tracked to external review.<sup>277</sup>

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271 ARC, *Internal Review of Agency Decision Making* (2000) p 16.

272 Above n 31, p 148.

273 HM Revenue and Customs, 'Appeals and Tribunals – an overview for agents and advisers' (undated) <[www.hmrc.gov.uk](http://www.hmrc.gov.uk)>; United States Government Accountability Office, *Government Accountability Office report: Tax administration: Compliance: Appeal feedback Project* (19 April 2006) p 6.

274 Above n 269; Canada Revenue Agency, *Resolving your dispute: objection and appeal rights under the Income Tax Act* (undated) <[www.cra-arc.gc.ca](http://www.cra-arc.gc.ca)>.

275 Above n 31, p 148.

276 Above n 42, p 50.

277 Above n 39, p 14; Above n 42, p 101.

4.45 There are benefits to co-locating responsibility for litigation (explored further below), objection and pre-assessment review functions. Greater synergies may be realised by, for example, efficiently converting an informal review decision to a formal objection decision and progressing these matters to litigation in appropriate cases.

### **Safeguarding sustainable audit decisions**

4.46 It should be noted that, where effective objection and pre-assessment dispute resolution mechanisms are in place, care must be taken to avoid auditors effectively delegating away their responsibility for making sustainable initial decisions.

4.47 One approach may be to refer matters back to the audit team for reconsideration if new information or evidence comes to light. The benefits of such an approach would be twofold. Firstly, the ATO's audit section would be provided with an opportunity to reconsider their position and to gain experience on the types of information and evidence which may be requested in similar cases in the future. Secondly, this would assist to minimise taxpayers seeking to disengage from the audit team and dealing only with objections or review officers.

4.48 Similar approaches are adopted in other jurisdictions, such as the US and Canada, where appeals officers who receive new information invite auditors to examine that information and provide their views on the matter. While the decision ultimately rests with the appeals officer, the opportunity for audit officers to consider the new information may assist to streamline the process and ensures that audit officers are not detached from the process or unfairly judged on their original decisions in the absence of pertinent information.

### **Independence from the ATO advisory function and challenging ATO precedential views**

4.49 In addition to the functions previously discussed, the LD&P Group has responsibility for tax law design, litigation and, through the TCN, high level technical advice and setting the ATO precedential view.

4.50 To address concerns regarding a lack of independence at the objection stage, the ATO has recently suggested that it may transfer all objections from the Compliance Group to the LD&P Group. The ATO has stated that 'it would be preferable to provide this separation by moving all objections to [the] RDR area within the LD&P Group.'<sup>278</sup>

4.51 However, the IGT considers that transferring all objections to the RDR business line alone is unlikely to address all the concerns raised.

4.52 The reasons which were previously outlined concerning co-location and proximity giving rise to perceptions of lack of independence between objection and compliance officers apply equally to the Appeals Group and the LD&P Group

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<sup>278</sup> ATO, Submission 10.2 to the House of Representatives Standing Committee on Tax and Revenue, *Inquiry into Tax Disputes* (19 November 2014) p 8.



respectively. As mentioned in Chapter 3, increasingly, the ATO is allocating technical staff to assist the compliance teams with specific taxpayers, particularly in the PGI business line. It may be possible that the same technical staff or other technical staff in close proximity may provide advice both at the initial decision making process as well as during pre-assessment review and/or the objection process.

4.53 The IGT also believes that the simple transfer of the entire objection function to the LD&P Group will not address stakeholders' concerns regarding objection officers being beholden to the ATO precedential view and unwilling to depart or reconsider its application to the particular facts of the case.

4.54 Furthermore, the IGT has previously observed that where ATO senior technical officers, such as those from the LD&P Group's TCN, have previously been involved in the original audit decision or in setting an ATO view on the particular issue, more junior or less experienced officers may lack confidence to challenge those decisions.

4.55 In this respect, the IGT does not advocate or support the ability of an officer within the ATO to disregard an existing ATO precedential view as this is likely to create uncertainty and inconsistency. However, a transparent and robust approach to questioning and providing feedback for reconsideration of arguably untenable ATO views would aid to better decision making and bolster public confidence in the ATO as a fair administrator. This could be achieved if the Appeals Group was separate from the ATO's advisory function.

4.56 A number of further benefits are to be realised by the separation between the Appeals Group and the LD&P Group. Firstly, the approach would help to ensure the Appeals Group focuses on facilitating resolution of issues by providing a more objective assessment of the likely outcomes of external review, including the likelihood of success and the merits of the ATO precedential view.

4.57 Secondly, it would provide feedback to the LD&P Group regarding any ATO views which need to be reconsidered and ensure that such feedback is clearly documented. In doing so, the relevant officer should inform the taxpayer of the escalation and suspend consideration of the issue until the view has been resolved.

4.58 Thirdly, by ensuring that any decisions to request a reconsideration of an ATO precedential view are made in a centralised area, rather than through disparate business lines, the ATO would be able to maintain a centralised repository of all matters being reconsidered and putting relevant cases on hold. Moreover, where there are internal disagreements as to the correct view of the law between the Appeals Group and the LD&P Group, the matter should be escalated for resolution and if uncertainty persists, then the matter could be fast tracked to litigation and referred to the Treasury for consideration of law change where appropriate.



4.59 It should be noted that separating the Appeals Group from the ATO advisory function aligns with arrangements in international jurisdictions such as the US and Canada.<sup>279</sup>

## Managing ADR and litigation

### Championing the use of ADR

4.60 Effective and efficient use of ADR accords with current international best practice as well as whole-of-Government initiatives within Australia.<sup>280</sup>

4.61 The use of ADR in the tax dispute context was examined in detail in the IGT's ADR Review.<sup>281</sup> It should be acknowledged that the ATO has implemented many of the recommendations in that review with some success – this is explored further in the next chapter.

4.62 The ATO's use of ADR is currently managed centrally in the RDR business line. The IGT considers that relocating this function to the Appeals Group would provide a more centralised and distinct ADR function within the ATO, which would bolster its profile throughout the organisation. It would also assist to instil the ATO's desired dispute resolution culture through improved access to ADR expertise, training and feedback.

4.63 Moreover, the Appeals officers would be able to champion the use of ADR through their management of pre-assessment reviews, objections and litigation. Importantly, in recognising that the use of ADR must be flexible to suit the context of the dispute, the ATO/taxpayer relationship as well as other factors, the Appeals officers would be able to advise and facilitate the most appropriate form of ADR to ensure that disputes are efficiently and effectively resolved.

### Independent assessment of litigation

4.64 It is important to recognise that litigation is a form of dispute resolution albeit at the extremities of the spectrum and the most costly and time consuming. The use of litigation, therefore, cannot be discounted completely. The creation of the Appeals Group with responsibility for managing litigation would help to address stakeholder concerns regarding the independence of the ATO's in-house litigation function.

4.65 The previous chapter discussed concerns raised by stakeholders and the judiciary<sup>282</sup> in respect of the degree of separation between the litigation function and other functions within the ATO, such as audit and objections, and the lack of independent judgment on the appropriateness of advancing certain litigation cases.

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279 Above n 97, IRM 1.1.6; Treasury Board of Canada Secretariat, 'Organization: Canada Revenue Agency' (26 January 2012) <<http://www.tbs-sct.gc.ca>>.

280 Above n 42, pp 3-8.

281 Above n 42.

282 *Pacific Exchange Corporation Pty Ltd v Commissioner of Taxation* [2009] FCA 1155 at [58]-[59]; *Deputy Commissioner of Taxation v Prentice (Trustee)* [2011] FCA 1535 at [26].

Particular concern was highlighted in relation to litigation officers reverting to the compliance officers for decisions on settlements or progressing litigation.

4.66 A number of stakeholders, including members of the judiciary, consider that in litigation, both sides benefit from having independent advisers examine the case and objectively assessing its merits. Such advisers should have no vested interest in defending the original decision and should fully and frankly evaluate the merits of the case. However, stakeholders are concerned that this does not occur in the ATO and the compliance officers, or technical officers involved in the original decision making, exercise undue influence over litigation decisions. Examples to this effect have been mentioned in the previous chapter.

4.67 In the US, officers within the appeals section are seen as internal adjudicators between the audit team and taxpayers and they do not undertake litigation. Instead, litigation is conducted by the officers within the Office of Chief Counsel or by attorneys from the Tax Division of the US Department of Justice.<sup>283</sup>

4.68 Similarly, in New Zealand the Solicitor-General is ultimately responsible for the conduct of all litigation in the name of the Commissioner, assisted by the Tax and Commercial Team in Crown Law.<sup>284</sup> The Solicitor-General also has responsibility for appointing Counsel to represent the Commissioner and may also approve members of the IRD's Litigation Management Unit to represent the Commissioner. In Canada, tax litigation is conducted by lawyers located within the Department of Justice<sup>285</sup> and, in the UK, HMRC works in conjunction with the Ministry of Justice to classify litigated cases before allocating appropriate personnel to represent the revenue authority.

4.69 Historically, in Australia all Commonwealth litigation was the responsibility of the Commonwealth Crown Law Office, including all tax litigation matters. However, this has since devolved following the rise of in-house government legal officers, the conversion of the Crown Law Office to the Australian Government Solicitor (AGS) and the introduction of competition and contestability in the provision of legal services to Government.

4.70 To an extent, the ATO does seek independent input on its litigated cases through referral of matters to the AGS, other private legal firms or Counsel to conduct litigation. This is especially true for cases concerning large businesses and HWIs, where issues may be more complex and the amounts of revenue in dispute may be higher. However, with the exception of cases which must be referred to the AGS, such as constitutional law matters,<sup>286</sup> the in-house litigation section of the ATO retains all discretion in relation to these outsourcing decisions. Therefore, not all litigated matters have the benefit of external independent advice and consideration before litigation is progressed. Accordingly, stakeholders have contended that the ATO appears to have the least amount of separation between the litigation and its other functions, particularly in relation to market segments other than large businesses and HWIs,

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283 Above n 97, para 1.1.6.1; US Department of Justice, 'About the Tax Division' (undated) <[www.justice.gov](http://www.justice.gov)>.

284 IRD, 'Protocols between the Solicitor-General and Commissioner of Inland Revenue' (2009) para [5.1].

285 Department of Justice, 'Various roles of lawyers at the Department of Justice' (30 April 2013) <[www.justice.gc.ca](http://www.justice.gc.ca)>.

286 *Legal Service Directions 2005* Appendix A.

when compared with some of its international counterparts. The situation is further exacerbated by the ATO's requirement that litigated cases be argued consistently with existing ATO views.

4.71 During the course of this review, the ATO has advised the IGT that it is refreshing its existing litigation practice statement to reflect new criteria on which its litigation outsourcing decisions will be made. Discussions between senior ATO officials indicate that the criteria will include such matters as the complexity of the issue, the complexity of the facts and evidence, the venue of the litigation, whether the case challenges existing ATO views and what would be commensurate to the taxpayer's representation.<sup>287</sup>

4.72 The IGT supports the need to instil greater public confidence in the independence and accountability of the ATO's litigation function through increased separation from the ATO's compliance and advisory functions. The IGT considers that this may be achieved by the Appeals Group managing the litigation function which would provide a greater level of independence whilst keeping the litigation function within the ATO which has the following benefits:

- an effective and efficient end-to-end process through improved information requests and evidence gathering, early identification of potential litigation cases and managing downstream activities;
- provide an independent assessment of the evidentiary risks of cases to be litigated;
- provide opportunities for the Appeals Group to engage with the LD&P Group on potential impacts of litigation to the operation of the law or the ATO's precedential view whilst at the same time maintaining the necessary degree of independence;
- ensure consistency of legal propositions and arguments across all tax litigation matters conducted by the ATO; and
- provide better accounting and consideration of public benefits which may be realised in litigation and to consider appropriate test case litigation funding (discussed in the previous chapter).

4.73 The management of the litigation function by the Appeals Group does not preclude the outsourcing of certain functions, such as the 'instructing solicitor function', to AGS or to private firms. In fact, as discussed in the previous chapter, this has significant merit and provides a further degree of independence.

4.74 The IGT acknowledges that some jurisdictions have greater levels of separation in their litigation function, i.e., they may be conducted by another government agency. Such further separation can be considered in the Australian context once the Appeals Group, as described above, has been established for an

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<sup>287</sup> ATO communication with the IGT, 17 July 2014.

appropriate period of time and if concerns relating to a lack of independence of the ATO's litigation function persist.

## **Management and accountability of settlements**

4.75 Settlements are an important feature of the Australian tax administration system enabling taxpayers and the ATO to negotiate and resolve their disputes in a cost effective manner without resorting to litigation. However, as mentioned in the previous chapter, appropriate management, accountability and transparency of the settlement process is essential to ensuring Government revenue is protected and public confidence is maintained.

4.76 In Australia, there is effectively no external oversight of the ATO's settlement of tax disputes. Whilst scrutineering agencies, such as the IGT, Commonwealth Ombudsman and the ANAO may conduct reviews into settlement processes or cases, they cannot override a settlement decision.

4.77 Internally, oversight of settlements is managed within the relevant compliance business lines, usually by a panel of senior officers, who can make direct decisions or recommendations on the appropriateness of settlements. For example, the PGH Settlement Panel provides oversight to ensure that settlements are in accordance with the ATO's Code of Settlement Practice, maintain accurate settlement records for that business line and undertake quality reviews of settlement cases after they are completed.<sup>288</sup>

4.78 The ATO also provides details of its settlement activities through its Annual Report which sets out the pre-settlement amounts, the amount settled and the variance between the two stratified by business line.<sup>289</sup> Some stakeholders have suggested that further information on settlements should be published to provide greater transparency and public confidence in the decision making process and the outcome of settlement negotiations. Other stakeholders have cautioned against the publication of too much information as this may remove the confidentiality aspect of settlement negotiations, which could be a major barrier for taxpayers to enter into settlement negotiations.

4.79 The IGT considers that the Appeals Group, particularly if it is headed by a person appointed by the Government rather than the Commissioner, could provide the necessary level of assurance and oversight in relation to settlement decisions to ensure they are consistent, technically defensible and made in accordance with appropriate governance procedures. Such oversight and assurance is particularly important having regard to the increased levels of settlements in recent years.

4.80 Statistics provided by the ATO indicate that over the past five years, it has settled a large number of cases with substantial proportions of the ATO's

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<sup>288</sup> ATO communication to the IGT, 17 July 2014.

<sup>289</sup> Commissioner of Taxation, *Annual Report 2009–10* (2010) p 31; Commissioner of Taxation, *Annual Report 2010–11* (2011) p 106; Commissioner of Taxation, *Annual Report 2011–12* (2012) p 93; Commissioner of Taxation, *Annual Report 2012–13* (2013) p 58.

pre-settlement position in those cases being varied. These statistics are outlined in Table 7 below.

**Table 7: Overall ATO settlement statistics 2010 – 2014**

| Financial Year | Number of settlements | Pre-settlement position \$m | Settled amount \$m | Variance \$m | Variance % |
|----------------|-----------------------|-----------------------------|--------------------|--------------|------------|
| 2013–14        | 393                   | 5,723                       | 2,617              | 3,106        | 54.3       |
| 2012–13        | 339                   | 3,564                       | 2,034              | 1,530        | 42.9       |
| 2011–12        | 256                   | 921                         | 482                | 439          | 47.7       |
| 2010–11        | 304                   | 2,028                       | 1,281              | 747          | 36.8       |
| 2009–10        | 621                   | 1,643                       | 1,095              | 548          | 33.4       |

Source: ATO Second Commissioner Briefing August 2014; Commissioner of Taxation Annual Reports 2009–10, 2010–11, 2011–12 and 2012–13.

Note: Values have been rounded to the nearest whole number. Percentages have been rounded to one decimal place.

4.81 As outlined above, in 2013–14, the ATO reported that it settled 393 cases and varying \$3.106 billion which accounts for 54.3 per cent of the pre-settlement position in those cases. While the quantity of settled cases is less than the number reported in 2009–10, the amounts which have been varied have significantly increased from that year (from \$548 million to \$3,106 million).

4.82 Statistics in relation to large business and HWI settlements are outlined in Tables 8 and 9 below. With the exception of a decline in 2011–12, the number of large business settlements has generally increased. HWI settlement numbers have also increased over the past five years, with the most dramatic increases occurring between 2011–12 (15 cases), 2012–13 (37 cases) and 2013–14 (61 cases).

**Table 8: Large Business settlement statistics 2010 – 2014**

| Financial Year | Number of Large Business settlements | Large Business settlements as a percentage of total settlements % | Pre-settlement position \$m | Settled amount \$m | Variance \$m | Variance from pre-settlement position % | Large Business variance as a percentage of total variance % |
|----------------|--------------------------------------|---|-----------------------------|--------------------|--------------|---|---|
| 2013–14        | 34                                   | 8.7   | 2,713                       | 1,524              | 1,189        | 43.8                                    | 38.3  |
| 2012–13        | 28                                   | 8.3   | 2,643                       | 1,646              | 997          | 37.7                                    | 65.2  |
| 2011–12        | 17                                   | 6.6   | 409                         | 216                | 193          | 47.2                                    | 43.9  |
| 2010–11        | 26                                   | 8.6   | 1,721                       | 1,124              | 597          | 34.7                                    | 79.9  |
| 2009–10        | 24                                   | 3.9   | 1,344                       | 904                | 440          | 32.7                                    | 80.3  |

Source: ATO Second Commissioner Briefing August 2014; Commissioner of Taxation Annual Reports 2009–10, 2010–11, 2011–12 and 2012–13.

