

## The governance framework

### The Inspector-General's report on tax disputes

6.1 The report of the Inspector-General of Taxation (IGT) was publicly released on Friday, 27 February 2015 and focusses on the governance issue of how much separation there should be between the Australian Taxation Office's (ATO's) audit and review functions. The IGT's report makes a strong case that the review function should be internally separated within the ATO in a new Appeals Group under a new Second Commissioner appointed for this purpose. The IGT envisages that the Appeals Group would have a range of functions, including:

- pre-assessment reviews
- objections
- litigation
- alternative dispute resolution (ADR)
- managing the protocols on communication between the Appeals Group and the rest of the ATO.<sup>1</sup>

6.2 The IGT found that the underlying cause of many taxpayer concerns was the perception of a lack of independence in objections and other review processes by the ATO. This has itself been caused by a lack of separation between original decision makers and reviewers within the ATO. Some taxpayers believe that they will not receive a fair hearing until their matter reaches the Administrative Appeals Tribunal (AAT). Similar to the

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1 This section refers to IGT, *The Management of Tax Disputes: A report to the Assistant Treasurer*, January 2015, pp. vii-viii.

Committee, the IGT has acknowledged the work of the ATO in improving its dispute resolution processes. However, the IGT has proposed these governance reforms because they will be sustainable and benefit smaller taxpayers.

- 6.3 The Committee supports the IGT on these matters and has made similar recommendations. The Committee's evidence and reasoning is set out below.

## **Governance overview**

### **The current governance framework**

- 6.4 A tax dispute occurs where a taxpayer disagrees with an opinion or decision of the ATO. One avenue for the dispute to be addressed is for the taxpayer to lodge an objection. Most small business and individual objections stem from assessments resulting from ATO compliance activities including audits and reviews.<sup>2</sup>
- 6.5 When a taxpayer disagrees with an assessment, they lodge an objection with the ATO. The dispute is then moved to the objections area, which considers the matters of the dispute afresh, and then issues a decision on the matter. The objections area may seek advice on matters of law from the Tax Counsel Network, a body within the ATO that provides specialist legal advice.
- 6.6 Where the taxpayer disagrees with the decision on the objection, the taxpayer can make an application to the Administrative Appeals Tribunal to review the decision or appeal the decision before the Federal Court. Use of either of these two mechanisms is uncommon in the small business and individual sector.

### **Pre-1995**

- 6.7 The mid-1990s was a period of some change in the appeals area of the ATO. In 1993 the Joint Committee of Public Accounts (JCPA)<sup>3</sup> recommended that the resources of the Appeals and Review Group be reallocated 'to the performance of internal review within the original

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2 Australian Taxation Office, *Submission No. 10*, pp. 7-8.

3 Joint Committee of Public Accounts, *Report 326: An Assessment of Tax*, November 1993.

decision making processes of the ATO.<sup>4</sup> The reason was to increase the chances that the ATO made the correct decision in the first instance, rather than a matter being properly resolved through the appeals process.

- 6.8 The Committee was advised that prior to this change, the Appeals and Review Group was divided into two sub-parts – the Objections Review Unit, and the Appeals Branch, with one witness suggesting that this Group functioned in a ‘quasi-independent’ manner.<sup>5</sup>
- 6.9 In discussing the changes suggested in 1993, Mr Neil Olesen noted the old organisational structure, calling it both ‘state-based’, and ‘heavily functionally based’. He advised that the ATO had then moved to a nationally-based, market segmented approach.<sup>6</sup>
- 6.10 Mr Andrew Mills, Second Commissioner, Law, cautioned about thinking that practice prior to the changes made in 1995 constituted a clearly separated objections area:

I think that perhaps the effluxion of time has allowed people to imagine a situation that perhaps was not quite the way it is. What I mean by that is that it was always in-house – it was always part of the tax office. It was a separate area in the same way that our review and dispute resolution area today is a separate area. Objections, certainly up to the early nineties, were always done as part of the same broader group that was raising assessments – but by separate teams within those groups. So, in a sense, that fundamental separation has not actually changed even though there is a perception that it was somehow different.<sup>7</sup>

- 6.11 Several witnesses provided their recollections about the appeals system prior to the changes made in 1995. One witness observed that the objection and appeal areas were separate from the audit area, and that the ATO was not organised along business lines. He advised that at the time, an auditor may not have ever known that an objection had been raised, and that they may have only found out if an objections officer called to obtain clarity on a matter.<sup>8</sup> This point was also corroborated by the Law Institute of Victoria.<sup>9</sup>

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4 Joint Committee of Public Accounts, *Report 326: An Assessment of Tax*, November 1993, p. 271.

5 Mr Bernard Marks, *Submission No. 26*, p. 5.

6 Mr Neil Olesen, ATO, *Transcript of Evidence*, 16 July 2014, p. 14.

7 Mr Andrew Mills, ATO, *Transcript of Evidence*, 16 July 2014, p. 15.

8 Mr Richard Wytkin, *Transcript of Evidence*, 29 October 2014, p. 2.

9 Mr Bernard Marks, Law Institute of Victoria, *Transcript of Evidence*, 14 August 2014, p. 27.

- 6.12 Mr Philip Hack SC, Deputy President of the Administrative Appeals Tribunal, also provided the Committee with his observations of the appeals system prior to 1995:

When I first started in practice in the tax area many years ago, it was then called the objections and advising section. They were quite independent and were frequently unconcerned about the basis upon which a decision had been reached. They saw their task as being to bring an independent mind to the decision. That, it seems to me, has disappeared with this notion that the tax office now has business lines.<sup>10</sup>

- 6.13 He later offered a simpler description of the structure, stating that the appeals area ‘used a fresh set of eyes that did not have to report to the original set of eyes’.<sup>11</sup> Mr Tony Fittler stated that ‘when an objection went in it was looked at independently’, but that the process now was ‘hit and miss’.<sup>12</sup>

- 6.14 Mr Bernard Marks of the Law Institute of Victoria, in praising the broader achievements of the 1993 report of the JCPA stated that the Committee may not have considered the natural justice and fair procedure consequences of the restructure it proposed at the time.<sup>13</sup>

## Improving the disputes system

- 6.15 In its first appearance before the Committee, the ATO discussed what would constitute a good disputes system:

I think a good system has at least a few characteristics to it. One is the point I have made a few times today about trying to get best-quality decision making as early in the process as you possibly can – I think that is a feature of a good system. Another feature of a good system is that you have affordable, accessible review points, both internally and externally, that involve people who have not been involved in the original decision. That is a feature of the current system.<sup>14</sup>

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10 Mr Philip Hack SC, AAT, *Transcript of Evidence*, 26 October 2014, p. 1.

11 Mr Philip Hack SC, AAT, *Transcript of Evidence*, 26 October 2014, p. 5.

12 Mr Tony Fittler, HLB Mann Judd, *Transcript of Evidence*, 18 August 2014, p. 3.

13 Mr Bernard Marks, Law Institute of Victoria, *Transcript of Evidence*, 14 August 2014, p. 31.

14 Mr Neil Olesen, ATO, *Transcript of Evidence*, 16 July 2014, p. 15.

6.16 Throughout the course of the inquiry, the Committee has sought to find ways to improve on the current system. Several key themes were explored through this process:

- ensuing ATO review processes reflect best practice
- perceived levels of independence
- perceptions that the objection stage is a 'rubber stamp', and that the 'ATO view' must be upheld
- communication protocols between auditors and objection officers
- the role of the Tax Counsel Network
- practice in other jurisdictions.

### **Ensuring ATO review processes reflect best practice**

6.17 In 2000, the Administrative Review Council produced a report on internal review across the Commonwealth public sector. Its best practice guide suggested that:

- internal review officers should be organisationally distinct from primary decision makers
- internal review officers should not be physically located close to the primary decision makers whose decisions they review
- managers should reinforce the role of internal review and the necessity of independence
- there be only one internal review within an agency to prevent 'appeal fatigue'
- review officers should make personal contact with the applicant
- review officers should be able to consider information not available to the primary decision maker (Sometimes in ATO processes, new information requires a dispute to return to the original decision maker.)
- review officers should contact the primary decision maker to discuss the reasons for decision
- agencies should gather detailed internal review data to analyse trends and identify problems

- agencies should use internal review data to identify problems in policy and legislation.<sup>15</sup>

6.18 The Administrative Review Council suggests that internal review officers should contact primary decision makers to discuss the initial decision. This is contrary to some revenue agencies overseas, where this practice is barred, or at least regulated.<sup>16</sup>

### Perceived levels of independence

6.19 Many witnesses and submitters questioned whether it was even possible for the public to perceive the current disputes system as adequately independent of the audit process. The Law Institute of Victoria noted that this was not an issue of whether ATO officers were biased in their dealings with taxpayers, but rather 'it is about whether a fair-minded observer would reasonably suspect bias'<sup>17</sup> (otherwise known as apparent bias). Other witnesses noted the importance of bringing genuine independence to the review process.<sup>18</sup>

6.20 The Commonwealth Ombudsman noted the importance of procedural fairness being afforded to taxpayers. He noted the general administrative law principle was that any general review process should be 'quite separate and independent'.<sup>19</sup>

6.21 Mr Stephen Madz stated that the ATO investigating a dispute constituted a conflict of interest and that he did not believe the current system could be regarded as being in any way independent.<sup>20</sup>

6.22 Mr Andre Spnovic of BDO summed up the perception of a lack of fairness when speaking about his client's case:

...having an objections and appeals process is great, but if that process is not transparent and is not truly independent - particularly in Ian's case where the objections officer seemed to merely toe the party line, if I can put it that way - it really does call

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15 Administrative Review Council, *Internal Review of Agency Decision Making*, Report No. 44, November 2000.

16 For example, in New Zealand (see below).

17 Law Institute of Victoria, *Submission No. 8*, p. 10.

18 Mr Mark West, McCullough Robertson, *Transcript of Evidence*, 26 October 2014, p. 10.

19 Mr Colin Neave, Commonwealth Ombudsman, *Transcript of Evidence*, 24 September 2014, p. 12.

20 Mr Stephen Madz, *Transcript of Evidence*, 18 August 2014, p. 19.

into question the value of the objections and appeals process itself. is transparent and that there will be an independent set of eyes.<sup>21</sup>

- 6.23 Mr Philip Hack SC identified an issue related to independence, noting that there was a need for 'functional independence', that is, officers being able to make decisions without having to seek the consent or approval of the original decision maker. Further, he stated a need for there to also be a perception of independence.<sup>22</sup>
- 6.24 Cultural and institutional impediments to perceived fairness were also discussed by witnesses and submitters. Mr John Hyde Page noted that ATO objection officers were familiar with the auditors located in their business lines, and they were regularly in contact with each other as a matter of day to day business. Further, he stated that objection officers reported to a superior higher up the business line, and that the primary interest of the business line may not be for the integrity of the objection process.<sup>23</sup>
- 6.25 However, refuting this point, the Community and Public Sector Union reported that its members had advised that there was no pressure for objection officers to agree with business line decisions.<sup>24</sup>
- 6.26 In its appearance before the Committee, the Community and Public Sector Union was asked whether a staff member would refuse to deviate from a business line decision. The witnesses said that it was unlikely, and that there was 'quite a bit' of cultural separation between auditors and objection officers, and that there was a high degree of professionalism amongst ATO staff.<sup>25</sup>
- 6.27 Civil Liberties Australia submitted that those closest to an audit or raising an assessment may feel an undue attachment to the raising of revenue, and that the resolution of disputes should be 'at arm's length' from auditors and those raising assessments.<sup>26</sup>
- 6.28 Mr Richard Wytkin was also highly critical of the role business lines played in disputes:

Certainly the business line or the auditor should have no input whatsoever to the objection unless there is some dispute on facts.

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21 Mr Andre Spnovic, BDO, *Transcript of Evidence*, 24 September 2014, p. 6.

22 Mr Philip Hack SC, AAT, *Transcript of Evidence*, 26 October 2014, p. 2.

23 Mr John Hyde Page, *Submission No. 22*, p. 3.

24 Community and Public Sector Union, *Submission No. 13*, p. 4.

25 Mr Alistair Waters, CPSU, *Transcript of Evidence*, 22 October 2014, p. 3.

26 Civil Liberties Australia, *Submission No. 6*, p. 4.

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>27</sup>

- 6.29 Philip Hack SC also commented on the role of business lines in disputes, reporting that those who decided objections in the business line lacked autonomy, and that he had been told by these officers that they would seek instructions from the business line about matters. He indicated that any agency representative that appeared before him at the Tribunal should have the independence to make a decision on the basis of their expertise, and their view on the prospects of the case at hand.<sup>28</sup>

### **Perceptions that the objection stage is a rubber stamp, and that the ‘ATO view’ must be upheld**

- 6.30 Several witnesses and submitters believed that the objection stage merely served as a ‘rubber stamp’ of the original audit decision, and did not constitute a full and fair review of the dispute at hand. Mr John Hyde Page submitted that once an objection was disallowed, he ‘often, but not always’ received a set of written reasons for disallowance that seemed to consist of little more than a ‘cut and paste’ of the original audit decision. He suggested that this made it difficult to believe that the review conducted had been genuinely independent.<sup>29</sup>
- 6.31 Mr Wayne Graham in describing the objection phase of his dispute said:
- Every other response from the ATO, both verbal and in writing, indicates that they have simply gone back to the original auditor and said, ‘Is this correct?’ He said, ‘No, the audit is valid,’ and that is the end of the discussion. There is nothing else that has come out, other than the original auditor and the material that he has generated in an attempt to justify his position.<sup>30</sup>
- 6.32 Mr Gary Kurzer supported this view when discussing the objection phase of his dispute:

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27 Mr Richard Wytkin, *Transcript of Evidence*, 29 October 2014, p. 2.