Note: Values have been rounded to the nearest whole number. Percentages have been rounded to one decimal place.

**Table 9: High Wealth Individual settlement statistics 2010 – 2014**

| Financial Year | Number of HWI settlements | HWI settlements as a percentage of total settlements % | Pre-settlement position \$m | Settled amount \$m | Variance \$m | Variance from pre-settlement position % | HWI variance as a percentage of total variance % |
|----------------|---------------------------|--|-----------------------------|--------------------|--------------|---|--|
| 2013–14        | 61                        | 15.5   | 1,612                       | 632                | 980          | 60.8                                    | 31.6   |
| 2012–13        | 37                        | 10.9   | 418                         | 171                | 247          | 59.1                                    | 16.1   |
| 2011–12        | 15                        | 5.9  | 240                         | 150                | 90           | 37.5                                    | 20.5   |
| 2010–11        | 7                         | 2.3  | 17                          | 9                  | 8            | 47.1                                    | 1.1  |
| 2009–10        | 8                         | 1.3  | 8                           | 6                  | 2            | 25.0                                    | 0.4  |

Source: ATO Second Commissioner Briefing August 2014; Commissioner of Taxation Annual Reports 2009–10, 2010–11, 2011–12 and 2012–13.

Note: Values have been rounded to the nearest whole number. Percentages have been rounded to one decimal place.

4.83 When compared with the total number of ATO settlements, those in relation to large businesses and HWI taxpayers represent a relatively small fraction. Across all years, large business settlement cases accounted for less than 10 per cent of the total number of settled cases. HWI settlement cases also represented a small fraction of the total number of settled cases, with the highest proportion occurring in 2013-14 where HWI settlements accounted for 15.5 per cent of all ATO settlements.

4.84 Notwithstanding that the numbers of settlements in these market segments represent only a low proportion of total settlements, the quantum of variances are high. As highlighted in Table 8, the variance in relation to large businesses accounted for the majority of variances in 2009-10 (80.3 per cent), 2010-11 (79.9 per cent) and 2012-13 (65.2 per cent). The remaining years also showed that large business variances accounted for a sizeable portion of total variances for all settlements.

4.85 While not as pronounced as large businesses, the proportion of variances attributable to HWI settlement cases is considerable, particularly in 2013-14 (31.6 per cent). When taken in combination with large business settlements, the statistics show that over the past five years, the majority of settlement variances are attributable to large business and HWI taxpayers.

4.86 The large proportions of settlement variances, in relation to large businesses and HWIs, are to be expected given the generally higher levels of revenue in dispute. However, the high levels of variance may give rise to perceptions of favouritism, especially in circumstances where third party observers are not privy to the reasons for settlement.

4.87 Concerns and allegations of ATO favouritism are not new and were raised in the late 1990s through media reports which resulted in a Senate inquiry into the



operation of the ATO.<sup>290</sup> As discussed in Chapter 3, similar concerns were recently expressed in relation to the UK's HMRC and its settlement of large disputes.<sup>291</sup> Following this experience, the HMRC appointed a Tax Assurance Commissioner, with Prime Ministerial approval, to scrutinise significant tax settlements, oversee the process for all other settlements and provide a separate annual report on these matters. Similarly, the US has a Congressional Joint Committee on Taxation which provides an oversight function on IRS settlements.

4.88 As noted earlier, the IGT considers that the creation of the Appeals Group to oversee the ATO's approach to settlements would provide independent assurance of the appropriateness of this approach. In this regard, it would be analogous to the HMRC's Assurance Commissioner and further accountability may be introduced through specific public reporting requirements.

4.89 Some stakeholders have also indicated that a heavy oversight function may not be desirable as it may discourage settlements if there is a risk of disclosure of confidential settlement information or potential delays by reason of overly bureaucratic oversight processes. The IGT believes that such concerns may be managed through appropriate information and communication management protocols. Moreover, the centralised management of confidential settlement information would minimise the risk of disclosure by limiting access to smaller pool of ATO personnel.

4.90 In addition to ensuring that settlement decisions are appropriately made, the Appeals Group may, through its pre-assessment review and objections function, identify appropriate cases for law clarification purposes, where there is a public benefit in doing so, and ensuring that these cases are not settled.

### **Protocols on intra-agency communication to maintain independence**

4.91 In the past the IGT has highlighted the concerns raised by stakeholders regarding the lack of independence between different areas of the ATO when reviewing original ATO audit decisions.<sup>292</sup> As illustrated in Chapter 3, the lack of restrictions and controls on intra-agency communications can give rise to perceptions of inappropriate and collusive conduct between officers.

4.92 The ATO itself has also recognised the risks associated with such communication but, as yet, has not instituted robust protocols or procedures to address these matters, instead leaving it up to the reviewer's judgment. In this regard, the ATO has noted:<sup>293</sup>

Contact with the original decision maker should not be used as a substitute for independent re-examination of the dispute. Whilst it is acknowledged that efficiencies can be gained through contact with the original decision maker (particularly in

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290 Four Corners, 'Reviews & Inquiries into the Australian Taxation Office' (30 June 2003) <[www.abc.net.au](http://www.abc.net.au)>; Senate Economics References Committee, *Interim Report on the Operation of the Australian Taxation Office*, Canberra, 10 November 1998.

291 Above n 239, p 19.

292 Above n 39.

293 Above n 72.



complex disputes) such contact should not be used to replace the reviewer's own understanding and research.

4.93 The issue has been addressed in other jurisdictions most notably the US which has a legislated prohibition against *ex parte* communications.<sup>294</sup> Appeals officers are not permitted to unilaterally contact the original decision makers, and vice versa, without informing the taxpayer and/or their adviser. Whilst not legislated, New Zealand also has strong protocols which redirect communications between the dispute resolution unit officer and the original decision maker through the Office of Chief Tax Counsel to ensure that impartiality is maintained.<sup>295</sup> The CRA has also implemented communication protocols between the compliance and appeals areas.<sup>296</sup>

4.94 Similar restrictions and protocols, if implemented by the ATO, may operate to minimise perceptions of undue influence between different sections of the ATO, particularly the input of audit officers into objections and litigation or policy advisers (such as the TCN) on dispute resolution decisions. It has also been argued that such contact may potentially delay matters as objection officers are unable to draw on existing ATO audit knowledge where cases may be especially complex or have long histories. The IGT considers that objections officers may be able to contact the audit area, in appropriate cases, provided that such contact is fully transparent to the taxpayer. Furthermore, improved documenting of cases and their progress would assist to alleviate the need for intra-agency contact between different functions within the ATO where there is a need to maintain actual and perceived independence.

4.95 The IGT believes that a legislated framework pursuant to which the ATO can establish protocols to manage intra-agency communication would further foster the independence of the Appeals Group from other areas within the ATO. The US model for managing intra-agency communications provides a helpful guide in this regard.

4.96 Stakeholders are generally supportive of the above approach and have drawn comparisons to the use of 'Chinese walls' in large professional services firms where strict protocols are in place to ensure that potential conflicts of interest and perceptions thereof are minimised.

4.97 The ATO has suggested that it was presently in the process of documenting protocols for communication between auditors and objection officers.<sup>297</sup> Some time should elapse before assessing whether those protocols assist in reinforcing the necessary independence.

4.98 In addition to having protocols and restrictions on intra-agency communication, stakeholders have suggested that, like professional services firms, there should also be consequences for the ATO officers breaching these protocols and restrictions. The IGT accepts that enforceable protocols and avenues of redress for taxpayers would increase confidence. However, in the US where the restrictions on intra-agency communication are strongest, there is no legislated remedy for the

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294 *Internal Revenue Service Restructuring and Reform Act 1998* (US) para 1001(a)(4).

295 Above n 184.

296 Anne-Marie Levesque, 'Appeals Branch' (Presentation delivered at the Toronto Centre Professionals Group Seminar, Canada, November 2013) <[www.canadiantaxlitigation.com](http://www.canadiantaxlitigation.com)>.

297 Above n 75, p 12.

taxpayer where IRS officers breach the *ex parte* rule. Rather, the IRS has taken a curative approach where breaches are reported internally and the breach is ‘cured’ by, for example, the taxpayer and their adviser being afforded an opportunity to respond to any communications or information provided.<sup>298</sup>

4.99 The absence of enforceable remedies in relation to communications between ATO officers touches on the broader issue of enforceable taxpayers rights against inappropriate ATO officer conduct in Australia. The IGT has indicated he will consider these broader issues in his upcoming review into the ATO’s *Taxpayers’ Charter* and taxpayer protections.<sup>299</sup>

## Feedback loops and rotation

### Feedback loops

4.100 In its second submission to the Committee, the ATO has rejected the creation of a separate agency and a new Second Commissioner on the basis that:

The risks and costs associated with either of these options include increased costs, isolation, lack of feedback loops, reduced confidence in primary decision making and lack of focus on the system as a whole.<sup>300</sup>

4.101 The IGT accepts that feedback loops are an important mechanism to improve ATO decision making, however, does not believe that the creation of a separate agency or indeed a separate area would lead to a lack of feedback loops. The IGT notes, for example, that as between agencies, the ATO’s Integrated Tax Design section collaborates and provides feedback to and from the Treasury on a near daily basis on the effectiveness and operation of existing tax laws and revenue matters more broadly.

4.102 Moreover, examples in other jurisdictions such as the IRS show that even where there is clear separation between audit staff and appeals staff, feedback loops are available and encouraged as a means of enhancing original decision making.<sup>301</sup>

4.103 The IGT considers that the creation of the Appeals Group would not diminish feedback but would enhance feedback loops by:

- having a centralised dispute resolution section which would be able to draw on observations for disputes across all ATO business lines and providing feedback from broader viewpoints rather than those narrowly observed in relation to specific taxpayers or market segments;
- auditors may be more willing to accept feedback provided by a separate and distinct section of the ATO with particular expertise in dispute resolution, objections and litigation; and

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<sup>298</sup> Above n 97, IRM 8.1.10.5.6.

<sup>299</sup> IGT, ‘New IGT work program’ (2014) <[www.igt.gov.au](http://www.igt.gov.au)>.

<sup>300</sup> Above n 278, p 4.

<sup>301</sup> Above n 97, IRM 8.1.1.5.1.

- encouraging greater auditor focus on the initial decision making where they are aware that their decisions will effectively be scrutinised by an independent area.

### **Rotation of staff**

4.104 The IGT also considers there is an opportunity to further imbue best practice across the ATO by rotating high performing staff across the different groups. Such a process is already in train in relation to the ATO's senior executive staff who are moved between different areas of the ATO every three to five years to avoid entrenched cultures and to ensure that they have a holistic view of the office.

4.105 A similar rotation service for other high performing staff would assist to build relationships across different groups within the ATO, ensure that officers do not become entrenched in their views and provide the opportunity for best practices from one area to be implemented in others.

4.106 The ATO has advised that senior executives within the RDR, PGI, PGH and Indirect Tax (ITX) business lines have considered options to embed RDR officers within business line teams to deliver a multi-skilled team to advise on legal risk, foster engagement and resolution of tax disputes in certain cases.<sup>302</sup>

4.107 The IGT recognises that there may be some issues associated with a rotation process, including the limitations on development of deep tax expertise, a lack of ownership of the work and potential conflicts of interest issues (such as those experienced in the US when compliance staff from so-called IRS campuses are moved into the Office of Appeals). However, these issues already exist for the ATO as part of its business operations and may need to be managed through strategies such as appropriate conflict checks, succession planning and ensuring corporate knowledge is appropriately recorded and accessible.

4.108 Moreover, the rotation opportunities should be appropriately promoted and targeted towards high performing officers to encourage internal competition for these opportunities. Where these opportunities are recognised as key career development milestones, the competition for these roles would ensure that ATO officers apply themselves to their respective areas.

## **A NEW SECOND COMMISSIONER TO LEAD THE APPEALS GROUP**

4.109 As the IGT and other parties have noted, full independence could only be achieved through the creation of a separate agency which is not subject to ATO management decision making or financial control. As noted earlier, there are challenges to that particular approach. However, independence (both actual and perceived) is critical and in the absence of creating a separate agency, steps should be taken to ensure that the Appeals Group is as independent as possible.

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302 ATO communication with the IGT, 17 July 2014.

4.110 The International Monetary Fund also supports this approach, noting that where organisational independence is not possible, an acceptable level of independence may be achieved through independent leadership. It has stated that:

...the manager of the appeals office should ideally not have any hierarchical relationship with the decision making managers or be subject to any type of instructions by them, and should be subordinate directly to the head of the office or a third authority (for example, a national appeals office).<sup>303</sup>

4.111 Separate leadership is also critical in the creation of the Appeals Group as the Government does not have the power to direct the ATO to separate its functions. The only method through which a separate area may be created by the Government within the ATO would be through the creation of a new Second Commissioner which would require legislative change as the TAA 1953 currently limits the number of Second Commissioners to three.<sup>304</sup>

4.112 In the Tax Forum Submission, the IGT had previously recommended, amongst other things, the appointment of an additional Second Commissioner to lead a separate appeals and review area.<sup>305</sup> This provides the highest level of independence while retaining the appeals function within the ATO for a number of reasons.

4.113 Firstly, whilst the proposed Second Commissioner would report to the Commissioner, his or her tenure and remuneration are determined by the Government and the Remuneration Tribunal respectively.<sup>306</sup>

4.114 Secondly, a dedicated new Second Commissioner would ensure independence and accountability of decision making, separate from the current Second Commissioners who presently lead the other groups within the ATO.

4.115 The IGT notes that a number of other jurisdictions, including the US and Canada, have separate appeals areas, the head of which directly reports to the Commissioner. For example, the IRS Chief of Appeals leads the Office of Appeals<sup>307</sup> while in Canada, the Appeals function is performed under the leadership of the Assistant Commissioner of Appeals, both of whom report directly to the relevant Commissioner or Agency Head.<sup>308</sup> Diagrammatic representations of these organisational structures are contained in Appendix 4.

4.116 Thirdly, a new Second Commissioner could be appropriately empowered to ensure that the appeals function is sufficiently resourced and not eroded by competing demands on budget allocations. This would avoid previously observed circumstances in which the ATO had insufficiently resourced its objections area to appropriately consider the disputes generated by shifting compliance focuses.<sup>309</sup>

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303 Above n 156, p 26.

304 *Taxation Administration Act 1953* s 4.

305 Above n 33, p 16.

306 This is the case for all statutory appointees.

307 IRS, 'Today's IRS Organization' (28 April 2014) <[www.irs.gov](http://www.irs.gov)>.

308 IRD, 'Office of the Chief Tax Counsel' (9 December 2004) <[www.ird.govt.nz](http://www.ird.govt.nz)>.

309 Above n 38, pp 77-80.

4.117 Fourthly, a Second Commissioner who also directly reports to the Commissioner would provide high level assurance to the Commissioner regarding the ATO's management of disputes and settlements and provides greater transparency and accountability of original ATO decisions. In this regard, the role would be analogous to that of the Tax Assurance Commissioner in HMRC who provides advice and oversight on settlements. Stakeholders have also compared the proposed role to that of the Solicitor-General, who provides advice and assurance on matters needing to be litigated and those which can be settled. Such assurance is particularly important having regard to the increased levels of settlements in recent years.

4.118 Finally, the separate leadership of the Appeals Group is critical to maintain a robust culture for staff so that they are sufficiently empowered to independently consider taxpayer cases and achieve a fair outcome for taxpayers and the ATO. Such a culture would assist the ATO to address stakeholder perceptions of an overpowering compliance function which the IGT has previously observed can give rise to undesirable behaviours such as 'seeking to wear down the applicant by avoiding resolution of the issue.'<sup>310</sup>

4.119 The ARC has also noted the importance of independent senior leadership in creating additional organisational distinction between internal review officers (such as those in the Appeals Group) and original decision makers as well as developing and promoting a robust culture:

...it is important that agencies are organised so that internal review officers are distinct from primary decision makers. There are several reasons for this. If internal review is seen as a truly distinct aspect of agency decision making, that will help to promote within internal review sections the culture that their role is to undertake a genuinely fresh reconsideration of decisions. It will also give internal review the credibility within agencies necessary to enhance its normative effects.<sup>311</sup>

and

The Council also considers that the promotion of an appropriate culture within internal review sections would be greatly assisted if formal responsibility for internal review lay with a senior agency executive, such as a deputy secretary. That effect would be strengthened if the role of that senior departmental executive was combined with formal responsibility for overseeing the promotion within the agency of the general effects of review tribunal decisions on the quality of the agency's decision making.<sup>312</sup>

4.120 The ATO has expressed concerns that a consequence of creating the Appeals Group under a new Second Commissioner would be 'the Commissioner spending time "umpiring" disputes and opinions between different areas of the ATO when this could be done at the second commissioner level, at less cost and in a more timely way.'<sup>313</sup>

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310 IGT, *Review of the Potential Revenue Bias in Private Binding Rulings Involving Large Complex Matters* (2008) p 39.

311 Above n 251, p 122.

312 Ibid, pp 122-123. See also: Administrative Review Council, *Internal Review of Agency Decision Making* (2000).

313 Above n 277, p 8.

4.121 The ATO's concerns in fact highlight the need for even clearer delineation between the many different functions which are currently subsumed within it. The IGT considers that the creation of the Appeals Group, supported by clear protocols for the management of disagreements between different ATO groups, would assist to better streamline case decision making, rather than having matters prolonged and protracted owing to unclear ownership and responsibility.

4.122 The Commissioner should not be required to 'umpire' disagreements between the Appeals Group and other areas of the ATO beyond what may presently be required as between the Second Commissioners for the Compliance and LD&P Groups. In any event, in the majority of cases, the Second Commissioner of the Appeals Group would be the final decision maker with respect to the resolution of a dispute. In rare cases, where for example, there are disagreements, as to the correct view of the law between the Appeals Group and the LD&P Group, and they cannot be resolved at the Second Commissioner level, the matter could be fast tracked to litigation and referred to the Treasury for consideration of law change where appropriate.

4.123 As previously recommended by the IGT, where the new Second Commissioner with appropriate expertise is appointed from outside of the ATO, this would have the added benefit of further diversifying the insights amongst the ATO's most senior executives.<sup>314</sup>

### **Appointment to a dedicated role**

4.124 Whilst the TAA 1953 provides for the number of Second Commissioners, their tenure and their powers under the taxation legislation,<sup>315</sup> it does not specify the roles that these Second Commissioners will have in respect of the ATO. This decision rests with the Commissioner who has complete control over the ATO's organisational structure.

4.125 In the past, the IGT has observed the shifting roles of Second Commissioners between the different Groups (or sub-plans as they were then known) particularly between the Compliance and Law sub-plans of the ATO. There is, therefore, a risk that if an additional Second Commissioner is created without a dedicated legislated role, their ability to lead the Appeals Group may be compromised if the Commissioner is able to reallocate them to a different leadership function.

4.126 The IGT therefore considers that the new Second Commissioner should be appointed to specifically lead the Appeals Group with such further powers to independently review ATO decisions, manage litigation and settlements as is necessary.

4.127 In this way, the new Second Commissioner would be able to discharge the duties of their office and lead the Appeals Group without concern that any adverse or unfavourable decisions made by them would result in a diminishing of resources to their area or a transfer of roles to other areas of the ATO. Such an approach would be

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<sup>314</sup> Above n 33, p 16.

<sup>315</sup> *Taxation Administration Act 1953* ss 5 and 6D.



analogous to the independence of other statutory appointees, where fixed statutory terms provide assurance that their roles may be discharged without concern that unflattering or unfavourable decisions would lead to their dismissal or affect their remuneration.

4.128 The creation of a dedicated Second Commissioner would be similar to the processes adopted by the US Congress in statutorily prescribing that the restructuring of the IRS include an independent Appeals function.<sup>316</sup>

4.129 In addition, where a Second Commissioner is appointed to a dedicated role, the Government could ensure that they discharge the duties of their office by legislating the expectations of that office together with appropriate reporting requirements.

4.130 It has been noted that ‘what gets measured gets done’<sup>317</sup> and accordingly, where the Government seeks to imbue fairness, equity, transparency and accountability in the management of tax disputes, such criteria and expectations should be legislated for the new Second Commissioner so that it forms a key part of the structural governance framework that cannot be later changed or modified.

## IMPLICATIONS FOR THE ATO STRUCTURE

4.131 To bolster the actual and perceived independence of the proposed Appeals Group, it would be ideal for its officers to be recruited from outside the ATO. These officers should also have strong tax experience and knowledge to effect an efficient transition. However, the IGT acknowledges that in the short term this may not be possible and it is likely that existing ATO personnel from other areas may also be allocated to the Appeals Group.

4.132 As discussed above in relation to creating a separate agency, the transfer of existing staff from other areas of the ATO potentially gives rise to those risks which have been identified in previous IGT reviews regarding ATO officer biases and capability,<sup>318</sup> including those which resulted in the ATO discounting views which were contrary to its position<sup>319</sup> or potential bias where the ATO seemingly appeared to have endorsed certain practices for some taxpayers but not for others.<sup>320</sup> To mitigate such risks, appropriate training for all officers who enter the Appeals Group (whether they are recruited externally or from within the ATO) should be provided to assist those officers develop appropriate technical expertise and cultural mindset as is the case with the IRS Office of Appeals. Over time, the appropriate management and promotion of the Appeals Group, capability building and the acquisition of new staff would aid to minimise the risk of persisting biases and undesirable behaviours.

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316 *Internal Revenue Service Restructuring and Reform Act of 1998* §1001(a)(4).

317 Above n 75, p 15.

318 Above n 310; Above n 37; Above n 38.

319 IGT, *Review of the Tax Office's management of complex issues – case study on research and development syndicates* (2007) p 45.

320 Above n 192, p 20.



4.133 The creation of the Appeals Group, therefore, will have implications for the existing ATO structure and would require a reallocation of the ATO workforce to accommodate the different functions. This could be a part of the restructure or ‘reinvention’<sup>321</sup> that the Commissioner is undertaking. As part of such ‘reinvention’, he has already made some structural changes including redefining the three sub-plans into overarching groups, transferring corporate services from the LD&P Group to the People, Services and Systems (PS&S) Group and shifting the management of certain objections from the Compliance Group to the LD&P Group.

4.134 To illustrate the potential staffing impacts of the Appeals Group on the existing ATO structure, the IGT has set out the current workforce arrangements within the ATO and applied some estimated staff ratios to illustrate new arrangements which could follow the creation of the Appeals Group.

### Current ATO Structure

4.135 As set out in Figure 1 below, the ATO is currently divided into three main groups, each of which is led by a statutorily appointed Second Commissioner.<sup>322</sup> During the review, the ATO was unable to provide up to date staffing figures and their respective functions due to the ongoing implementation of its corporate reviews. The IGT therefore has made reference to published staffing figures as set out in the ATO’s 2013–14 Annual Report.<sup>323</sup>

**Figure 1: Current ATO structure**

| Commissioner of Taxation                   |       |                                   |       |                               |     |
|--|-------|-----------------------------------|-------|-------------------------------|-----|
| Second Commissioner                        |       | Second Commissioner               |       | Second Commissioner           |     |
| Compliance                                 |       | People Services and Systems       |       | Law Design and Practice       |     |
| Aggressive Tax Planning                    | 223   | ATO Corporate                     | 699   | Integrated Tax Design         | 196 |
| Compliance Support & Capability            | 140   | ATO Finance                       | 462   | Review and Dispute Resolution | 244 |
| Indirect Tax                               | 1,800 | ATO People                        | 1,110 | Tax Counsel Network           | 218 |
| Private Groups and High Wealth Individuals | 1,444 | Business Reporting & Registration | 264   |                               |     |
| Public Groups and International            | 1,407 | Client Account Services           | 4,585 |                               |     |
| Serious Non-Compliance                     | 533   | Customer Service & Solutions      | 1,338 |                               |     |

<sup>321</sup> Above n 246.

<sup>322</sup> *Taxation Administration Act 1953* s 4.

<sup>323</sup> Above n 4, pp 130-131.

**Figure 1 (continued)**

|  |               |                                     |               |                  |
|--|---------------|-------------------------------------|---------------|------------------|
| Small Business and Individual Taxpayers  | 2,221         | Debt                                | 1,798         |                  |
| Superannuation                           | 1,087         | Enterprise Solutions and Technology | 2,032         |                  |
| Tax Practitioner and Lodgment Strategies | 1,268         | Office of the Commissioners         | 13            |                  |
|  |               | Service Delivery Support            | 201           |                  |
| <b>TOTAL</b>                             | <b>10,123</b> | <b>TOTAL</b>                        | <b>12,502</b> | <b>TOTAL</b> 658 |

Source: ATO.

4.136 The Compliance Group currently incorporates the ATO's business lines which manages its investigatory function, including all audits and reviews. It also manages all objections for taxpayers with turnovers less than \$100 million and is responsible for issuing advice (in consultation with the TCN in certain cases). Each compliance business line also has internal technical case leadership teams which provide advice to the teams as well as law design and policy teams which interface with the LD&P Group and other stakeholders on key law design issues.

4.137 The PS&S Group is presently responsible for delivering the ATO's corporate, information technology and human resources services. Moreover, it has oversight of the Debt business line which manages debt collection in respect of all taxpayers and maintains the current call and contact centres within the ATO.

4.138 The LD&P Group has responsibility for law design input through advising and liaising with the Treasury and is also responsible for providing technical advice and settling the ATO precedential view of the law through the TCN. The LD&P Group also has responsibility for the RDR business line.

### Proposed new ATO structure

4.139 The introduction of the proposed new separate internal group, i.e. the Appeals Group, may result in a shifting of some of the above functions, many of which are presently within the Compliance Group, to more closely align ATO activities with its compliance, appeals/litigation and policy/technical advice functions. Such a realignment would entail a redistribution of staff to ensure that each new area is sufficiently resourced to meet the challenges they face. Figure 2 below provides an illustration of a potential restructure and separation of functions within the ATO.

4.140 As the numbers in Figure 2 are drawn from those contained in Figure 1, the same caveat applies in relation to the completeness and accuracy of the present staffing levels within the ATO. In order to estimate the potential Full-time equivalent (FTE) staffing shifts as a result of the structural change, the IGT drew from the PGH Line Plan 2013-14, which was the only ATO business line plan that provided an indicative

breakdown of the different functions within that line. Based on that Plan, the IGT notes that within the PGH business line:<sup>324</sup>

- 65 per cent of staff undertake active compliance work (e.g., audits and risk reviews);
- 12.7 per cent are responsible for interpretative advice work (including issuing of rulings and dealing with objections) – as the Line Plan did not provide a further breakdown of these functions, the IGT has assumed that half (6.35 per cent) are allocated to objections and the other half are responsible for providing advice to taxpayers;
- 10 per cent are in risk management and intelligence;
- 1 per cent undertake policy work;
- 1.25 per cent undertake legal and law assurance work; and
- the remaining 10 per cent provide support and other functions specific to the PGH business line.

4.141 The IGT has applied the above ratios to the ATO FTE figures to provide an indication of the potential staffing changes. These are set out in Figure 2 below.

**Figure 2: Proposed new ATO structure**

| Commissioner of Taxation                   |       |                                   |       |  |     |
|--|-------|-----------------------------------|-------|--|-----|
| Second Commissioner                        |       | Second Commissioner               |       | Second Commissioner                        |     |
| Compliance                                 |       | People Services and Systems       |       | Law Design and Practice                    |     |
|  |       |                                   |       | Appeals                                    |     |
| Aggressive Tax Planning                    | 190   | ATO Corporate                     | 699   | Integrated Tax Design                      | 196 |
| Compliance Support & Capability            | 119   | ATO Finance                       | 462   | Tax Counsel Network                        | 218 |
| Indirect Tax                               | 1,531 | ATO People                        | 1,110 | BSL Legal and Law Assurance                | 227 |
| Private Groups and High Wealth Individuals | 1,228 | Business Reporting & Registration | 264   | BSL Interpretative Assistance (Advice)     | 642 |
| Public Groups and International            | 1,197 | Client Account Services           | 4,585 |  |     |
|  |       |                                   |       | Review and Dispute Resolution              | 244 |
|  |       |                                   |       | BSL Interpretative Assistance (Objections) | 642 |

324 ATO, 'Private Groups and High Wealth Individuals Line plan 2013–14' (internal ATO document, 2013) p 28.

**Figure 2 (continued)**

|  |               |                                     |               |              |             |
|--|---------------|-------------------------------------|---------------|--------------|-------------|
| Serious Non-Compliance                   | 453           | Customer Service & Solutions        | 1,338         |              |             |
| Small Business and Individual Taxpayers  | 1,889         | Enterprise Solutions and Technology | 2032          |              |             |
| Superannuation                           | 924           | Office of the Commissioners         | 13            |              |             |
| Tax Practitioner and Lodgment Strategies | 1,078         | Service Delivery Support            | 201           |              |             |
| Debt                                     | 1,798         |                                     |               |              |             |
| <b>TOTAL</b>                             | <b>10,408</b> | <b>TOTAL</b>                        | <b>10,704</b> | <b>TOTAL</b> | <b>1283</b> |
|  |               |                                     |               | <b>TOTAL</b> | <b>886</b>  |

Source: IGT constructed from ATO Annual Report 2013–14, PGH Line Plan 2013–14.

4.142 Based on the functional separations within the PGH Business Line, the above table provides an indication of the potential staff movements which may need to be made to give effect to the proposed Appeals Group. The change will necessarily see a movement of both the taxpayer advisory (e.g. rulings) and objection functions within the ATO.

4.143 It is noted that the proposed staffing figures for the Appeals Group are significantly lower than those in the Compliance and PS&S Groups. It is appropriate that the Compliance and PS&S Groups should have the largest proportions of staff as they are responsible for the largest sections of the taxpayer community.

4.144 As fewer cases progress through towards pre-assessment reviews, objections and ultimately litigation, it is expected that Appeals Group would have a smaller number of staff. This is in line with staffing levels in other revenue authorities. For example, data from the US shows that in 2013, the IRS Office of Appeals only had 811 FTE staff which is 0.93 per cent of the entire IRS workforce. This contrasts with 12,270 revenue agents, 8,724 tax examiners, 4,748 revenue officers<sup>325</sup> and approximately 2,000 National Taxpayer Advocate (the IGT's counterpart) officers.<sup>326</sup>

### Technical advice and dispute resolution within Compliance Group

4.145 The IGT envisages that with the introduction of the Appeals Group, the ATO's Compliance Group will continue to undertake audits and retain high level technical

<sup>325</sup> IRS, 'SOI Tax Stats - Personnel Summary, by Employment Status, Budget Activity, and Selected Type of Personnel - Databook Table 30' (5 March 2014).

<sup>326</sup> Treasury Inspector General for Tax Administration, *A Statistical Portrayal of the Taxpayer Advocate Service for Fiscal Years 2005 Through 2009* (2010) p 4.

advisers to guide audit staff on matters not requiring reconsideration of the ATO precedential view or policy issues. Moreover, each business line should have dedicated groups and contacts to facilitate and drive dispute management and resolution. These teams could operate in collaboration with the Appeals Group to receive, consolidate and develop feedback into improved processes and procedures.

4.146 The IGT is aware that such initiatives are already occurring in some business lines such as the PGI business line where a dedicated Dispute Prevention and Resolution team has been established to drive dispute resolution. This team works in collaboration with the RDR business line to instil better dispute resolution practices in PGI through an appropriate feedback communication strategy, making available facts and evidence clinics and providing broader communications on disputes and resolution techniques.<sup>327</sup>

### Transfer of Debt business line

4.147 The IGT also considers that a transfer of the ATO's debt collection function to the Compliance Group could better streamline the taxpayer experience. The IGT is aware that the ATO has begun implementing similar actions with audit staff in the ITX business line undertaking debt and payment discussions during audits.<sup>328</sup>

4.148 The linkage between compliance activity and debt collection was examined and considered in the IGT's Settlements Review<sup>329</sup> which noted at the time that the ATO could improve the linkage between the two functions so that debt collection officers were more responsive to taxpayers seeking to re-engage on tax liability issues to ensure that correct amounts were raised.<sup>330</sup>

4.149 The IGT has also previously noted the role of debt in the tax dispute resolution context. In particular, submissions made to the IGT's ADR Review suggested that one of the reasons a taxpayer may initiate or progress a dispute was to defer or manage payable tax debts owing to their financial circumstances.<sup>331</sup>

4.150 In the current review, as in the IGT's ADR Review,<sup>332</sup> issues concerning the use of collateral debt collection action, while disputes as to the underlying assessment were on foot, have been raised. Stakeholders have expressed concern that the ATO's use of its powers in relation to debt collection and recovery actions may unfairly hamper the ability of taxpayers to properly prosecute their challenges to assessments.<sup>333</sup>

4.151 Moreover, inefficiencies are created for both the ATO and taxpayers where multiple proceedings are on foot in different forums for the recovery of debts on the one hand and challenging underlying assessments on the other. This situation may

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<sup>327</sup> ATO communication to the IGT, 16 October 2014.

<sup>328</sup> See for example: ATO, 'Indirect Tax AC SME/Micro and cash economy guidelines for the collection of outstanding debt and lodgment' (internal ATO document, 12 November 2013).

<sup>329</sup> Above n 40.

<sup>330</sup> Ibid, pp 29-30.

<sup>331</sup> Ibid, p 93.

<sup>332</sup> Ibid.

<sup>333</sup> *Taxation Administration Act 1953* ss 14ZZM and 14ZZR; *Denlay v Commissioner of Taxation* [2013] FCA 307.

arise as taxpayers initiate tax proceedings in either the AAT or the Federal Court, while the ATO may initiate debt recovery proceedings in different State courts.

4.152 The movement of the Debt business line to the Compliance Group would allow for earlier and more holistic engagement in relation to tax and debt disputes. As noted by the IGT in the ADR Review, the ability of taxpayers to engage on both the technical tax and debt collection issues through a single port of call provides a more efficient and effective forum to resolve all issues within a dispute.<sup>334</sup>

4.153 It should be noted that the IGT is currently undertaking a broad review of the ATO's approach to debt collection which will consider further debt collection issues.<sup>335</sup>

### **Law design and taxpayer advice**

4.154 Under the proposed new structure, the LD&P Group would continue to interact and advise the Treasury and the Government on new tax law design and will also, through the TCN, be responsible for developing the ATO precedential view.