28 Mr Philip Hack SC, AAT, *Transcript of Evidence*, 26 October 2014, p. 2.

29 Mr John Hyde Page, *Submission No. 22*, p. 3.

30 Mr Wayne Graham, *Transcript of Evidence*, 1 October 2014, p. 6.

I have got to the point where, even dealing with a commissioner at that level, they assure me that a proper review has been undertaken, yet everyone subordinate to that had said: 'We haven't actually reviewed it. What we did was that we went back to the auditors. The auditors told us we got it right.' There was not an independent review as such.<sup>31</sup>

- 6.33 These points were reinforced by Mr Andre Spnovic of BDO Australia, who spoke about a dispute he had been involved in. He observed that in this case, there was no independence applied through the objections and appeals processes.<sup>32</sup>
- 6.34 Mr Philip Hack SC also passed on his observations regarding this issue to the Committee, stating: 'I am sometimes troubled that the consideration can be perfunctory and often driven by the original views rather than forming an independent view by the reviewing person in the objection section.'<sup>33</sup>
- 6.35 Ms Sarah Blakelock from McCullough Robertson agreed with the evidence provided by Mr Hack, stating that there should be greater transparency in dealing with objections, and that the view of the auditor often spilled over into the objection phase when it should, instead, be a fresh examination of the facts and application of the law to those facts.<sup>34</sup>
- 6.36 Mr David Hughes from Small Myers Hughes suggested that a culture had developed at the ATO that resulted in objection officers and litigators accepting the original view of the auditor without critical review.<sup>35</sup>
- 6.37 The Community and Public Sector Union suggested that, once a decision was made by an ATO officer on behalf of the Commissioner, there was a reluctance to deviate from that established 'ATO view.'<sup>36</sup>
- 6.38 A related issue was discussed by the Community and Public Sector Union. They stated that time pressures on auditors may lead to the auditor taking a 'close enough is good enough' approach, and that they may choose not to escalate a dispute, instead choosing to make a decision that fits with their understanding of the ATO's view of an issue.<sup>37</sup>

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31 Mr Gary Kurzer, *Transcript of Evidence*, 18 August 2014, p. 48.

32 Mr Andre Spnovic, BDO Australia, *Transcript of Evidence*, 24 September 2014, p. 6.

33 Mr Philip Hack SC, AAT, *Transcript of Evidence*, 26 October 2014, p. 1.

34 Mrs Sarah Blakelock, McCullough Robertson, *Transcript of Evidence*, 26 October 2014, p. 7.

35 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence*, 26 October 2014, p. 15.

36 Mr Richard Wytkin, *Transcript of Evidence*, 29 October 2014, p. 1.

37 Mr Alistair Waters, CPSU, *Transcript of Evidence*, 22 October 2014, p. 3.

## Communication protocols between auditors and objection officers

6.39 Through the public hearing process, the Committee asked the ATO about communication protocols between the audit and objection areas. At the Committee's first public hearing, Mr Steve Vesperman from the ATO described the current practice as follows:

When you start to get into levels of more detail... there is not a clear guideline in relation to communications, but there is an emphasis on the person deciding the objection to ensure that they are fully informed of all the information before them before they make that decision. To the extent to which there is communication with the original audit team, it is documented on our system, so it is very clear that contact has been made and what sorts of discussions have been held. But, at the end of the day, the person making that objection decision makes that decision completely independently from what happened earlier on in the original decision.<sup>38</sup>

6.40 The Committee asked a similar question at its final public hearing, with Mr Steve Vesperman answering:

We are now putting in place and working through documenting appropriate protocols so it is very clear in our systems that there has been a conversation between the person determining the objection and the auditors if a conversation takes place. We are now in the process of documenting those protocols. That applies in relation to the small business and individuals end. There are very clear protocols – I think written protocols – for the large market end that we talked about earlier.<sup>39</sup>

6.41 The Committee also asked the ATO if objection officers were handed files containing pertinent dispute information along with subjective judgements about a taxpayer. The ATO responded that if this information was exchanged, it was the responsibility of the objection officer to discern the difference between a value judgement and the facts of the dispute.<sup>40</sup>

6.42 The Committee discussed the issue further, asking how the ATO could address the perception that objections were being prejudiced by the contents of case files. The ATO replied that it was impossible to deal with a case based solely on the objection supplied, and that perceptions of

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38 Mr Steve Vesperman, ATO, *Transcript of Evidence*, 16 July 2014, p. 14.

39 Mr Steve Vesperman, ATO, *Transcript of Evidence*, 26 November 2014, p. 12.

40 Mr Andrew Mills, ATO, *Transcript of Evidence*, 26 November 2014, p. 6.

unfairness underestimated 'the capacity of the objection officer to determine the difference between what is a value judgement and what is the real basis.'<sup>41</sup>

- 6.43 Mr Steve Vesperman added that the ATO internal procedure was for information seen to be prejudicial to not be recorded on the ATO system, and that there was a control measure to prevent the documentation of these views.<sup>42</sup>
- 6.44 The Committee asked the ATO to provide its written protocols regarding communication between auditors and objections officers. These protocols were provided to the Committee.<sup>43</sup>
- 6.45 Although the protocols emphasise the importance of an independent review, they nonetheless allow some communication between the reviewer and original decision maker. In his tax disputes report, the IGT stated that the protocols are not robust and rely on the reviewer's judgement.<sup>44</sup> It appears that communication between the reviewer and the original decision maker would speed up a review at the expense of independence, especially perceptions thereof. The protocol titled 'Independence' states:

When conducting a review of an original decision, tax officers must maintain an objective and impartial stance. It is acknowledged that the original decision maker or other tax officers may provide input into the review of a decision. The reviewer must ensure that they are not subject to a conflict of interest or any undue influence.

The critical first step for the reviewer is to look at the original decision with 'fresh eyes' and make their own assessment of the facts, law and policy relevant to the decision.

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.

Contact with the original decision maker would usually be to:

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41 Mr Andrew Mills, ATO, *Transcript of Evidence*, 26 November 2014, p. 7.