4.155 Moreover, the LD&P Group could also assume responsibility for providing advice to taxpayers through the current private rulings process and other relevant advice documents.

4.156 There are benefits to ensuring that the responsibility for developing public and private binding advice is consolidated. As the IGT has previously observed, disputes may arise where public rulings are issued which are inconsistent with existing private rulings.<sup>336</sup> In particular, such occurrences have given rise to allegations of so-called ATO 'U-turns' where the ATO proposes to apply changes to perceived longstanding views retrospectively.<sup>337</sup> Often these perceptions are based on existing private rulings.

4.157 By consolidating the responsibility for both managing public and private ATO advice within the LD&P Group, the IGT believes that the ATO would be able to better manage the risk of such inconsistencies occurring in the future.

### **Dispute resolution and litigation**

4.158 As set out earlier in this chapter, the IGT considers the Appeals Group would incorporate the existing RDR business line and have responsibility for the management of pre-assessment reviews, objections and the litigation function. Moreover, under the leadership of a new Second Commissioner, the Appeals Group would provide oversight of the ATO's approach to settlements and the Second Commissioner would adopt an assurance role in this regard with separate reporting requirements.

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<sup>334</sup> Above n 42, p 93.

<sup>335</sup> Above n 211.

<sup>336</sup> IGT, *Review into the delayed or changed Australian Taxation Office views on significant issues* (2010); Above n 192.

<sup>337</sup> Ibid.

## CHAPTER 5 — OTHER INQUIRY ISSUES

5.1 Thus far, this IGT report has focused on structural reform and a governance framework for tax disputes and the appropriate level of independence and separation between compliance, investigation, objection and litigation functions. However, the terms of reference for the Committee's Inquiry has canvassed a broader spectrum of issues, some of which have been examined by previous IGT reviews whilst others are currently being examined or will form the basis of future IGT reviews. For completeness, these areas are briefly addressed below.

### COLLECTING REVENUES DUE

5.2 The collection of revenues is a vital aspect of a revenue authority's work, as stated by the OECD:

Even the most sophisticated strategies for facilitating or enforcing compliance are worth little if the tax owed is not actually collected. Having appropriate strategies in place for debt management is particularly pressing in the present climate of financial crisis, where most revenue bodies face rising levels of tax debt with corresponding resource pressures and risks.<sup>338</sup>

5.3 In Australia, 89 per cent of taxes are paid with little intervention from the ATO, if at all.<sup>339</sup> Of the remainder, 97 per cent are paid within 12 months of the due date following ATO engagement activities leaving only approximately 3 per cent which require further action.<sup>340</sup> In relation to taxes which are not paid on time, the ATO reports that the majority arise in the small business market segment (62.4 per cent), with a smaller proportion being attributable to large businesses and HWIs.<sup>341</sup>

5.4 Submissions to this review indicate that the ATO's approach to debt collection in relation to large businesses and HWIs during disputes can vary. In some examples provided in submissions, the ATO had granted payment arrangements or not taken recovery action whilst the dispute was on foot. In other examples, however, the ATO had not exhibited similar flexible treatment, instead adopting approaches such as refusing offers to partially repay the debt while the dispute remains on foot, issuing garnishee notices with insufficient reasoning, restricting taxpayer movement with departure prohibition orders (DPO) or placing pressure on taxpayers to sell property to meet their debts.

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338 OECD, *Working smarter in structuring the administration, in compliance, and through legislation* (Forum on Tax Administration, January 2012) para [127].

339 ATO, 'Debt Strategy 2014 – 2018' (internal ATO document).

340 Ibid.

341 Above n 4, p 49.



5.5 Other submissions have highlighted concerns in respect of taxpayers being unaware or not being informed that they have tax debts outstanding, and they only become aware once the ATO has commenced debt recovery action.

5.6 The ATO's use of administrative tools such as garnishee notices and DPOs have been cited as causing particular concerns. In respect of garnishee notices, stakeholders have asserted that the use of these notices may potentially hamper the ability of taxpayers to fund their challenges to ATO assessments<sup>342</sup> and may adversely impact the taxpayer's businesses. This may have far reaching consequences, especially where the taxpayer has employees and trade creditors who are in turn deprived of payments due.

5.7 The use of DPOs has previously been the subject of judicial consideration and investigations by the Commonwealth Ombudsman. It has attracted considerable media attention owing to some high profile matters. During the course of this review, further concerns were raised with the IGT in relation to the ATO's use of DPOs to restrict movement of a taxpayer who required urgent travel overseas for family commitments. Notwithstanding the taxpayer and his adviser's attempts to engage with the ATO to provide security for the debt owing (and under challenge) as well as assurance of his return to Australia, the ATO's delay in responding created considerable anxiety and distress.

5.8 Stakeholders have called for greater external control on the ATO's use of such administrative powers, particularly during the course of disputes. A number of suggestions have been proffered in this regard, including that the ATO should be restrained from issuing garnishee notices or DPOs where there is a challenge to the underlying debt (e.g. by way of objection or litigation) or that the ATO should be required to seek judicial approval before garnishees and DPOs are issued as they are required to do when seeking to freeze taxpayer assets.<sup>343</sup> Although the ATO currently requires senior ATO officers to approve the issue of any DPOs, a more robust approval process, such as a degree of judicial oversight before a DPO is issued, may be justified.

5.9 The concerns surrounding the ATO's approach to debt collection are wide-ranging and affect a broader spectrum of taxpayers beyond large business and HWIs. They have also persistently been the subject of review by the IGT and others.<sup>344</sup>

5.10 As previously noted, the IGT is currently undertaking a new review into the ATO's approach to debt collection.<sup>345</sup> This review is warranted given that a substantial period of time has elapsed since the IGT's previous review into this area and the economic environment has fundamentally changed. Accordingly, the IGT will examine the debt collection issues raised in the context of the Inquiry through this more comprehensive review. The review will examine a range of issues including the ATO's management of collectable and disputed debt, debt assistance initiatives such as debt

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<sup>342</sup> *Denlay v Commissioner of Taxation* [2013] FCA 307.

<sup>343</sup> See for example: *Federal Court Rules 2011* div 7.4.

<sup>344</sup> IGT, *Review into the Tax Office's Small Business Debt Collection Practices* (2005); see for example: Australian National Audit Office (ANAO), *The Engagement of External Debt Collection Agencies* (2012); ANAO, *Management of Debt Relief Arrangements* (2013).

<sup>345</sup> IGT, 'New IGT Work Program' (2014) <[www.igt.gov.au](http://www.igt.gov.au)>; Above n 211.

payment arrangements and more intensive recovery activities such as the use of garnishee notices, insolvency action, director penalty notices and DPOs.

5.11 It is also pertinent to note that the collection of revenues due necessarily impinges on issues relating to settlement and the suggestion that sometimes, the ATO has ‘given away too much’. These issues were set out in detail in Chapters 3 and 4. As discussed, the IGT considers that the Appeals Group would be well-placed to provide independent advice and oversight on significant ATO settlements and report on these matters.

## **EFFICIENCY, EFFECTIVENESS AND TRANSPARENCY**

5.12 The efficient and effective management of tax disputes is important both for the revenue authority and for taxpayers, ensuring that disputes do not become entrenched, protracted and resource-intensive for all parties. Similarly, the transparent management of disputes is also an important feature to ensure that there is accountability. It also enables parties external to the dispute to objectively assess the appropriateness of outcomes. These features imbue and enhance confidence in the administration of the tax system.

5.13 In Chapter 3, the IGT has noted that notwithstanding the ATO’s increased settlement of cases prior to litigation, the numbers of matters which have been filed in the AAT and the Federal Court continue to rise. Furthermore the vast majority of these cases are being settled without a hearing. Accordingly, there appears to be room for improvement in terms of early engagement and the timely use of ADR to increase the efficiency of dispute resolution and to minimise the instances of unnecessary litigation. For the reasons set out in Chapter 4, a centralised and independent dispute resolution and litigation function, i.e., the Appeals Group, should realise such improvements.

5.14 In relation to the transparency of its dispute resolution processes, the ATO has published some general information regarding the outcomes and achievements of its more recent dispute resolution efforts on its website. These relate to a range of activities including the IR process, settlements, its use of ADR and in-house facilitation.<sup>346</sup>

5.15 The IGT has also previously recommended that the ATO implement a more formalised system of receiving and collating feedback from participants in ADR processes. In line with that recommendation, the ATO engaged the Australian Centre for Justice Innovation (ACJI) at Monash University to undertake the research and evaluate, amongst other things, whether resources were used efficiently and whether effective and acceptable outcomes were achieved. On 2 December 2014, the ACJI published its report which found that the ATO’s use of ADR was effective in about 70 per cent of matters in fully or partly resolving the dispute or enabling facts or issues to be clarified.<sup>347</sup>

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<sup>346</sup> ATO, ‘Our dispute resolution strategies’ (22 October 2014) <[www.ato.gov.au](http://www.ato.gov.au)>.

<sup>347</sup> Australian Centre for Justice Innovation, *Evaluating Alternative Dispute Resolution in Taxation Disputes* (28 November 2014) p 39.

5.16 The ATO has recently indicated that there are other avenues available for feedback on the effectiveness of its engagement and dispute resolution, including through consultation forums such as the National Tax Liaison Group and the Dispute Resolution Working Group.<sup>348</sup>

5.17 The IGT considers that the creation of the Appeals Group will provide greater opportunities to assess and evaluate the efficiency and effectiveness of its dispute resolution capability through the implementation of specific effectiveness criteria and reporting requirements.

## FAIR TREATMENT AND RESPECT OF TAXPAYERS

5.18 The fair and respectful treatment of taxpayers is an important aspect of tax administration. It has been judicially recognised as being in the interest of both individual taxpayers and the revenue.<sup>349</sup> The OECD has observed that taxpayers 'who are aware of their rights and expect, and in fact receive, a fair and efficient treatment are more willing to comply.'<sup>350</sup>

5.19 However, notwithstanding its importance, there is presently no specific right of fair treatment and respect of taxpayers in the Australian tax system. Research in this area has noted that, unlike jurisdictions such as the US, which have legal provisions promoting fair treatment, the Australian position is that fair treatment and respect is aspirational.<sup>351</sup>

5.20 In Australia, the administrative rights and responsibilities of taxpayers when interacting with the ATO are set out in a series of documents collectively referred to as the *Taxpayers' Charter* (the Charter) which was developed following a recommendation of the JCPA in 1993.<sup>352</sup>

5.21 The Charter states that the ATO will treat taxpayers fairly and with respect. Specifically:<sup>353</sup>

### TREATING YOU FAIRLY AND REASONABLY

We will:

- treat you with courtesy, consideration and respect
- behave with integrity and honesty
- act impartially

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<sup>348</sup> Above n 160, p 6.

<sup>349</sup> *Vestey v Inland Revenue Commissioners* (No 2) [1979] Ch 177.

<sup>350</sup> OECD, *Principles of Good Tax Administration* (Practice Note GAP001, 2001) p 3.

<sup>351</sup> John Bevacqua, 'From moral duty to rule of law - Lessons from the United States in treating taxpayers fairly' (Paper presented at the 25th Australasian Tax Teachers Association Conference, Auckland, New Zealand, 20-22 January 2013) p 20.

<sup>352</sup> Above n 11, p 314.

<sup>353</sup> ATO, *Taxpayers' Charter - What you need to know* (14 August 2013).

- respect and be sensitive to the diversity of the Australian community
- make fair and equitable decisions in accordance with the law
- resolve your concerns, problems or complaints fairly and as quickly as possible.

5.22 At a broader level, the ATO, as an Australian Public Service (APS) agency, is bound by the APS Code of Conduct and APS Values from which the requirements for respectful and fair treatment may be deduced.<sup>354</sup>

5.23 The Commissioner has also publicly committed the ATO to fairness and respect in its administration of the tax laws:

But a principle of our change is that we have to be fair and respectful in our dealings with taxpayers and not approach every single taxpayer with the view that we are seeking to extract the maximum amount of tax possible.<sup>355</sup>

5.24 The Commissioner's statement is reflective of those requirements set out in the Charter and which have been in place for over a decade. However, there are a range of stakeholder concerns regarding fair treatment that have been raised in this review and in previous IGT reviews.

5.25 Certain stakeholder submissions to this review also focused on taxpayer treatment in more serious tax cases, such as those involving potential fraud or evasion. There have also been media reports which have highlighted potential issues in taxpayer treatment in serious tax cases, such as those in 'Project Wickenby' investigations relating to offshore tax avoidance.<sup>356</sup>

5.26 Another issue which has emerged in relation to the Charter and other similar documents and statements from the ATO is that there are presently no avenues for redress beyond a complaint made to the ATO which is managed administratively.

5.27 The issue has been recognised by some academic commentators who have called for legislative change and enforceable remedies in relation to these rights and protections.<sup>357</sup>

5.28 In the most recent work program, the IGT noted:

Stakeholders have raised a range of concerns regarding the adequacy of the ATO's *Taxpayers' Charter* and related taxpayer protections. These concerns included access to enforceable remedies for defective ATO administration, commitment to procedural fairness and, more broadly, adherence to the model litigant obligations. Stakeholders point to international developments regarding a 'taxpayer bill of rights' with enforceable remedies. The Commonwealth Ombudsman has also noted that in many

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<sup>354</sup> *Public Service Act 1999* ss 10 and 13; APSC, 'The APS – Defined by Values' (undated) <[www.apsc.gov.au](http://www.apsc.gov.au)>.

<sup>355</sup> Above n 246; Above n 160, p 6.

<sup>356</sup> Australian Broadcasting Corporation, 'Tax Office faces accusations of abuse of power' (9 April 2012) <<http://www.abc.net.au/7.30/content/2012/s3473563.htm>>.

<sup>357</sup> See for example: Above n 351; Justin Dabner, 'Australian tax controversies and human rights', *CCH Tax Week* (19 November 2014).

cases the aggrieved taxpayers do not receive the desired remedy with certain taxpayer cases garnering significant media attention. The IGT has previously acknowledged concerns with aspects of the ATO's *Taxpayers' Charter*, compensation schemes and their administration in a number of reviews and in the *IGT Annual Report 2012–13*.

The review will consider the above stakeholders concerns, including the nature of the *Taxpayers' Charter*, the existing avenues available to taxpayers seeking redress for defective ATO administration and further forms of redress that may be required.

5.29 The IGT envisages that that review will broadly consider the range of taxpayers' rights and protections in Australia including the need for enforceable remedies on these rights.

## USE AND PUBLICATION OF PERFORMANCE INFORMATION

5.30 The use and publication of performance information is an important feature of transparent and accountable administration. As the Department of Finance has noted:

Managers require good-quality performance information and evaluation data to help measure whether they are achieving their business and policy goals. Performance information is also important for stakeholders to enable them to judge whether resources are being used efficiently and whether programmes and services are achieving intended results. Good-quality performance information improves transparency and accountability and, as a result, the confidence of the Parliament and the public in government operations.<sup>358</sup>

5.31 Within this context, 'performance' is not strictly confined to measures of financial outcomes and time-sensitive efficiency, though these are relevant. Performance may also describe taxpayer and community satisfaction in the ATO's services and approach as well as its conduct in other forums such as in the AAT or the Federal Court.

5.32 The publication of performance information provides an impetus for the ATO to ensure that it measures its performance and the publication of such information provides the ATO with key measures of its success. Moreover, through published performance information, the community at large is able to assess the ATO's approach and effectiveness.

## Sources of ATO performance information

5.33 In its submission to the Committee, the ATO indicated that:<sup>359</sup>

We are committed to measuring our performance around the handling of disputes and being transparent about that performance. We include material in our annual report to parliament. We assess our performance through a number of lenses:

- service commitments;

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358 Department of Finance, *Enhanced Commonwealth Performance Framework* (Discussion Paper, August 2014) p 1.

359 Above n 215, p 34.

- quality;
- early resolution;
- aged cases;
- complaints; and
- legal expenditure.

5.34 In addition to the ATO's own measures, there are also external reports which shed light on this such as the number of complaints received and resolved by the Commonwealth Ombudsman,<sup>360</sup> the performance audits of the Auditor-General<sup>361</sup> and reports and findings of the IGT through his reviews into systemic tax administration issues.<sup>362</sup>

5.35 Each section within the ATO also has its own set of performance indicators and these may vary between different products and activities undertaken within that business line. For example, the former SME business line had a range of expected cycle times for completion of various compliance activities.<sup>363</sup> These measures are generally not published externally except where they also serve as service standards, such as determining objections within 56 days following receipt of all relevant information.<sup>364</sup>

5.36 More recently, the ATO's *Corporate Plan 2014 – 2018* has identified dispute resolution as an area of focus for the ATO. As a broad objective, the ATO states:<sup>365</sup>

We want to work collaboratively to reduce the time to resolve disputes, reduce the number of disputes and lower the costs both for taxpayers and us.

5.37 The Corporate Plan sets out six criteria on which the ATO proposes to measure its success in this area. Specifically, these criteria are:<sup>366</sup>

**Early Engagement**

Earlier resolution of disputed cases

Average age of disputes

Number of disputed cases resolved

**Independent review**

Client satisfaction with independence of review and the service provided

**Litigation**

Proportion of disputes which result in litigation

Number of test case litigation finalised

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<sup>360</sup> Commonwealth Ombudsman, *Annual Report 2012-13* (2013).