42 Mr Steve Vesperman, ATO, *Transcript of Evidence*, 26 November 2014, p. 8.

43 ATO, *Exhibits 10-16*.

44 IGT, *The Management of Tax Disputes: A report to the Assistant Treasurer*, January 2015, p. 83.

- obtain case documentation
- discuss the facts or evidence
- understand the reasons for the decision.<sup>45</sup>

6.46 Mr Richard Wytkin agreed that an objection officer should not be provided with the commentary of a dispute:

...in some ways, the objection officer probably should just get the facts and the actual decision and work out his own commentary as to how that decision may or may not be right.<sup>46</sup>

6.47 Mr Matthew Wallace of BDO Australia noted that a feature of a 'truly independent' review would be less 'special lines of communication' between auditors and objection officers.<sup>47</sup> This point was supported by Mr Michael Bersten of PwC, who identified 'some form of structural firewall' to ensure that a truly independent review was conducted.<sup>48</sup>

6.48 Mrs Sarah Blakelock from McCullough Robertson offered further context relating to the contact between auditors and objection officers, and suggested a way forward:

One needs to keep the evidence separate in one place and keep the observations and the commentary with respect to that evidence separate from the actual pure evidence. The end of the audit phase is usually when assessments are raised, and that is when a debt will be formed and is collectable. What needs to happen is the evidence is handed on when an objection is lodged and not all of the thinking and formulation of ideas and the commentary that gets recorded in the ATO's system. So when the objection officer gets to have a look at the evidence, they get to actually consider it in the context in which it was collected and in the context in which it was received, having regard to any interview notes which were taken contemporaneously with the receipt of the evidence, rather than viewing that evidence through the eyes of the audit officer, which could colour things one way or the other.<sup>49</sup>

6.49 Mr Bernard Marks from the Law Institute of Victoria suggested an appropriate protocol for communication between auditors and objection officers:

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45 ATO, *Exhibit 10*, p. 4.

46 Mr Richard Wytkin, *Transcript of Evidence*, 29 October 2014, p. 2.

47 Mr Matthew Wallace, BDO Australia, *Transcript of Evidence*, 18 August 2014, p. 7.

48 Mr Michael Bersten, Pricewaterhouse Coopers, *Transcript of Evidence*, 18 August 2014, p. 23.

49 Mrs Sarah Blakelock, McCullough Robertson, *Transcript of Evidence*, 26 October 2014, p. 9.

...the way it should work in practice and the way it formerly worked was that the files of the auditors - you might call them examiners - were bundled up and transferred to an objection reviewing officer. Generally the only question that reviewing officer would ask would be 'Have I got everything?' That person would then start afresh. That is what an objections review is: it is a total, fresh look - clean with new eyes - of what has happened.<sup>50</sup>

- 6.50 Dr Niv Tadmire of the Tax Institute agreed that there should be a balanced communication protocol between taxpayers, auditors and objection officers, and that he saw no reason for ATO communication about a taxpayer to not also be transparent to that taxpayer.<sup>51</sup>

### **The Role of the Tax Counsel Network**

- 6.51 The Tax Counsel Network (TCN) provides high level technical advice in tax matters by working collaboratively with other ATO business lines to resolve the most significant issues arising under the laws administered by the Commissioner of Taxation. This ensures a consistent view of the law within the ATO. However, this has ramifications in the area of disputes.
- 6.52 The Committee received evidence on the role the TCN plays in audits and objections through the public hearing process. Dr Niv Tadmire of the Tax Institute noted that most of the technical expertise was located in the TCN, and auditors and objection officers generally didn't have the same technical expertise. As a result, both auditors and objection officers sought advice from the TCN. As a result, the same advice was often provided, resulting in less independence at the objection stage.<sup>52</sup> The Tax Institute's submission argued that this situation was inconsistent with the principle of full and true independence.<sup>53</sup>
- 6.53 As a result, Mr Michael Flynn of the Tax Institute advised that any potential separate appeals area should be adequately supported with technical expertise to reinforce the independence of said separate appeals area.<sup>54</sup>
- 6.54 The Law Institute of Victoria observed that it was hypothetically possible for an officer in the Tax Counsel Network to provide advice at the audit stage, and then to be able to be involved in and influence the objection

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50 Mr Bernard Marks, Law Institute of Victoria, *Transcript of Evidence*, 14 August 2014, p. 26.

51 Dr Niv Tadmire, The Tax Institute, *Transcript of Evidence*, 14 August 2014, p. 14.

52 Dr Niv Tadmire, The Tax Institute, *Transcript of Evidence*, 14 August 2014, p. 14.

53 The Tax Institute, *Submission No. 11*, p. 3.

54 Mr Michael Flynn, The Tax Institute, *Transcript of Evidence*, 14 August 2014, p. 14.

officer at the objection stage.<sup>55</sup> The submission argued that once an auditor sought advice from the TCN, a TCN officer issued an 'Interpretative Decision', which has the effect of 'formalising' that view of the law. As a result, once an objection is made, the reviewing officer cannot make an independent decision on the law, as they are effectively bound by the Interpretative Decision. The Law Institute of Victoria argued that this practice 'breaches the apparent bias rule, if not the actual bias rule in administrative law'.<sup>56</sup>

- 6.55 The Administrative Review Council has issued a best practice guide, titled, *Decision Making: Natural Justice*, which looks at apparent bias in detail:

'Apparent bias' means that in the circumstances a fair-minded observer might reasonably suspect that the decision maker is not impartial. In most cases, apparent bias is enough to disqualify a person from making a decision.

Whether a decision maker is disqualified or not is a legal question. A decision maker is not disqualified simply because a person whose interests are affected by the decision alleges bias or asks for a different decision maker. It is not about whether an affected person thinks the decision maker is biased; it is about whether a fair-minded observer would reasonably suspect bias.<sup>57</sup>

- 6.56 Mr Bernard Marks from the Law Institute of Victoria considered the ARC's report and stated that the current review process 'failed' the ARC's criteria.<sup>58</sup> Mr Marks suggested in his submission that if a TCN officer provides advice at the audit stage, and then becomes indirectly involved with the review process, this compromises the independence of the reviewing officer.<sup>59</sup>

- 6.57 The Committee asked the ATO whether it was possible for an officer in the TCN to provide advice at both the audit and objection stage of a dispute. Mr Andrew Mills replied:

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55 Law Institute of Victoria, *Submission No. 8*, p. 6.

56 Law Institute of Victoria, *Submission No. 8*, p. 7.

57 Administrative Review Council, *Decision Making: Natural Justice, Best Practice Guide No. 2*, August 2007, p. 3.

58 Mr Bernard Marks, Law Institute of Victoria, *Transcript of Evidence*, 14 August 2014, p. 28.

59 Mr Bernard Marks, *Submission No. 26*, p. 5.

No, that is not our current operating model. I understand that there have been accusations of that in the past and, to the extent that that has been the case, it should not have been.<sup>60</sup>

## Practices in other jurisdictions

### New Zealand<sup>61</sup>

- 6.58 In New Zealand, a dispute is initiated by one party (either the Tax Commissioner or the taxpayer) issuing a Notice of Proposed Adjustment to the other. If the recipient of the notice disagrees with it, they must issue a Notice of Response.
- 6.59 Following the rejection of a Notice of Proposed Adjustment, a conference between the parties is usually scheduled, although this is not legislatively required, to discuss the issue and attempt resolution. This is similar to the ATO's in-house facilitation, which is not used as extensively as the process in New Zealand. Taxpayers are offered a facilitated conference in which a senior Inland Revenue officer with no prior involvement in the dispute will manage the conference. The facilitator attempts to assist both parties in resolving their issues.
- 6.60 If matters remain unresolved, both parties issue a Statement of Position, outlining their final position on the issues. Matters are then referred to the Disputes Review Unit for consideration. If the Unit finds in favour of the taxpayer, the Commissioner has no right of appeal. However, if it finds in favour of the Commissioner, the taxpayer may take the matter to the New Zealand equivalent of the AAT or the Federal Court.
- 6.61 The Disputes Review Unit is separate to the audit/investigation function at Inland Revenue. Each dispute is considered by a team of three who are either qualified accountants or solicitors. The team take into account the Notice of Proposed Adjustment, the Notice of Response, and the Statements of Position. The unit considers these items, as well as any other evidence sent, with the final decision being made by a Disputes Review Manager.

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60 Mr Andrew Mills, *ATO Transcript of Evidence*, 26 November 2014, p. 12.

61 New Zealand Inland Revenue Department, *The Disputes Review Unit – its role in the dispute resolution process* <http://www.ird.govt.nz/technical-tax/general-articles/ga-adjudication-unit.html> (accessed 20/1/15).

- 6.62 A comprehensive adjudication report is produced and provided to the parties. It outlines the facts of the dispute, the issues that need to be addressed, analysis of the legal issues involved, the application of this analysis to the facts of the dispute, and the conclusions that can be reached on each issue.
- 6.63 The Disputes Review Unit does not mediate disputes, does not conduct any further investigation, and does not have any direct communication during its reviews with either the initial decision maker or the taxpayer involved in the dispute. It is impartial and independent. To ensure openness and transparency, communication between the Disputes Review Unit and the parties involved in a dispute all pass through a separate unit, which copies all communication to both parties.
- 6.64 Approximately 75 per cent of decisions made by the Disputes Review Unit were in favour of Inland Revenue.

### **The United States<sup>62</sup>**

- 6.65 In the United States, Appeals operates separately and independently of the Internal Revenue Service (IRS) office that proposes an adjustment. Appeals reviews the strengths and weaknesses of the issues within a case, conferencing with the taxpayer as soon as possible by correspondence or via telephone. Appeals considers what the outcome of a dispute might be if taken to court, and reports that to the taxpayer. Most differences are settled via appeals and without court action. Alternative dispute resolution is also available, and the option of taking a matter through an alternative dispute resolution process is available at several points through the process.
- 6.66 The significant part of the US system, which is similar to New Zealand, is the use of 'ex-parte communications.' This prevents the appeals officer from conversing with the IRS office that proposed an adjustment. If there is a need for the appeals area to confer with the initial decision maker at the IRS, the rules require Appeals to provide the taxpayer with the opportunity to take part in the conversation. It should, however, be noted that this requirement does not apply in matters of administration or procedure.

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62 United States Internal Revenue Service, *Appeals... Resolving Tax Disputes*, <http://www.irs.gov/Individuals/Appeals...-Resolving-Tax-Disputes> (accessed 20/1/15).

## A separate appeals area

6.67 The overwhelming majority of submitters and witnesses called for some form of separation for the objections area of the ATO. (It should be noted that while they did not make a submission to the inquiry, the Law Council of Australia supported the status quo.<sup>63</sup>) The Committee weighed up the arguments in favour of full separation through the creation of a new agency, and internal separation, improving the independence of the objections area, while preserving it as part of the ATO.

## Full separation

- 6.68 Over the course of the inquiry, the Committee heard few arguments in favour of a full, formal separation of the appeals area. There were many more arguments raised against the idea of creating a separate agency to handle tax disputes.
- 6.69 The Law Institute of Victoria was one of the only submitters to advocate for full separation of the appeals area, stating that it proposed a separate organisation with its own Commissioner and Act, reporting to the Assistant Treasurer or the Parliament. It suggested the new organisation would consist of few staff, and would simply focus on reviews and appeals, with no other involvement in the tax process.<sup>64</sup>
- 6.70 In its first appearance before the Committee, the ATO cautioned against full separation, stating that it would add delay and cost to the dispute resolution process, be less efficient, and also not assist in promoting a productive relationship between taxpayers and the revenue authority.<sup>65</sup>
- 6.71 Treasury agreed that there 'does not seem to be a lot of merit' in full separation, noting it would increase costs and expertise, and create difficulties relating to information flow. Treasury suggested the most efficient model would be to ensure an appeals area remained within the ATO 'provided there are proper boundaries or walls in between decision making and appeal within an organisation.'<sup>66</sup>
- 6.72 In its supplementary submission, the ATO identified fewer feedback loops and reduced confidence in primary decision making as further reasons against a full separation. It also cautioned against creating a new Second

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63 Law Council of Australia, *Exhibit No. 2*, p. 16.

64 Law Institute of Victoria, *Submission No. 8*, pp. 14-16, Mr Bernard Marks, *Transcript of Evidence*, 14 August 2014, p. 27.

65 Mr Chris Jordan AO, ATO, *Transcript of Evidence*, 16 July 2014, p. 2.

66 Mr Rob Heferen, Treasury, *Transcript of Evidence*, 16 July 2014, p. 3.

Commissioner position, as it 'would involve the Commissioner spending time "umpiring" disputes and opinions between different areas of the ATO.'<sup>67</sup>

- 6.73 The Community and Public Sector Union supported the ATO's position on full separation leading to a reduction in feedback loops.<sup>68</sup> It also articulated further reasons to oppose a full separation, noting that there would be a significant efficiency loss, that staff would be de-skilled, and that it would dilute access to corporate<sup>69</sup> and expert<sup>70</sup> knowledge. This concern was shared by Mr Richard Wytkin.<sup>71</sup>
- 6.74 Ms Thilini Wikramasuriya from The Tax Institute agreed that there would be resourcing issues and the potential for 'passing the buck' were a new Commissioner to be established.<sup>72</sup> Additionally, Dr Niv Tadmores of the Tax Institute noted there was the potential for two different views on the same law to be established, leading to an undermining of the certainty of the tax system.<sup>73</sup>
- 6.75 PwC observed that an entirely separate disputes agency was not found in any comparable jurisdictions, that a separate agency faced 'a lot of downsides and risks', and that it 'would be doomed to almost immediate failure'.<sup>74</sup>
- 6.76 Further, PwC observed that a separate agency would lack the 'critical mass' to succeed, and would lack influence and the ability to effectively engage the ATO to improve outcomes at the agency.<sup>75</sup>
- 6.77 Mr Tony Greco of the Institute of Public Accountants suggested that full separation may be an option in the future if changes made through this Committee's inquiry process do not produce a more independent appeals system.<sup>76</sup>

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67 Australian Taxation Office, *Submission No. 10.2*, p. 8.