<sup>361</sup> See for example: Above n 51, ANAO, *Compliance Performance Methodology* (2014); ANAO, *Management of Complaints and Other Feedback* (2014).

<sup>362</sup> IGT, 'Reports of Reviews' (undated) <[www.igt.gov.au](http://www.igt.gov.au)>.

<sup>363</sup> See for example: Above n 38, p 68.

<sup>364</sup> See for example: ATO, 'Service Standards to 30 June 2013' (19 November 2013) <[www.ato.gov.au](http://www.ato.gov.au)>.

<sup>365</sup> ATO, *Corporate Plan 2014 – 2018*, p 40.

<sup>366</sup> Above n 365.



5.38 The above criteria as with the performance indicators previously mentioned appear to be largely quantitative in nature and not directed at the qualitative and taxpayer experience aspects of such feedback. The exception is the feedback received in relation to the twenty or so taxpayers who have participated in the IR process.

5.39 The ATO also recently informed the Committee that it would be undertaking its annual review of performance indicators in line with the recently published OECD principles for performance evaluation. These principles direct focus on identifying the scope of evaluation, developing indicators and making use of these to foster improvement.<sup>367</sup>

5.40 The IGT also notes that a range of new reporting requirements are currently being introduced by the Government which will directly affect the way the ATO evaluates and publicly reports on its performance. These are explored further below.

### **Performance Framework under the *Public Governance, Performance and Accountability Act 2013***

5.41 The *Public Governance, Performance and Accountability Act 2013* (PGPA Act) commenced operation on 1 July 2014 and provides a single piece of legislation which outlines Commonwealth entities' obligations in relation to planning, measuring, assessing and reporting of financial and non-financial performance.

5.42 It has been recognised that the 'current performance management arrangements are ad-hoc and fragmented in nature and lack coherence at a whole-of-system level.'<sup>368</sup> To facilitate better reporting and support of the PGPA Act, the Department of Finance is currently undertaking consultation to develop a Commonwealth performance framework.

5.43 As the PGPA Act has only recently commenced operation and the framework is still developing, it is not possible to assess the extent of changes which may be applied. It is expected that the ATO's reporting will be augmented by the implementation of this Commonwealth Framework, which will also involve the Department of Finance undertaking a monitoring and evaluative role.<sup>369</sup>

### **Regulator Performance Framework**

5.44 In its regulatory role, the ATO will also be subject to the Regulator Performance Framework<sup>370</sup> issued by the Government which is largely based on the recommendations of the Productivity Commission.<sup>371</sup>

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<sup>367</sup> OECD, *The Governance of Regulators* (2014) p 106.

<sup>368</sup> Department of Finance, 'Brief for Joint Committee of Public Accounts and Audit (JCPAA) on a proposed approach to the performance framework under the *Public Governance, Performance and Accountability Act 2013* (PGPA Act)' (Undated) <[www.pmra.finance.gov.au](http://www.pmra.finance.gov.au)> p 1.

<sup>369</sup> Ibid, p 3.

<sup>370</sup> Australian Government, *Regulator Performance Framework* (2014).

<sup>371</sup> Productivity Commission, *Regulator Audit Framework* (2014).



- 5.45 The new framework consists of six performance indicators, including:<sup>372</sup>
- regulators do not unnecessarily impede the efficient operation of regulated entities;
  - communication with regulated entities is clear, targeted and effective;
  - actions undertaken by regulators are proportionate to the regulatory risk being managed;
  - compliance and monitoring approaches are streamlined and coordinated;
  - regulators are open and transparent in their dealings with regulated entities; and
  - regulators actively contribute to the continuous improvement of regulatory frameworks.

5.46 Regulators will be expected to self assess their performance against these performance indicators and the Government may require external reviews of regulators' performance against this framework.<sup>373</sup>

5.47 The Government anticipates that the implementation of this framework will result in improved regulator performance and should, amongst other things, enhance accountability and transparency.<sup>374</sup>

5.48 It is expected that regulators will align their internal policies and practices to the Framework by no later than 1 July 2015.<sup>375</sup>

5.49 The IGT is hopeful that the implementation of the Regulatory Performance Framework and the PGPA Act framework will provide a more consistent basis for the ATO to report its performance across the agency leading to greater transparency and public understanding of its approach.

## Nature of ATO performance information

5.50 As noted earlier, the ATO's performance measures are, in large part, quantitative in nature.<sup>376</sup> They may include observing changes in cycle times for completion of a particular type of case, numbers and trends in lodgments of objections and appeals, strike rates in projects seeking to detect instances of non-compliance or the amount of revenue raised in relation to particular compliance projects.

5.51 While this provides a good snapshot of aspects of the organisation's performance, it does not provide a holistic picture of ATO performance and does not accurately capture the impacts on taxpayers throughout the end-to-end process. For

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<sup>372</sup> Above n 371, pp 16-26.

<sup>373</sup> Ibid, pp 8-9.

<sup>374</sup> Ibid, p 10.

<sup>375</sup> Ibid, pp 6-7.

<sup>376</sup> See for example: ATO, 'Public Groups and High Wealth Individuals Line Plan 2013-14' (internal ATO document, 2013) p 13; ATO, 'Tax Compliance for Small-to-Medium Enterprises and Wealthy Individuals' (26 October 2012) <[www.ato.gov.au](http://www.ato.gov.au)>; ATO, 'Large Business and Tax Compliance' (14 October 2014) <[www.ato.gov.au](http://www.ato.gov.au)>.

example, a decrease in audit cycle times may indicate more efficient completion of audit cases but may also lead to high levels of dispute because audit decisions were not as robust as they could be. Similarly, a reduction in audit cycle times may lead to extended or protracted objections owing to taxpayers having to engage in lengthier discussions and provide more evidence which should have been done at audit stage. In these situations, the overall experience for the taxpayer remains unchanged.

5.52 Similarly, in the tax dispute context, the majority of available performance information is outcome driven, such as success rates in litigation or completion rates for cases. It does not focus on whether the management of the disputes process itself was fair or if taxpayers felt they had been treated with respect and afforded appropriate procedural fairness. No inferences may be confidently drawn in this regard, even where the ATO's position is ultimately upheld to be correct as that only goes to the technical correctness of the ATO's decision and not the quality and fairness of the process. The issue is exacerbated by the ATO's present reporting systems not readily being able to capture whole-of-case performance information. As the IGT noted in Chapter 2, the absence of such reporting capability hampers the ATO's ability to effectively assess its performance against the taxpayer experience.

5.53 An illustrative example provided to the IGT concerned a risk review and audit of a taxpayer, his wife and their company which has run over the course of almost six years with multiple extensions of time for the ATO complete its audit, notwithstanding that an audit plan had been completed and approved by the Deputy Commissioner. The taxpayer noted that the ATO's conduct during the audit was aggressive, using repeated interviews, section 264 notices and threats of prosecution. Moreover, the taxpayer considered that the ATO's risk hypotheses were seemingly contradictory and further compounded by the ATO's attempts to apply Part IVA to their circumstances.

5.54 The taxpayer considers that the ATO's treatment of him over the past six years has caused him, his wife and his staff considerable stress and anxiety in addition to incurring over a million dollars of legal fees. The taxpayer considered that his treatment had been unfair and disrespectful and, even though complaints had been lodged at the highest levels of the ATO and with other agencies, the matter was not sufficiently addressed.

5.55 At a recent hearing with the Committee, the ATO was asked on its measures for fairness:<sup>377</sup>

**Ms BUTLER:** Thank you—I appreciate it. I appreciate you have only just released [the ATO Corporate Plan 2014 – 2018], but is there a measure in this plan for reporting against that goes to the perception of fairness outside of the dispute situation, prevention obviously being better than cure?

**Mr Olesen:** I would need to check. In our annual reports we routinely report on the community perception survey that we do. We have done that for quite some time. Whether there is an express measure there I cannot recall, but we do routinely put those results in our annual report, because naturally they are very important for us in

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<sup>377</sup> Above n 160, p 6.

understanding how the community perceives our professionalism, our courtesy and our fairness.

5.56 In a supplementary submission made to the Committee, the ATO expanded on its response, providing results from a number of perception surveys which contained questions seeking to elicit community views on ATO fairness and professionalism.<sup>378</sup> The ATO's general community perceptions survey reported high ratings in relation to fairness with 79 per cent, 80 per cent and 81 per cent of taxpayers in 2011, 2012 and 2013 respectively agreeing or strongly agreeing that the ATO was fair and reasonable in its administration. However, a new survey conducted in November 2013 shows that only 53 per cent gave the ATO that rating. The ATO notes that owing to the transition from a 4 point rating scale to a six point rating scale, the November 2013 results are not directly comparable to previous years.<sup>379</sup>

5.57 The IGT notes that in respect of its Single Corporate Perceptions Survey, which consolidates other market segment-based surveys, 66 per cent of taxpayers agreed or strongly agreed that the ATO was fair and professional. The ATO again notes that as this survey was only introduced in May 2014 and uses a 6 point rating scale, it is not directly comparable to prior year results.<sup>380</sup>

5.58 The IGT notes that in respect of tax practitioners, perceptions of the ATO's fairness and professionalism have been generally lower than in other surveys. In 2011, 2012 and 2013, respectively, 49 per cent, 47 per cent and 58 per cent of tax agents agreed or strongly agreed that the ATO was fair and professional. Business Activity Statement agents were more favourable in their assessment, with 59 per cent and 66 per cent giving the ATO those ratings in 2012 and 2013.<sup>381</sup>

5.59 The ATO has also provided the IGT with some additional information regarding internal performance measures in relation to tax disputes. These largely comprise statistical reports of outcomes on objections and litigation cases, outcomes on IR matters and numbers of cases being considered for test case litigation funding.<sup>382</sup>

5.60 There is a need for the ATO to better understand its own performance from the perspective of the taxpayer. This is necessary to assess satisfaction and fairness as a continuum of all taxpayer interactions with the ATO and not stratified or divided by different business lines, sections or functions. At present, the IGT is not aware of any measures which assess a 'whole of case' satisfaction level from the taxpayer's perspective. There is merit in the ATO considering developing such a measure and publishing the outcomes and learnings.

5.61 The IGT also envisages that, following the creation of the Appeals Group, specific performance indicators would be developed to incentivise ATO officers to initiate and engage with taxpayers to resolve disputes at the earliest point in time. Moreover, such indicators should also be designed to assess how cases were resolved

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378 ATO, Submission 10.1 to the House of Representatives Standing Committee on Tax and Revenue, *Inquiry into Tax Disputes* (16 July 2014) pp 3-4.

379 Ibid.

380 Ibid.

381 Ibid.

382 ATO communication to the IGT, 14 November 2014.

and whether the method of resolution was optimal in the circumstances. In doing so, the ATO should consult widely with the taxpayers and tax practitioners and their representatives on the most appropriate measures to evaluate its effectiveness.

## Publication of ATO performance information

5.62 The ATO publishes details of its performance through a number of channels including its website, Annual Report and Corporate Plan. For example, in its 2012-13 Annual Report, the ATO set out some statistics on its compliance work on HWIs including the number of audits and reviews completed, revenue raised and collected and the quantity and quantum of settlements.<sup>383</sup> Settlement statistics were also reported in relation to large businesses as well as the level of Goods and Services Tax adjustments in this market segment and the efficiency and time taken to complete private rulings.<sup>384</sup>

5.63 The ATO's Compliance Program publication, a forward looking document of the ATO's proposed focus areas in the coming financial year, also provided statistics and key details on its past year performance and achievements on each market segment.<sup>385</sup> Since 2013, the Compliance Program has been rebadged *Compliance in Focus*, a web-based publication which provides similar information to the Compliance Program. The IGT notes that some past performance information is also provided though the level of detail and information appears to have decreased from previous compliance programs.<sup>386</sup>

5.64 The ATO's dispute resolution performance has also, in recent years, been reported in the *Your Case Matters* publication which outlines different aspects of the ATO's dispute resolution approach up to 31 December 2012.<sup>387</sup> The ATO has not published further editions of this document and in discussions with the IGT has indicated that it would explore other channels through which to publish this information, such as the Annual Report or its website.<sup>388</sup>

5.65 The IGT's ADR Review identified concerns that the ATO's publication of its litigation work was inadequate, especially in relation to significant litigation matters and test cases.<sup>389</sup> Following the IGT's recommendation, the ATO developed a test case litigation register which provides updates on matters which had been referred for test case funding and the progress of those matters.<sup>390</sup>

5.66 The IGT is of the view that further and more timely information could be published regarding the ATO's litigation work on significant matters. However, it should be noted that the ATO has indicated publicly that it is currently consulting with stakeholders on strategies to better communicate test cases and issues on which the

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383 Commissioner of Taxation, *Annual Report 2012-13* (2013) pp 44-45 and 58.

384 Ibid, pp 28, 50 and 58.

385 ATO, *Compliance Program 2011-12* (2011) pp 42 - 48; ATO, *Compliance Program 2012-13* (2012) pp 70-85.

386 ATO, *Compliance in Focus 2013-14* (19 December 2013) <[www.ato.gov.au](http://www.ato.gov.au)>.

387 ATO, *Your Case Matters* (1st ed, 2012); ATO, *Your Case Matters* (2nd ed, 2012); ATO, *Your Case Matters* (3rd ed, 2013).

388 ATO communication with the IGT, 30 July 2014.

389 Above n 42, pp 58-59.

390 ATO, 'Test Case Litigation Register' (26 September 2014) <[www.law.ato.gov.au](http://www.law.ato.gov.au)>.

ATO is seeking to test the law.<sup>391</sup> The IGT considers that this is a positive first step and that it is likely to provide improved transparency of the ATO's approach to litigation.

## THE LEGAL FRAMEWORK FOR DISPUTES

5.67 The legal framework for the resolution of tax disputes in Australia comprises a number of different avenues. These include the objections and litigation processes which were discussed earlier in the report. There are also other legislative avenues such as judicial review through the *Administrative Decisions (Judicial Review) Act 1975* and the *Judiciary Act 1903* and the use of declaratory proceedings which the IGT previously recommended in his 2012 ADR Review.<sup>392</sup> It should be noted that the Chief Justice of the Federal Court has more recently encouraged the use of declaratory proceedings and the current Commissioner has indicated that this warrants further dialogue with the legal profession.<sup>393</sup>

5.68 In addition to these, there are a number of other legislative and administrative mechanisms designed to ensure early and efficient dispute prevention, identification and resolution. These include the model litigant rules, the use of alternative dispute resolution and the use of real time compliance initiatives. Each of these are discussed below.

### Model litigant rules

5.69 The obligation for the Commonwealth to act as a model litigant (commonly referred to as the model litigant rules or model litigant obligation) is contained in Appendix B to the *Legal Services Directions 2005* (LSD 2005).<sup>394</sup> It requires:

...the Commonwealth and its agencies, as parties to litigation, to act with complete propriety, fairly and in accordance with the highest professional standards. This obligation may require more than merely acting honestly and in accordance with the law and court rules. It also goes beyond the requirement for lawyers to act in accordance with their ethical obligations.<sup>395</sup>

5.70 The LSD 2005 and model litigant rules are administered by the Office of Legal Services Coordination (OLSC), a section of the Attorney-General's Department. The OLSC is also responsible for investigating alleged breaches of the LSD 2005 which may be brought to its attention by media reports, judicial comments and complaints made directly to it.<sup>396</sup> In May 2013, the Compliance Framework for the LSD 2005 was amended such that the OLSC no longer investigates or resolves complaints from

391 The Tax Institute, 'ATO dispute resolution working group' (23 October 2014) <[www.taxinstitute.com.au](http://www.taxinstitute.com.au)>.

392 Above n 42, pp 61-62.

393 Chris Jordan AO, 'Commissioner's Address to the Tax Bar Association' (speech delivered to the Tax Bar Association, Melbourne, 6 November 2014) <[www.ato.gov.au](http://www.ato.gov.au)>; Jennifer Batrouney QC, 'Declaratory relief in revenue matters' (5 November 2014) p 1.

394 *Judiciary Act 1903* s 55ZF.

395 *LVR (WA) Pty Ltd v Administrative Appeals Tribunal* [2012] FCAFC 90 at [42].

396 Office of Legal Services Coordination, 'Guidance Note No 3' (undated) <<http://www.ag.gov.au>>.

members of the public, but refers the complaint to the relevant agency for appropriate action.<sup>397</sup>

5.71 The ATO has reported that between 1 July 2007 and 31 December 2012, there have been 47 alleged breaches of the model litigant rules. Of these, 37 were self-reported by the ATO, 8 were raised by taxpayers and 2 were identified and investigated by the OLSC following media reports.<sup>398</sup> Of these allegations the OLSC has found that there were 5 breaches, 3 of which were administrative in nature.<sup>399</sup> Information provided to the IGT indicates that, in relation to one of the breaches, the ATO accepts that it breached the LSD 2005 by pursuing two related taxpayers in instances where Counsel's advice was that its prospects of success were poor.<sup>400</sup>

5.72 Submissions to the IGT in this review note that while the model litigant rules provide an aspirational template for the Commonwealth to act with the highest levels of propriety, it does not confer any enforceable rights. Indeed, the *Judiciary Act 1903* makes it clear that only the Attorney-General can enforce the LSD 2005.<sup>401</sup> However, some members of the community believe that avenues of redress exist. This mistaken belief has been borne out in attempts to enforce the rules through litigation which have inevitably failed due to the nature and design of the rules.<sup>402</sup> Accordingly, stakeholders consider that there is a disconnect between the Government's intended purposes for the rules and the community's understanding and expectations of them.

5.73 The IGT has previously, and during this current review, received submissions which have called for greater enforceability of the model litigant rules. The issue of enforceability of the model litigant rules extends beyond the operations of the ATO. The Productivity Commission has recently considered the effectiveness of the model litigant rules as part of its *Access to Justice Arrangements* report.<sup>403</sup> In doing so, the Commission reflected stakeholder concerns that variable compliance with the rules was a result of difficulties with enforcement and sanctions.<sup>404</sup> The Commission has made a draft recommendation that:

Compliance should be monitored and enforced, including by establishing a formal avenue of complaint to government ombudsmen for parties who consider model litigant obligations have not been met.<sup>405</sup>

5.74 While the IGT considers that this is a matter which warrants careful consideration, such consideration needs to be undertaken in conjunction with other key government agencies and departments, including the OLSC and the Attorney-General's Department. The IGT proposes to explore these issues in more detail in his previously announced review into the *Taxpayers' Charter* and taxpayer protections.

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397 Attorney-General's Department, *Legal Services Directions 2005 Compliance Framework* (2013) p 6.

398 ATO, *Your Case Matters* (3rd edition, 2013) p 34.

399 Ibid, p 35.

400 ATO communication with the IGT, 18 July 2014.

401 *Judiciary Act 1903* sub-ss 55ZG(2)-(3).

402 *Caporale v Deputy Commissioner of Taxation* [2013] FCA 427.

403 Above n 217, pp 429 and 431.

404 Ibid, p 434.

405 Ibid, recommendation 12.3, p 442.



## Alternative dispute resolution

5.75 As set out earlier in this report, the IGT's 2012 ADR Review was a broad-based examination of the ATO's dispute resolution work throughout its end-to-end compliance process.<sup>406</sup> Following completion of the review, the ATO embarked on a significant program of reform in its dispute resolution approaches, using the IGT's report as the foundation.

5.76 As part of that review the IGT considered the dispute resolution approaches of the US, New Zealand, Canada and the UK. For example, the IGT drew upon the UK's pilot to facilitate discussions between HMRC officers and taxpayers to resolve disputes earlier without recourse to the tribunals.<sup>407</sup> The IGT made a recommendation for the ATO to pilot a similar program to engage ATO in-house facilitators to assist small business and individual taxpayers to resolve their disputes expeditiously and cost effectively.<sup>408</sup> As a result, the ATO has reported that following a successful pilot, it has expanded the program to include a wider group of taxpayers and disputes.<sup>409</sup>

5.77 During the course of the review, the IGT was also conscious of domestic developments in ADR across the APS and was mindful to ensure that matters recommended reflected a whole-of-Government approach. To this end, the IGT engaged with and referred to the work of the Attorney-General's Department's Access to Justice Taskforce<sup>410</sup> and the National Alternative Dispute Resolution Advisory Council.<sup>411</sup>

5.78 In total, the report made 21 recommendations to the ATO and one to the Government. The ATO agreed in full, in part or in principle with all but one of the recommendations.<sup>412</sup> The recommendations were largely aimed at:<sup>413</sup>

- Ensuring the ATO and the taxpayer engage earlier to ascertain and agree on those matters that are agreed and those that remain in contention;
- Streamlining of information exchange between the parties to ensure that the matters in dispute are understood;
- Ensuring clear escalation channels to appropriate ATO personnel to engage in dispute resolution processes;
- Bringing early engagement and ADR to the forefront of ATO dispute resolution efforts and only litigating cases which turn on genuine and fundamental disputes as to law and where there is a public benefit in having the matters judicially determined;
- Enhancing the skills and understanding of both ATO staff and taxpayers of the different types of engagement available in ADR and the circumstances in which

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406 Above n 42.

407 HM Revenue and Customs, 'Alternative Dispute Resolution for SMEs and Individuals Project Evaluation Summary' (undated) <[www.hmrc.gov.uk](http://www.hmrc.gov.uk)>.

408 Above n 42, recommendation 3.6, p 44.

409 ATO, 'Facilitation process' (14 October 2014) <[www.ato.gov.au](http://www.ato.gov.au)>.

410 Attorney-General's Department, 'Access to Justice' (undated) <[www.ag.gov.au](http://www.ag.gov.au)>.

411 Attorney-General's Department, 'Alternative Dispute Resolution' (undated) <[www.ag.gov.au](http://www.ag.gov.au)>.

412 Above n 42, pp 107-108.

413 Ibid, pp v-vi.



these may be appropriate through increased training and publication of information respectively; and

- Identifying opportunities for continuous improvement through implementing processes to enable feedback to be provided regarding the use of ADR in the tax dispute context.

5.79 The recommendation with which the ATO disagreed sought to address perceptions of a lack of independence in the ATO's objections function from its compliance function by recommending a pilot where objections for the most complex cases be moved from the Compliance Group to the LD&P Group. While the ATO disagreed with this recommendation at the time, it has since largely implemented it by moving objections for taxpayers with turnover of \$100 million or more from the Compliance Group to the LD&P Group.<sup>414</sup>

5.80 The IGT recognises that since that review, the ATO has made significant progress in its dispute resolution work. The ATO has increased the number of initiatives and avenues through which taxpayers may engage with the ATO on tax disputes. However, as noted earlier, some of these initiatives are restricted to certain classes of taxpayers which have given rise to perceptions of arbitrariness and unfairness. Moreover, stakeholders have also raised concerns with the IGT that in some instances, engaging with relevant senior ATO officers may still be problematic, hampering effective early engagement and leading to unnecessary litigation, the vast majority of which are resolved without hearing.

5.81 The IGT considers that the Appeals Group, with responsibility for objections, pre-assessment reviews and dispute resolution including ADR, would be well-placed to ensure that taxpayers have a single port of call to engage with the ATO on dispute resolution. Moreover, with a single centralised area, the ATO would be able to better assess the nature of the dispute and identify the most appropriate means of resolution without arbitrary restrictions and delineations which may result in perceptions of inconsistent treatment.

## **Real time compliance initiatives**

5.82 The self assessment system is generally predicated on the basis that taxpayers assess their own tax liabilities and the ATO assures itself of compliance after an assessment issues. Typically, such assurance may involve information gathering, site visits with relatively straight forward risk reviews escalating to audits in more serious or significant matters.

5.83 In more recent years, the ATO has increasingly sought compliance assurance and verification earlier in the process. Such processes are more contemporaneous or real time than traditional compliance assurance activities and, at present, are largely confined to large businesses. They may take the form of pre-lodgment compliance reviews, annual compliance arrangements and international dealings schedules.<sup>415</sup> In relation to large multi-national companies, the ATO may also engage in negotiating

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414 Above n 58.

415 Above n 37, p 21.

APAs which seek to resolve transfer pricing issues before transactions are undertaken.<sup>416</sup>

5.84 The above pre-lodgement compliance activities have been examined in earlier IGT *reviews into improving the self assessment system* and the Transfer Pricing review.<sup>417</sup> The IGT has made a number of recommendations as to how these compliance activities might be improved. Ultimately, they must balance creating efficiencies in the compliance assurance and verification processes whilst providing timely certainty for taxpayers and the ATO alike.

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<sup>416</sup> Above n 162, pp 80, 151-168.

<sup>417</sup> IGT, *Review into improving the self assessment system* (2013); Above n 162.



## CHAPTER 6 — RECOMMENDATION TO GOVERNMENT

6.1 Tax disputes are a feature of any tax system and to some extent reflect the complexities which have evolved. In some instances, disputes serve to support the health of the system by clarifying areas of uncertainty for the benefit of the community. However, there are costs associated with tax disputes for both the ATO and for taxpayers. These costs may be financial, emotional or reputational. Having regard to these impacts and the concerns discussed in previous chapters, the majority of stakeholders have called for improved governance and processes in the management of tax disputes for all taxpayers.

6.2 The importance of a robust governance framework cannot be overstated. The ATO, by necessity, is a monopoly service provider and has considerable power, such as compulsory extraction of money and restricting freedom of movement, which may largely be exercised without the need for a Court order. Therefore, there is a need for robust checks and balances. In the past, the IGT has recommended the establishment of an oversight or advisory Board to bring a diverse mix of expertise into the ATO.<sup>418</sup> This recommendation remains relevant having regard to the practices of other OECD jurisdictions as well as those of other agencies in Australia.<sup>419</sup>

6.3 There is also a need for specific structural reform and a governance framework to address concerns with the management of tax disputes. This has been explored in Chapter 4 as well as the Tax Forum Submission.

6.4 The IGT acknowledges that the ATO has made recent efforts in implementing a more effective approach to minimising disputes, particularly in the large business and HWI taxpayer segments. Such changes are welcomed and necessary to meet changing community expectations of it as a service provider rather than merely administrator and regulator. These changes also mark a stage in the ATO's evolution from one of a managerially directed organisation focused on technical accuracy to an organisation that achieves appropriate technical outcomes in a responsive and equitable manner.

6.5 Notwithstanding the recent positive changes, significant concerns, set out in the previous chapters, continue to be raised and the IGT is of the view that they can only be addressed by structural change, i.e. through the creation of the Appeals Group. The Appeals Group would be a centralised, dedicated and separate internal group within the ATO to manage tax disputes independently for all taxpayers, including conducting pre-assessment reviews, objections and litigation processes and employing ADR as necessary.

6.6 As set out in Chapter 4, the centralisation of the disputes management function through the Appeals Group would yield a number of benefits. Firstly, it

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418 Above n 33, p 1.

419 *Competition Policy Review* (Ian Harper, Chairman) (Draft Report, 2014) pp 62-63.

would ensure equal access for all taxpayers to effective pre-assessment reviews, without arbitrary distinctions between categories of taxpayers, by providing a singular channel through which taxpayers may seek access where discussions with the compliance team have reached an impasse. An effective pre-assessment review process would operate as quality assurance of the audit decision before NOAs are issued, which can have significant adverse impacts on taxpayers. As discussed in Chapter 3, this is particularly important for small business and individual taxpayers for whom the financial and emotional costs of external dispute management processes, i.e. the court and tribunal systems, may act as a barrier to accessing justice.

6.7 Secondly, it would enhance the actual and perceived independence of the objection process by removing all objections from the Compliance Group. This would assist to enhance community confidence that where objections are lodged, they will be approached with 'fresh eyes' and all matters will be considered without influence from other areas within the ATO, i.e. the LD&P and Compliance Groups.

6.8 Thirdly, the conduct and management of litigation would be enhanced by empowering litigation officers to independently consider the merits of a case, the competing legal positions of the ATO and the taxpayer and determine whether the case should be progressed or otherwise settled. In so doing, the Appeals Group would also provide independent oversight and advice on the ATO's approach to settlements, ensuring that any settlements are in accordance with the existing governance processes and in the best interests of the community. In this role, the Appeals Group would perform a function akin to the Solicitor-General in providing advice on significant matters and would be analogous to the current Tax Assurance Commissioner in HMRC.

6.9 Fourthly, the Appeals Group would provide a centralised resource for the ATO on all dispute resolution matters and, in particular, the use of ADR. The Appeals Group would be well-placed to provide advice and assistance on the use of ADR throughout the compliance and dispute resolution process, including at the above three stages to ensure that the most effective techniques are applied to resolve disputes as early as possible. In addition to providing advice and assistance, the consolidation of the dispute resolution and ADR function within the Appeals Group would increase its profile within the ATO and assist to embed the ATO's intended dispute resolution culture throughout the organisation.

6.10 Finally, there are synergistic benefits to be realised through centralising the ATO's end-to-end tax disputes management process. These include:

- having multiple points at which disputes are reconsidered and learnings captured and fed back earlier in the process to minimise the instances of disputes arising in the future; and
- enabling early intervention from disputes resolution specialists who may be better able to settle cases or identify significant or test cases to be litigated for law clarification purposes.

6.11 The effectiveness and independence of the Appeals Group in the performance of these functions requires strong leadership through the appointment of a new Second Commissioner, dedicated to lead this area within the ATO. As previously noted, whilst

an internal area cannot be truly independent of the organisation, it can be made as independent as possible through separate and distinct senior leadership with specific accountability and reporting requirements. As noted earlier, the tenure and remuneration of the Second Commissioner would be determined by the Government and the Remuneration Tribunal respectively and not the Commissioner.

6.12 The creation of the Appeals Group would also be in line with the majority of submissions received by the IGT during the course of this review, current international practice across a number of jurisdictions as well as IGT recommendations made in earlier reviews and other forums.<sup>420</sup>

6.13 The IGT has also had the benefit of examining transcripts of public hearings and submissions made by the ATO to the Committee. In particular, the IGT has considered the ATO's concerns regarding the creation of a new Second Commissioner to lead a separate appeals area.<sup>421</sup> However, the ATO has discussed and opposed this option together with the option to create a separate agency to handle tax disputes.<sup>422</sup> Whilst, the IGT agrees with the ATO position with respect to the latter, the IGT does not believe they have made a compelling case against the former.

6.14 The ATO's concerns with a new Second Commissioner leading the Appeals Group centres around costs, restricted communication and a barrier to effective feedback loops. In the IGT's view, such suggestions of costs and restricted communication do not only apply to dispute resolution but to the demarcation of any function within the ATO. Wherever there is separation between any functions, there will be limits to communication and information exchange. In relation to dispute resolution such separation ensures that taxpayers are perceived to be given genuine reconsideration of their disputes and the organisational framework supports a robust internal culture of dispute resolution.

6.15 The IGT accepts that feedback loops are an important mechanism to improve ATO decision making. However, the creation of the Appeals Group should not diminish feedback loops due to the restricted communication. This is not borne out by the experience in other jurisdictions, such as the IRS, and the IGT further notes that existing arrangements between the ATO and the Treasury demonstrate that ongoing effective feedback can occur even between separate agencies.

6.16 The ATO has also raised concern about tensions between the Appeals Group and other areas of the ATO and the Commissioner effectively having to 'umpire'. The IGT believes that such tensions, when appropriately managed, would assist the ATO to build community confidence and address any remaining perceptions of bias by reason of the function remaining within the ATO and not in a separate agency.

6.17 The IGT also considers that the Commissioner should not be required to 'umpire' disagreements between the Appeals Group's leadership and other areas of the ATO beyond what may presently be required as between the Second Commissioners for the Compliance and LD&P Groups. In the majority of cases, the

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420 Above n 42, p 107; Above n 33, pp 17-18.

421 Above n 160, p 2; Above n 278, p 4.

422 Above n 278, p 8.

Second Commissioner of the Appeals Group would be the final decision maker with respect to the resolution of a dispute. Where disagreements as to the correct view of the law are unable to be resolved at the Second Commissioner level, the matter could be streamlined to litigation for judicial clarification.

6.18 Clearly, the creation of the Appeals Group would require structural change within the ATO. The IGT recognises that structural change may present challenges, and understands that there may be some reticence in that regard. Change takes time to implement, test and embed, such was the experience with the establishment of the IRS Office of Appeals in the early 1990s and the dissolution of the ARG within the ATO during the same time. However, the ATO is currently undergoing a 'reinvention' and the formation of the Appeals Group could be a part of that restructure. Accordingly, the IGT believes that it is an ideal time to implement such a positive step in improving tax dispute resolution in this country.

6.19 The IGT also notes that, generally, there is some inertia towards change. However, once such changes are implemented and bear fruit, the initial opposition fades and positive outcomes are embraced. In this respect, parallels may be drawn in relation to a number of IGT recommendations which were initially rejected by the ATO, or required substantial persuasion, but ultimately were adopted and resulting successes celebrated by the ATO. The ATO's most recent submission to the Committee<sup>423</sup> highlights a number of such examples including:

- the implementation of the ATO's in-house facilitation program (IGT ADR Review, recommendation 3.6) and IR process (IGT Large Business Review, recommendation 9.3);<sup>424</sup>
- earlier and better engagement in person to minimise the extent of disputes arising particularly when the ATO is interacting with individual and small business taxpayers (IGT ECT Review, recommendation 3.5);<sup>425</sup>
- improving early identification of potential test cases and adopting a more flexible approach to test case funding (IGT ADR Review, recommendation 4.2);<sup>426</sup>
- increasing transparency of ATO decisions by engaging with small business taxpayers before issuing position papers to explain technical positions and why taxpayers have been selected for audit (IGT SME/HWI Review, recommendations 5.2 and 5.4);<sup>427</sup>

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<sup>423</sup> Above n 278.

<sup>424</sup> Above n 42, recommendation 3.6; Above n 37, (2011) recommendation 9.3.

<sup>425</sup> IGT, *Review into the ATO's compliance to individual taxpayers – superannuation excess contributions tax* (2014) recommendation 3.5. See also IGT, *Review into the ATO's compliance to individual taxpayers – use of data matching* (2014) p 60; IGT, *Review into the ATO's compliance to individual taxpayers – income tax refund integrity program* (2014) p 51.

<sup>426</sup> Above n 42, recommendation 4.2.

<sup>427</sup> Above n 38, recommendations 5.2 and 5.4.