68 Mr Greg Miller, CPSU, *Transcript of Evidence*, 22 October 2014, p. 6.

69 Community and Public Sector Union, *Submission No. 13*, p. 2.

70 Mr Greg Miller, CPSU, *Transcript of Evidence*, 22 October 2014, p. 4.

71 Mr Richard Wytkin, *Transcript of Evidence*, 29 October 2014, p. 1.

72 Ms Thilini Wickramasuriya, The Tax Institute, *Transcript of Evidence*, 14 August 2014, p. 11.

73 Dr Niv Tadmores, The Tax Institute, *Transcript of Evidence*, 14 August 2014, p. 11.

74 Mr Michael Bersten, Pricewaterhouse Coopers, *Transcript of Evidence*, 18 August 2014, p. 23.

75 Mr Michael Bersten, Pricewaterhouse Coopers, *Transcript of Evidence*, 18 August 2014, p. 23.

76 Mr Tony Greco, Institute of Public Accountants, *Transcript of Evidence*, 14 August 2014, p. 7.

## Internal separation

- 6.78 The majority of witnesses and submitters clearly favoured some form of internal separation of the objection area within the ATO.
- 6.79 The simplest approach was articulated by several witnesses, who advised that objection officers should be separated from the audit officers, and moved outside of the same business line.<sup>77</sup> Some witnesses also suggested that this action should be enshrined in statute.<sup>78</sup>
- 6.80 The Tax Institute supported the approach of moving objection officers outside of the business lines, suggesting that a properly resourced and independent area within the ATO should be established to handle objections, reviews, and litigation. The Tax Institute also suggested that taxpayers should be able to request a review by this area at the audit stage and prior to assessments being raised.<sup>79</sup>
- 6.81 Witnesses and submitters made comments on the importance of developing a positive culture in both the ATO and any potential new appeals area.
- 6.82 Dr Niv Tadmore from the Tax Institute noted that a culture of independence needed to be created in a new framework, and that this different cultural mandate should be focussed on fairness, addressing the public perception that the appeals system is not sufficiently independent of the audit area.<sup>80</sup>
- 6.83 Dr Tadmore observed that there has been rapid cultural change in the ATO recently, but that there was no guarantee that that cultural change would not regress over time. Placing a new Second Commissioner in charge of an appeals area would establish sufficient independence in the appeals function.<sup>81</sup> PwC suggested that a new Second Commissioner for disputes should still report to the Commissioner of Taxation.<sup>82</sup>

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77 Mr Richard Wytkin, *Transcript of Evidence*, 29 October 2014, p. 2., Mr John Hyde Page, *Transcript of Evidence*, 29 October 2014, p. 9.

78 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence*, 26 October 2014, p. 17, Mr John Hyde Page, *Submission No. 22*, p. 5.

79 Ms Thilini Wickramasuriya, The Tax Institute, *Transcript of Evidence*, 14 August 2014, p. 9, The Tax Institute, *Submission No. 11*, pp. 8-9.

80 Dr Niv Tadmore, The Tax Institute, *Transcript of Evidence*, 14 August 2014, p. 12.

81 Dr Niv Tadmore, The Tax Institute, *Transcript of Evidence*, 14 August 2014, p. 12.

82 Mrs Judy Sullivan, Pricewaterhouse Coopers, *Transcript of Evidence*, 18 August 2014, p. 22.

- 6.84 Mr John Hyde Page cautioned about the unreliability of culture, stating that it waxed and waned and that articulating the character of an organisation's culture was dependent on the person talking about it.<sup>83</sup>
- 6.85 The Commonwealth Ombudsman also noted that improving the review process was possible with the right mixture of cultural change, new processes, and staff training.<sup>84</sup> He suggested that reviewers should understand that they were to consider matters afresh, and to consider things independently, rather than potentially picking up a position that they know is the general ATO view on a matter.<sup>85</sup> Further, the Commonwealth Ombudsman stated that review officers should understand they have the support of the ATO's Commissioners and that they needed to understand they had to act independently of the rest of the ATO.<sup>86</sup>
- 6.86 Mr Richard Wytkin, a witness with experience both as an ex-ATO employee and a private accountant, noted the need for the ATO to ensure that any change was being made 'at the workplace', rather than just being articulated at the top level.<sup>87</sup>
- 6.87 Chartered Accountants Australia and New Zealand emphasised the need for ATO officers to obtain the support they required from the Tax Counsel Network, but that those Tax Counsel Network officers do not re-engage with the case during the review stage, something that would need to be carefully managed by the ATO.<sup>88</sup>
- 6.88 The Community and Public Sector Union cautioned that shifting objections out of business lines was 'likely' to see jobs move from regional offices to city offices, further diluting the available expertise in regional areas.<sup>89</sup>

### **Not a new idea**

- 6.89 This suggestion of a new, separate, independent but internal appeals area is not new.

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83 John Hyde Page, *Transcript of Evidence*, 29 October 2014, p. 11.

84 Mr Colin Neave, Commonwealth Ombudsman, *Transcript of Evidence*, 24 September 2014, p. 12.

85 Mr Colin Neave, Commonwealth Ombudsman, *Transcript of Evidence*, 24 September 2014, p. 10.

86 Mr Colin Neave, Commonwealth Ombudsman, *Transcript of Evidence*, 24 September 2014, p. 11.

87 Mr Richard Wytkin, *Transcript of Evidence*, 29 October 2014, p. 2.

88 Chartered Accountants Australia and New Zealand, *Submission No. 5*, p. 14.

89 Mr Alistair Waters, CPSU, *Transcript of Evidence*, 22 October 2014, p. 8, 10.

6.90 In May 2012, the Inspector-General of Taxation's review into the ATO's use of early and alternative dispute resolution recommended the creation of a separate appeals area to address concerns about the current independence of the ATO's review function. The recommendation was:

In working towards a fully functioning independent appeals area to be headed by a new Second Commissioner as set out in the IGT's October 2011 submission to the Tax Forum, the IGT recommends that the ATO establish a pilot 'Appeals Section':

- ⇒ under the leadership of the current Second Commissioner – Law to carry out the objection and litigation function for the most complex cases;
- ⇒ establish clear protocols regarding communication between Appeal officers and compliance officers, including a general prohibition against ex parte communication, save where all parties are informed of, and consent to, such communication taking place; and
- ⇒ empower the appeals function to independently assess and determine whether matters should be settled, litigated or otherwise resolved (for example, ADR).<sup>90</sup>

6.91 The ATO had three reasons for rejecting the recommendation:

- establishing an extra Second Commissioner is a matter for Government
- stakeholders have expressed a preference for involving legal experts early in disputes (this is similar to the reasoning in the JCPA's 1993 report)
- 'the organisational logistics of such a pilot would be burdensome.'<sup>91</sup>

6.92 During the inquiry, further issues came to light, namely the actual business line location of the objections area. At the public hearing into the 2012-13 ATO Annual Report, when asked about the potential to create a separate appeals area, the Commissioner of Taxation stated:

...we did move the entire objections function out of the compliance group into law design and practice. So we have totally rejigged law design and practice and the objection dispute method. We have created a new group ... review and dispute resolution. If we want to call that 'appeals', we can call it that, but

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90 Inspector General of Taxation, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution*, p. 107.