- making greater use of declaratory proceedings in tax disputes (IGT ADR Review, recommendation 4.3);<sup>428</sup>
- reducing timeframes for considering objections (IGT Objections Review, recommendation 4);<sup>429</sup>
- improving technical decision making, including by improving auditor access to technical experts and emphasising greater focus on facts and evidence (IGT, SME/HWI Review, recommendation 3.2);<sup>430</sup>
- implementing performance measures which focus on the taxpayer experience (IGT SME/HWI Review, recommendation 2.17; IGT ADR Review, recommendation 5.4);<sup>431</sup> and
- developing a dispute resolution charter (IGT ADR Review, recommendation 5.2).<sup>432</sup>

6.20 A less celebrated change has been the transfer of the objections function for large businesses from the Compliance Group to the Law Group. This recommendation was made by the IGT in the ADR Review and originally rejected by the ATO.<sup>433</sup>

6.21 The number of past IGT report recommendations which have been implemented and evolved into lasting improvements in the ATO's administration highlights two important points. Firstly, it illustrates the importance of external scrutineering within a transparent system of administration where a different and principled professional viewpoint on improvements may be discussed, negotiated and implemented for the benefit of the whole community. Secondly, it demonstrates that change is not always immediate and that significant and lasting change may require some time to become accepted and the benefits fully realised.

6.22 The creation of the Appeals Group would be an example of such a significant change. The IGT accepts that there may be some resistance at the outset to the change but is confident that such change is necessary to ensure that the benefits presently being initiated are appropriately enhanced and captured within an appropriate legislative framework that will stand the test of time. Such a framework should outline key aims and expectations whilst allowing flexibility to accommodate future needs and requirements.

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428 Above n 42, recommendation 4.3, pp 61-63.

429 Above n 39, recommendation 4.

430 Above n 38, recommendation 3.2.

431 Ibid, recommendation 2.17; Above n 42, recommendation 5.4.

432 Above n 42, (2012) recommendation 5.2. See also: Above n 30, key recommendation 1.

433 Above n 42, (2012) recommendation 6.1.

## RECOMMENDATION

*The IGT recommends that the Government consider legislatively:*

- 1. creating a separate Appeals Group, which would be headed by a new and dedicated Second Commissioner, responsible for managing tax disputes for all taxpayers, through:*
  - (a) pre-assessment reviews;*
  - (b) objections;*
  - (c) litigation including identifying test cases and providing oversight on settlements; and*
  - (d) facilitating the use of ADR throughout the compliance and dispute resolution process; and*
- 2. establishing a framework for the development of communication protocols between the Appeals Group and other areas of the ATO to ensure that the Appeals Group is, and is seen to be, independent in its dispute resolution function.*

# APPENDIX 1 — TERMS OF REFERENCE AND COMMITTEE MEDIA ALERT

## BACKGROUND

On 2 June 2014, the Acting Assistant Treasurer, Senator the Hon Mathias Cormann, referred an Inquiry into Tax Disputes (the Inquiry) to the House of Representatives Standing Committee on Tax and Revenue (the Committee). The Committee adopted the Inquiry and announced that it would consider, amongst other things, 'whether a separate agency should manage ATO litigation, whether the ATO should have a separate appeals area, or if current arrangements should continue.'<sup>434</sup> On 11 June 2014, the Committee requested the IGT to undertake a review under his legislation on the large business<sup>435</sup> and high wealth individual (HWI)<sup>436</sup> themes of the Inquiry. The IGT has accepted the Committee's request.

The ATO's statistics indicate that there is a much higher level of disputation within the large business and HWI market segments than all other market segments. For example, between 1 July 2012 and 31 December 2012, the ATO reported that, with respect to large businesses, it conducted 230 compliance activities which resulted in liability adjustments. There were 130 objections which suggest that an objection was raised in 56% of the cases.<sup>437</sup> Over the same period, the ATO conducted 226,200 such activities and received 16,480 objections in relation to all taxpayers (7.2%).<sup>438</sup> Moreover, disputes within the large market and HWI market segments often involve significant amounts of revenue.<sup>439</sup> For example, in 2012-13, totals of \$997m and \$247m in revenue were varied in settlements with large businesses and HWIs respectively.<sup>440</sup>

Since 2010, the IGT has undertaken a number of reviews examining the ATO's compliance approach to large businesses,<sup>441</sup> HWIs<sup>442</sup> as well as its use of Alternative Dispute Resolution (ADR).<sup>443</sup> As a result of these reviews, the ATO has undertaken a range of improvement initiatives including committing to engage with taxpayers earlier to resolve disputes, making broader use of ADR and implementing an

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434 Standing Committee on Tax and Revenue, *Inquiry into tax disputes launched*, Media Alert, 6 June 2014.

435 Australian Taxation Office (ATO), *Large Business and Tax Compliance*, May 2014. The large business segment includes 1,800 economic groups or entities encompassing some 35,000 business. Of those 1,800, approximately 1,100 have an annual turnover greater than \$250m.

436 The ATO defines high wealth individuals as those controlling more than \$30m or more in wealth.

437 ATO, *Your Case Matters*, 3rd edition, 19 April 2013, p 6.

438 The objection rates of 56% and 7.2% include instances of taxpayers objecting to their own self assessments.

439 Standing Committee on Tax and Revenue, *Hansard*, 28 February 2014, p 7.

440 Commissioner of Taxation, *Annual Report 2012-13*, p 58.

441 Inspector-General of Taxation (IGT), *Report into the Australian Taxation Office's large business risk review and audit policies, procedures and practices*, 7 September 2011

442 IGT, *Review into the ATO's compliance approaches to small and medium enterprises with annual turnovers between \$100 million and \$250 million and high wealth individuals*, 24 April 2012.

443 IGT, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution*, 31 July 2012.

independent review function for some large businesses.<sup>444</sup> Having regard to the high levels of disputation within these market segments, the potential for significant impacts on revenue and the ATO's improvement initiatives following earlier IGT reviews, the IGT considers that the Committee's Inquiry is timely and appropriate.

## TERMS OF REFERENCE

The terms of reference for the Committee's Inquiry are reproduced below.

*The Committee is to inquire into and report on disputes between taxpayers and the Australian Taxation Office (ATO), with particular regard to:*

- *Collecting revenues due*
- *fair treatment and respect of taxpayers*
- *efficiency, effectiveness and transparency, from the perspective of both taxpayers and the ATO, and*
- *how the ATO supports the outcomes of efficiency, effectiveness and transparency through the use and publication of performance information.*

*The Committee is to examine these issues through the following themes:*

- *small business*
- *large business*
- *high wealth individuals*
- *individuals generally*
- *the legal framework for disputes, including:*
  - *the model litigant rules*
  - *real time compliance initiatives, including annual compliance arrangements, pre-lodgement compliance reviews, and the reportable tax position schedule, and*
  - *alternative dispute resolution, and*
- *the governance framework for disputes, including:*
  - *the arrangements for and appropriate level of separation between the compliance, investigation, objection and litigation functions, and*
  - *comparisons with tax administration bodies overseas.*

*The Committee may consider and report on these themes individually or group them together.*

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<sup>444</sup> ATO, *Independent review of Large Business and International Statement of Audit Position*, 16 January 2014, <[www.ato.gov.au](http://www.ato.gov.au)>.

Pursuant to the Committee's request, the IGT will undertake a review on the large business and high wealth individual themes of the Inquiry which may also examine related legal and governance frameworks.

## **SUBMISSION GUIDELINES**

We envisage that your submission will set out your experiences and views on the ATO's management of tax disputes.

It is important to provide a detailed account of your experiences with the ATO's management of the tax dispute and its impact on you. In this respect, it would be useful to provide a timeline of events outlining your key interactions with the ATO including key correspondence.

In addition to your views on potential improvements, we are seeking examples of ATO approaches that have contributed to positive outcomes.

The following questions may assist you in your response.

### **Your dispute with the ATO**

- Q1. Please provide details of your dispute with the ATO, including a chronology of events, the details of the legal or factual matters, the type of taxes involved and disputed amount.
- Q2. Did you, or the ATO, seek to resolve the dispute informally or by using alternative dispute resolution (ADR) processes? If so, please provide details including:
  - a. who initiated the process;
  - b. when was the process initiated;
  - c. what the process involved;
  - d. how long did the process take to finalise;
  - e. whether the dispute was resolved; and
  - f. the costs associated with this process.

### **Independent review process**

- Q3. If your annual turnover exceeds \$250m, were you aware, or did the ATO inform you, of the independent review process for Statements of Audit Position?
- Q4. Did you participate in the independent review process? If so, please provide your views on:
  - a. the ATO's general approach to the independent review process;

- b. whether you and your adviser were provided with sufficient opportunity to address the independent reviewer;
- c. the outcome of the independent review process;
- d. whether the ATO audit team accepted the independent reviewer's findings;
- e. whether the independent review process resolved the dispute; and
- f. the time taken to complete the independent review process and the costs (including opportunity costs) you incurred (if any).

Q5. Please point out those aspects of the independent review process that you found beneficial as a dispute resolution mechanism as well as those which may need improvement. In doing so, you may wish to consider, for example, whether the independent review officer should be allowed to consider new facts and materials, whether taxpayers should be allowed to engage additional advisers to assist them in the process or whether such options should be reserved for the objection process? Please provide reasons for your views.

Q6. Is the timing of the independent review appropriate? For example, should it take place earlier in the audit process or later as part of the objection process? Please consider whether the present timing renders the objection process obsolete and whether this would be possible within the current legal framework. Alternatively if the independent review and the objection process were to coexist and provide taxpayers with two genuine review opportunities, would this cause unnecessary delay in resolving disputes?

Q7. Do you believe the ATO should extend the independent review process to all taxpayers? If so, what resources do you believe the ATO would need to do so effectively?

### **The objection process**

Q8. If your dispute was not resolved by the above processes, did you lodge an objection? Please explain your reasons.

Q9. In relation to the ATO's management of your objection, please provide details including:

- a. when you lodged the objection and when the objection decision was issued;
- b. whether the objection was considered by a Compliance officer or by an officer in the Law Group of the ATO;
- c. whether you were afforded with sufficient opportunity to provide information and engage with the ATO officer during the objection

process; and

d. the outcome of the objection.

Q10. Were any dispute resolution processes, including ADR, considered or undertaken during the objection process? If so, please provide details as requested in Q2.

Q11. Do you consider that your objection was fully and objectively considered? Please provide reasons for your view.

Q12. If you participated in the independent review process before objecting, what were the positive aspects of participating in the independent review process before the objection? Was there any negative impact such as introducing an unnecessary step which resulted in avoidable delay in resolving the dispute? Are there any improvements the ATO could make?

## Litigation

Q13. Did you apply for review or appeal to the Administrative Appeals Tribunal (AAT) or Federal Court of Australia (Federal Court)?

Q14. If so, did you or the ATO consider any dispute resolution options other than proceeding the matter to hearing, including ADR or any Court-ordered processes, after the application was lodged with the AAT or Federal Court? Was the dispute resolution process effective?

Q15. What are your views on the ATO's engagement in such dispute resolution processes and do you have any ideas on how this could be improved?

## Settlement

Q16. Did you or your adviser approach the ATO to settle the dispute or did the ATO approach you? If so, please provide the following details:

- a. at what stage of the dispute did settlement discussions commence;
- b. who within the ATO did you approach or approached you regarding settlement;
- c. was the settlement offer based on legal advice;
- d. describe the response to the settlement offer; and
- e. did the dispute ultimately settle?

Q17. What were your general impressions of the ATO's settlement process, including the conduct of its officers during negotiations? What aspects of the process worked well? Are there any improvements the ATO could adopt to enhance the process?



### **Collecting disputed debts**

- Q18. During the course of your dispute, did the ATO seek to collect the disputed taxes or did you approach the ATO to discuss the matter? If so, please provide details.
- Q19. Did the ATO make use of any administrative or legal mechanisms to collect the debts? For example, did the ATO offer you a 50/50 payment arrangement, issue a garnishee notice or commence debt litigation proceedings?
- Q20. What are your views on the ATO's approach to managing and collecting disputed debts? Please identify those aspects of the ATO's approach which contribute to a positive outcome as well as your suggestions for improvement (if any).

### **Fair treatment and respect**

- Q21. Throughout your dispute with the ATO, do you consider that you were treated fairly and with respect? Please provide reasons for your answer.
- Q22. Did you lodge a complaint in relation to your dispute? If so, please provide details of the complaint that you lodged, with whom it was lodged and the outcome.

### **Other**

- Q23. Are there any other areas on which you would like to make submissions? For example, you may wish to consider whether the current ATO organisational arrangements for making objection or litigation decisions are appropriate or whether they could be made in separate areas within the ATO or in a separate Government Department. In considering your views, you may wish to cite international experiences or comparisons, as well as the potential improvements and trade-offs.

## **LODGMET**

The closing date for submissions is 18 July 2014. Submissions can be sent by:

Post to:           Inspector-General of Taxation  
                      GPO Box 551  
                      SYDNEY NSW 2001

Email to:         [For enquiries regarding this review, please email  
                      enquiries@igt.gov.au]

## CONFIDENTIALITY

Submissions provided to the IGT are in strict confidence (unless you specify otherwise). This means that the identity of the taxpayer, the identity of the adviser and any information contained in such submissions will not be made available to any other person, including the ATO. Sections 23, 26 and 37 of the IGT Act safeguard the confidentiality and secrecy of such information provided to the IGT — for example, the IGT cannot disclose the information as a result of an FOI request, or as a result of a court order generally. Furthermore, if such information is the subject of client legal privilege (or legal professional privilege), disclosing that information to the IGT will **not** result in a waiver of that privilege.

## APPENDIX 1 (CONTINUED)



House of Representatives  
Standing Committee on Tax and Revenue

### **MEDIA ALERT**

*Issued: 6 June 2014*

*Chair: Mr John Alexander OAM MP  
Deputy Chair: Dr Jim Chalmers MP*

### **Inquiry into tax disputes launched**

The House Tax Committee today launched its inquiry into tax disputes.

The inquiry will cover all categories of taxpayers and include:

- fair treatment and respect of taxpayers
- how the ATO uses performance information in managing tax disputes
- whether the legal framework could be updated to encourage earlier dialogue between taxpayers and the ATO, such as through alternative dispute resolution and real time compliance strategies
- whether a separate agency should manage ATO litigation, whether the ATO should have a separate appeals area, or if current arrangements should continue
- comparisons with revenue agencies overseas.

As part of the inquiry, the Committee has requested the Inspector-General of Taxation to conduct a formal review into tax disputes in relation to large businesses and high wealth individuals. The Committee will concentrate on small business and individuals generally. The Inspector-General has not previously conducted an inquiry at the request of a parliamentary committee.

Committee chair John Alexander said, "Through the Committee's work to date, the ATO has made clear their efforts to promote taxpayer confidence and trust in the system. This inquiry will assist the Committee to ensure these goals, particularly with regards to mechanisms for dispute resolution."

"We are pleased to ask the Inspector-General of Taxation to conduct a formal review as part of our inquiry. The Inspector-General has a good track record and we look forward to benefitting from his expertise."

Although the Committee will receive evidence of individuals' experience with the tax system, it will not act on behalf of individual taxpayers in the inquiry. Full details are available on the Committee's website. Submissions are due Friday, 4 July 2014.

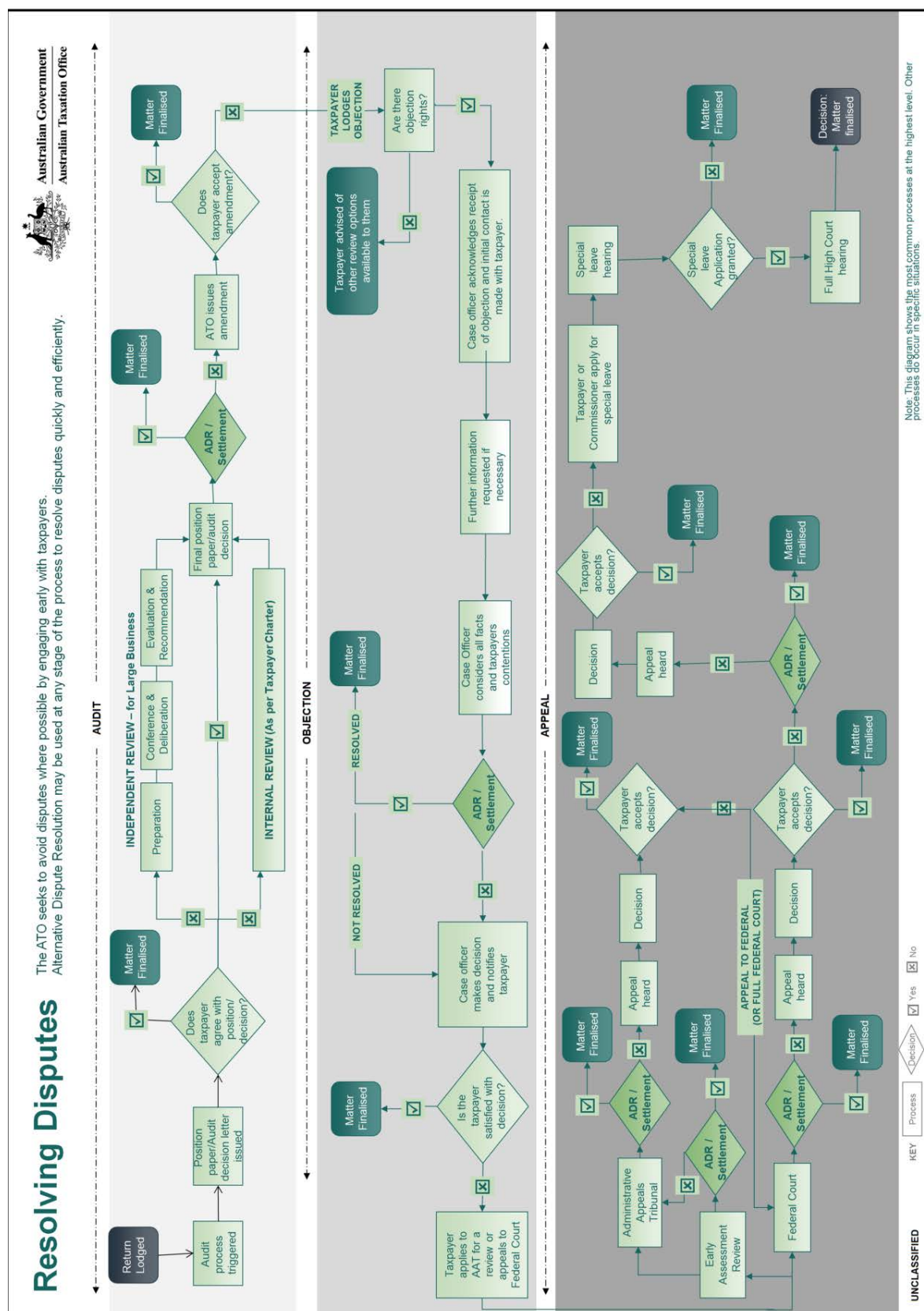
**For media comment:** please contact Committee Chair, Mr John Alexander OAM MP, on (02) 6277 4804.