91 Inspector General of Taxation, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution*, p. 108.

there is a separate group, it is just not headed by a separate second commissioner. So review and disputes is a new group with a new focus that takes all the objections function and people out of compliance.<sup>92</sup>

- 6.93 However, the ATO's supplementary submission to this inquiry (provided 19 November 2014) clarified the issue:

The ATO has a long standing practice of objections processing being removed in a management sense from the people who make the initial decision. These arrangements are still in place, and most objections are dealt with in the Compliance Group with organisational separation between the teams that make the original decision and the teams that determine the objections to these decisions.

From 1 July 2013 objections for clients with income over \$250 million were transferred to Review and Dispute Resolution and on 1 July 2014 for those with income over \$100 million.

The ATO will continue to monitor outcomes from these changes and consider whether we should further extend these approaches to other parts of our taxpayer populations.<sup>93</sup>

### **Committee comment – building a new governance framework**

- 6.94 The Committee commends the ATO on its openness and willingness to discuss issues that go right into the internal workings of its organisation. Further, it commends the ATO on its recent innovations on disputes in the Private Groups and High Wealth Individuals area. The Committee understands that the ATO makes a lot of innovations in these areas and then attempts to cascade them down to smaller taxpayers. However, the Committee also believes that some of these innovations are of limited value to small business and individual taxpayers. The Committee is of the belief that changes at the objection stage can have the most benefits for small business and individual taxpayers.
- 6.95 The Committee has discovered through this inquiry that a lot of the issues discussed are about perceptions. Even in discussing how disputes worked prior to the changes made in 1995, perceptions are important. The ATO

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92 Mr Chris Jordan, ATO, *Transcript of Evidence (Review of the 2012-13 ATO Annual Report)*, 28 February 2014, p. 19.

93 Australian Taxation Office, *Submission 10.1*, p. 12.

stated that things then weren't so different to now, but many witnesses and submitters perceived things differently.

- 6.96 Witnesses perceived the Appeals and Review group to be more independent, to have engaged less with audit teams (or not to have engaged at all), and to have had a stronger culture of independence. It is clear from the base of evidence that there was a different spirit and culture than currently exists in the objection area of the ATO.
- 6.97 It is clear to the Committee that moving the objection area into business lines has had an effect on the culture of objections and objection officers. Some of this effect has been extremely positive – there are broader career paths for officers, and information sharing appears to have improved.
- 6.98 However, there are also negative consequences to the objection area being associated with a business line. The potential for close day to day contact and a stronger institutional culture have an impact on the perceived independence of objection officers. The Committee does not believe that all objection officers are institutionally biased in favour of the ATO or their individual business lines, or that pressure is exerted on them via business lines. However, there is clearly a perception that this structure compromises the professionalism and independence of objection officers.
- 6.99 In considering the changes recommended by the Joint Committee of Public Accounts in 1993, it is entirely possible that this erosion of a perceived culture of independence amongst objection officers has been an unintended consequence of the JCPA's recommendation.
- 6.100 In considering whether taxpayers are advised to deliberately withhold information to obtain a better outcome later in the dispute process, the Committee doesn't doubt that this has happened, but was pleased to hear that it was not a mainstream practice amongst accountants and legal counsel. It is clear that taxpayers should seek to provide as much information as possible at the early stages of a dispute to prevent complications further down the line.
- 6.101 The Committee was disappointed to hear that once a taxpayer was involved in a dispute, they found it difficult to find an appropriate officer with whom to talk to achieve a speedier resolution. Both taxpayers and the ATO have an interest in disputes being resolved not just fairly, but quickly, and the ATO should look at changes it can make in this area. The Committee agrees with the evidence which suggests that poor taxpayer communication lengthens and even deepens disputes, and believes the ATO can make quick and effective changes to the way it engages with taxpayers in the early stages of a dispute.

- 6.102 Regarding the issue of taxpayers occasionally having to speak to several officers over the course of a dispute, the Committee understands these frustrations. In some cases this has no doubt been unfortunate but also unavoidable. Nonetheless, the Committee believes that this issue can also be addressed in a broader re-evaluation of taxpayer engagement at the early stages of a dispute.
- 6.103 It is clear to the Committee that the centralisation of expertise has had both benefits and costs. There are clear benefits to centralising expertise and improving information sharing, but this comes at the price of removing access to expert advice from regional areas and some smaller cities. The ATO should consider how they can prevent cases like those raised above by Mr Bernard Marks from occurring, primarily through their expansion of mediation and other alternative dispute resolution mechanisms.
- 6.104 The Committee was inundated with calls for the ATO to intervene earlier in the dispute process. Witnesses and submitters were unanimous in their calls for improvements in this area. However, there are also challenges here for the ATO. It is difficult from a resourcing standpoint to have senior officers evaluate every dispute and determine how it should be handled.
- 6.105 Nonetheless, the Committee supports the idea raised by the Commonwealth Ombudsman of introducing a triage system to categorise and deal with disputes. This is especially true for small business. Small business faces considerable challenges, and being caught up in a tax dispute can be quickly fatal, especially in the case of new and expanding businesses, as the Committee heard time and again through its program of public hearings.
- 6.106 The Committee also believes that the ATO should strive to reflect administrative best practice. As one of the Australian Government's flagship agencies, and an agency held to a high degree of scrutiny by the public, the ATO needs to ensure its public engagement reflects best practice.
- 6.107 Despite the ATO's convictions, it is clear to the Committee that the current disputes system does not reflect best practice with regard to fairness and independence. Regarding the Administrative Review Council's criteria for internal review, it is clear from the perception of witnesses and submitters that the ATO's objection area is not organisationally distinct from the broader ATO or its individual business lines.
- 6.108 The Committee acknowledges that it is difficult for the ATO to fulfil every criteria set out by the Administrative Review Council. While best practice

dictates that an appeals officer should have no contact with the original decision maker, tax matters are so complex that occasional contact is not avoidable. This issue is considered in more detail below.