**For further information:** please contact the committee secretariat by telephone 02 6277 4821, e-mail [taxrev.reps@aph.gov.au](mailto:taxrev.reps@aph.gov.au), or visit the committee website <http://www.aph.gov.au/taxrev>.

Telephone: 02 6277 4821  
Facsimile: 02 6277 2220  
E-mail: [taxrev@aph.gov.au](mailto:taxrev@aph.gov.au)  
Website: <http://www.aph.gov.au/taxrev>

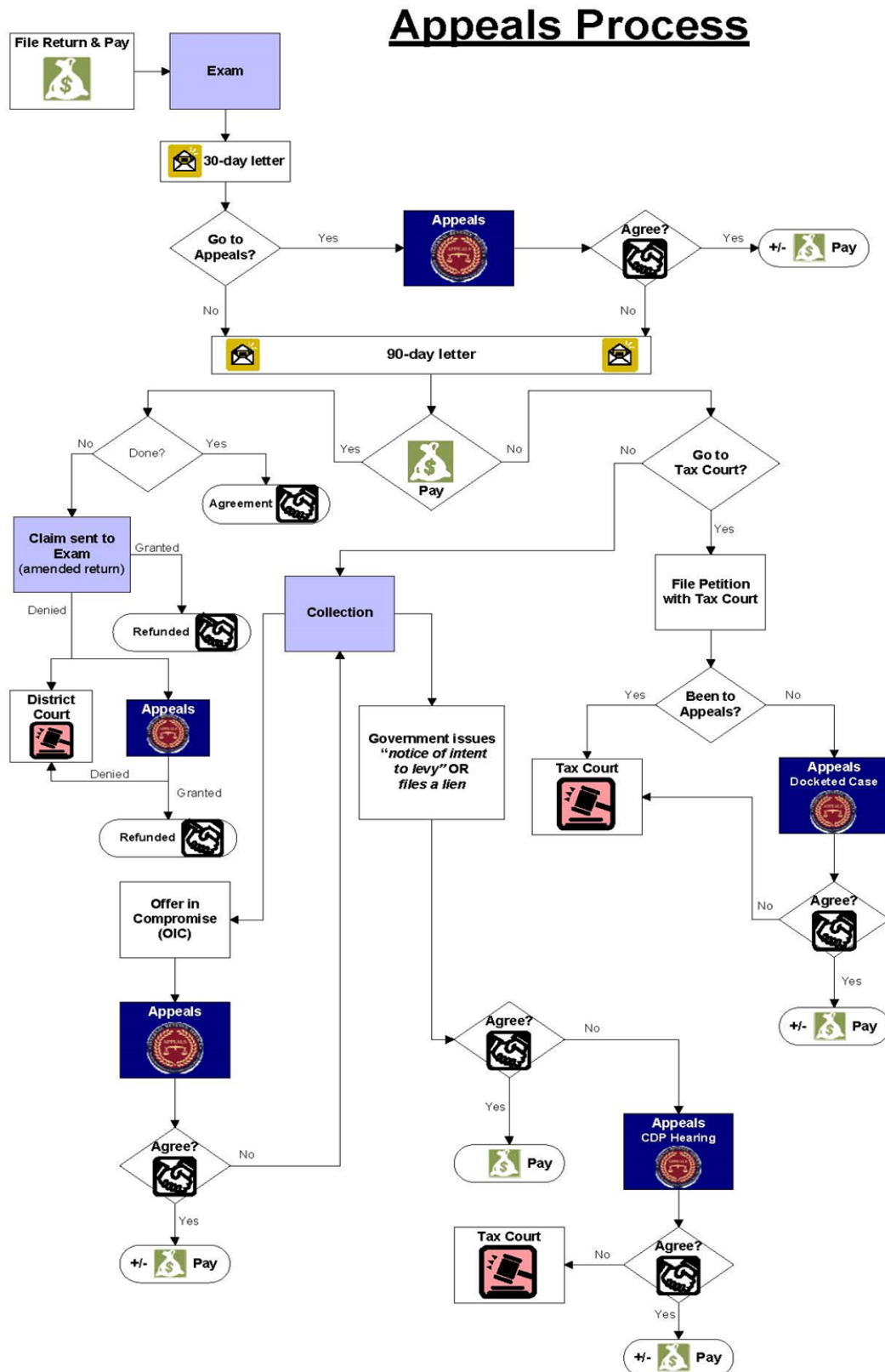
Parliament House  
PO Box 6021  
CANBERRA ACT 2600

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## APPENDIX 3 — US INTERNAL REVENUE SERVICE APPEALS PROCESS

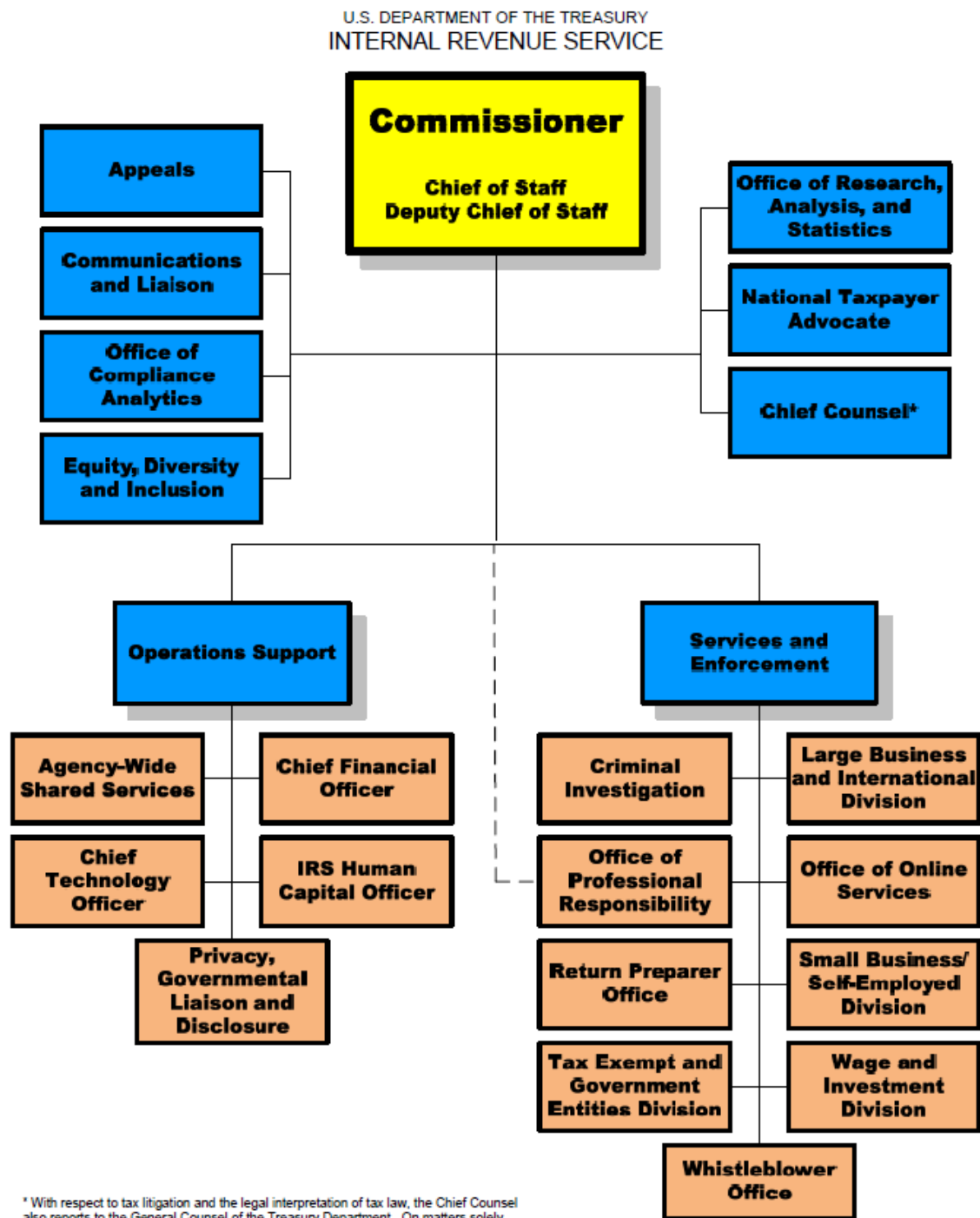






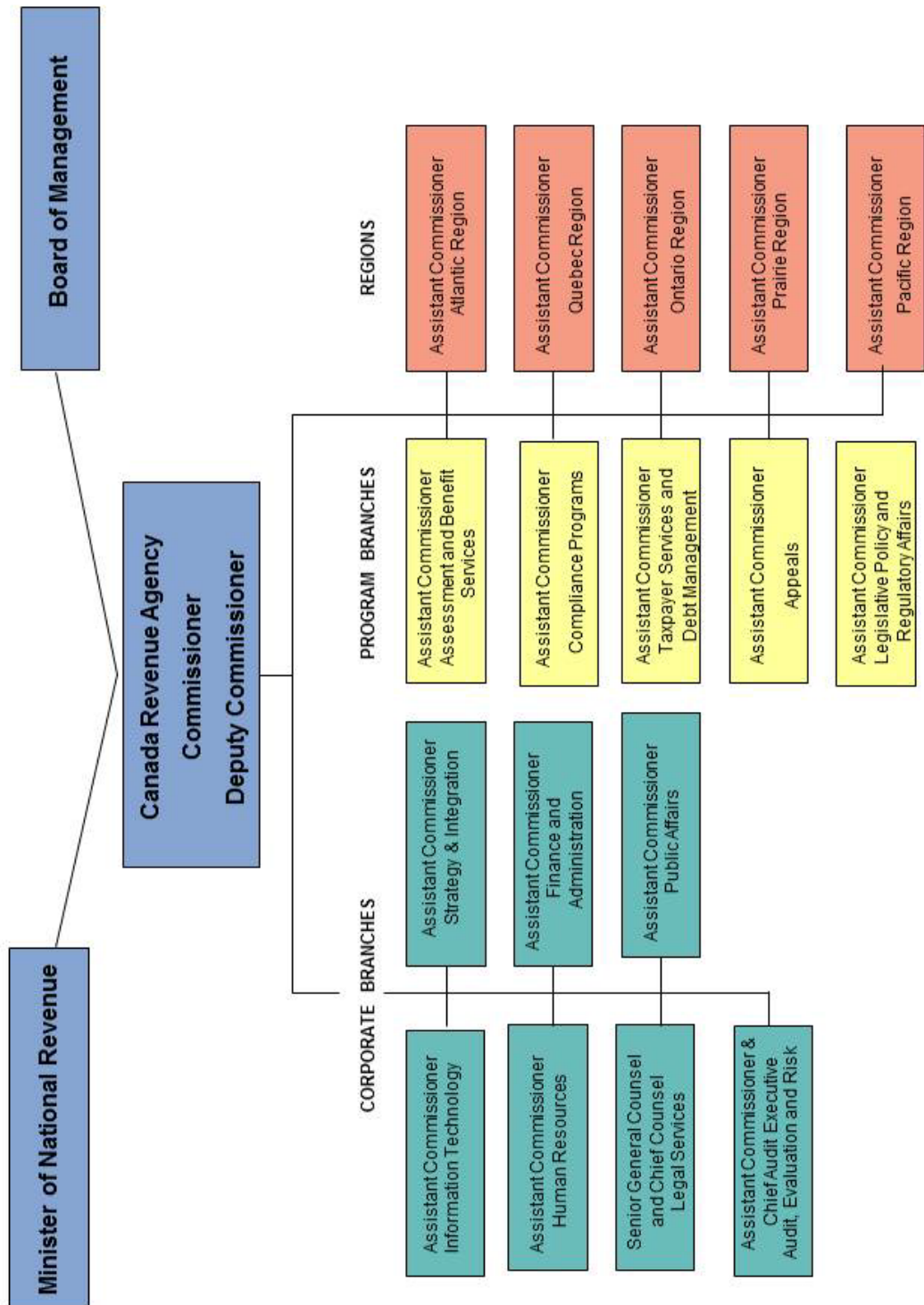
## APPENDIX 4 — INTERNATIONAL ORGANISATIONAL STRUCTURES

### IRS ORGANISATIONAL STRUCTURE



## CRA ORGANISATIONAL STRUCTURE

### CRA Organizational Structure



## ABBREVIATIONS/GLOSSARY

|        |   |
|--------|---|
| AAT    | Administrative Appeals Tribunal                           |
| ABSB   | Assessment and Benefit Services Branch (Canada)           |
| ADR    | Alternative Dispute Resolution                            |
| AGS    | Australian Government Solicitor                           |
| AJAC   | Appeal Judicial Approach and Culture (US)                 |
| ANAO   | Australian National Audit Office                          |
| APS    | Australian Public Service                                 |
| APSC   | Australian Public Service Commission                      |
| ARC    | Administrative Review Council                             |
| ARG    | Appeals and Review Group                                  |
| ATO    | Australian Taxation Office                                |
| ATO ID | ATO Interpretative Decision                               |
| CPB    | Compliance Program Branch (Canada)                        |
| CRA    | Canada Revenue Agency                                     |
| DCTC   | Deputy Chief Tax Counsel                                  |
| DPO    | Departure Prohibition Order                               |
| DRU    | Disputes Review Unit (New Zealand)                        |
| ENE    | Early Neutral Evaluation                                  |
| FTE    | Full-Time Equivalent                                      |
| HMRC   | Her Majesty's Revenue and Customs (UK)                    |
| HWI    | High Wealth Individuals (also Highly Wealthy Individuals) |
| IGT    | Inspector-General of Taxation                             |
| IR     | Independent Review  |
| IRD    | Inland Revenue Department (New Zealand)                   |

|                      |   |
|----------------------|---|
| IRS                  | Internal Revenue Service (US)   |
| LB&I                 | Large Business and International  |
| LD&P Group           | Law Design and Practice Group   |
| IRS Reform Act       | Internal Revenue Service Restructuring and Reform Act of 1998 (US)                          |
| ITAA 1936            | Income Tax Assessment Act 1936  |
| ITX                  | Indirect Tax  |
| JCPA                 | Joint Committee of Public Accounts  |
| LSD 2005             | Legal Services Directions 2005  |
| NOA                  | Notice of Assessment  |
| NOPA                 | Notice of Proposed Adjustment (New Zealand)   |
| NOR                  | Notice of Response (New Zealand)  |
| OECD                 | Organisation for Economic Cooperation and Development                                       |
| OLSC                 | Office of Legal Services Coordination   |
| PGH                  | Public Groups and High Wealth Individuals   |
| PGI                  | Public Groups and International   |
| PGPA Act             | Public Governance, Performance and Accountability Act 2013                                  |
| PS&S Group           | People, Services and Systems Group  |
| Ralph Review         | Review of Business Taxation (1999)  |
| RC                   | Revenue Commissioners (Ireland)   |
| RDR                  | Review and Dispute Resolution   |
| SME                  | Small to Medium Enterprises   |
| SOAP                 | Statement of Audit Position   |
| SOP                  | Statement of Position (New Zealand)   |
| STCT                 | Small Taxation Claims Tribunal  |
| TAA 1953             | Taxation Administration Act 1953  |
| Tax Forum Submission | <i>Tax Forum – Next Steps for Australia, A Submission to the Tax Forum (September 2011)</i> |

|     |   |
|-----|---|
| TCN | Tax Counsel Network                     |
| TLS | Tax Laws Services (Canada)              |
| TRA | Taxation Review Authority (New Zealand) |
| UK  | United Kingdom                          |
| US  | United States                           |