- 6.109 It is difficult for the Committee to disagree with the notion that any objective observer would consider the current objection process to appear to be fair. Again, this is a matter of perception. Nonetheless, the weight of evidence on this point is considerable. There is perceived bias in the current objection system. The system does not closely align with the best practice outlined by the Administrative Review Council, nor does the Commonwealth Ombudsman consider the current system to be perceivable as fair.
- 6.110 The ATO should take opportunities such as reviews by the Inspector-General of Taxation, the Auditor-General or by the Committee itself to re-evaluate its practices. Doing this is never easy or comfortable, but these scrutiny mechanisms serve a valuable purpose, bringing in outside knowledge, expertise, and a fresh set of eyes.
- 6.111 Bringing objections into business lines has clearly had an impact on perceived fairness. While the vast majority of witnesses found ATO staff to be professional, and the Committee has no reason to disagree with this view, there have been clear changes to the institutional culture of objection officers at the fringes of that culture.
- 6.112 The Committee was disappointed to hear from a Deputy President of the Administrative Appeals Tribunal that ATO representatives before the Tribunal would take matters back to the business line for approval. The Committee believes that matters taken to the Tribunal by ATO representatives should be the responsibility of those representatives, and not allowing it to be casts an aspersion on the professionalism and competence of those acting on behalf of the ATO.
- 6.113 That so many witnesses and submitters considered the objection process to be a 'rubber stamp' of the audit decision was also of concern to the Committee. It shows again that many do not perceive the objection stage as fair. When one then considers the costs for an individual or small business in taking a dispute further through to the Administrative Appeals Tribunal or a higher court, it is not difficult to see where disenchantment with the appeals regime comes from.
- 6.114 Philip Hack SC's observation that some objection decisions he has seen are 'perfunctory and often driven by the original views' is also of some concern. While this may be more acceptable in simple matters where there has been a clear breach of the tax law, that these sorts of evaluations are

being brought to disputes strong enough to be taken to the Administrative Appeals Tribunal is worrying.

- 6.115 The evidence presented by the Community and Public Sector Union stating that auditors may adopt a 'near enough is good enough' approach to an audit when dealing with time pressures could well apply to objection officers when one considers the argument that they sometimes just adopt the 'ATO view'. Both of these actions by officers point to problems at the managerial level in managing case loads, and at the cultural level within the ATO.
- 6.116 Addressing the issue of communication protocols, the Committee was confused by the ambiguity of evidence provided by Mr Steve Vesperman at the ATO's two appearances before the Committee. In the first he states that there were documented protocols regarding the recording of prejudicial comments on taxpayers in ATO databases, while in the second he states that the ATO is still working through this issue.
- 6.117 Nonetheless, the Committee believes the ATO could make improvements in this area. It agrees with the ATO that objection officers are capable of distinguishing between value judgements and facts, and it believes that they shouldn't have to in the first instance. Additionally, that these items are recorded is another failure of the test of apparent bias. If a dispute is being evaluated by a 'fresh set of eyes', any value judgements should be removed from the files in the interests of giving the taxpayer a fair evaluation of their case.

### **Recommendation 17**

- 6.118 **The Committee recommends that the Australian Taxation Office ensure that the information passed between an auditor and an objection officer surrounding a dispute only consist of the factual case documents, and the audit conclusion provided to the taxpayer. Any internal auditor commentary on the dispute should remain with the audit team.**
- 6.119 The Committee also considered the issue of whether or not a taxpayer should be allowed to see any internal ATO correspondence relating to the dispute. While taxpayers may use Freedom of Information requests to secure this information, it can be a costly and time consuming process for both the taxpayer and the ATO. In considering the regimes in New Zealand and the United States, the Committee saw value in ensuring that the ATO disclosed any correspondence to the taxpayer in the interests of fairness and openness.

- 6.120 Turning to the issue of the Tax Counsel Network, the Committee acknowledges that it is difficult to find the right balance on this issue. The TCN is small, and expert, and its skills are in demand by both auditors and objection officers. Nonetheless, the Committee notes the evidence raised by witnesses and submitters that an individual TCN officer can have an effect on an audit and objection into the same matter.
- 6.121 At its second appearance before the Committee, the ATO was unable to deny that this was possible, and indeed, unable to deny that it had occurred, stating: 'to the extent that that has been the case, it should not have been'.
- 6.122 The Committee acknowledges the ATO does not support this practice. However, to address this, the ATO needs to better monitor the disputes being considered by the Tax Counsel Network and do more to prevent the possibility of apparent bias.

### **Recommendation 18**

- 6.123 **The Committee recommends that the Australian Taxation Office develop protocols to ensure that an individual Tax Counsel Network officer only be allowed to provide advice or contribute to the provision of advice at the audit or objection stage of a dispute.**
- 6.124 Briefly considering the regimes of New Zealand and the United States, the Committee can see benefits in these approaches, and believes that both systems offer a fairer objection process to the taxpayer. The firm protocols on communication between auditors and objection officers are something that should be embraced by the ATO to address the issue of apparent bias.
- 6.125 The Committee evaluated the proposals for full and partial separation of the objections area from the ATO. It saw no convincing reason why objections should be completely split off and developed into a new agency. The arguments against this proposal were compelling. However, the Committee agrees with the suggestion of the Institute of Public Accountants that the idea could be revisited if any new objection regime did not lead to improvements in outcomes and greater independence.
- 6.126 The Committee supports the general proposal that the objection functions should be moved out of the business lines and into their own separate area. Making this change addresses the single biggest criticism of the current system – that it is too influenced by its presence within business lines and its proximity and contact with auditors. It also increases the

likelihood that a culture of independence will again develop as was observed prior to the changes made in 1995.

- 6.127 Further, an internal separation will retain expertise within the ATO and within objection areas. It will not reduce potential career paths for ATO officers, and will ensure that there is relative continuity compared to the impact of a full separation.

### **Recommendation 19**

- 6.128 **The Committee recommends that the Australian Taxation Office establish a separate Appeals area:**
- **under the leadership of a new Second Commissioner – Appeals to carry out the objection and litigation function for all cases;**
  - **establish and publicly articulate clear protocols regarding communication between Appeal officers and compliance officers, including a general prohibition against ex parte communication, save where all parties are informed of, and consent to, such communication taking place; and**
  - **empower the appeals function to independently assess and determine whether matters should be settled, litigated or otherwise resolved (for example, Alternative Dispute Resolution).**
- 6.129 The Committee considered the suggestion of enshrining this separation in statute. However, it has decided for the moment to leave this matter to the ATO for its attention to retain some flexibility in how the appropriate changes are made. Nonetheless, the Committee reserves the right to recommend the appropriate changes to law if it believes they are necessary.
- 6.130 The Committee has also considered the leadership of a separate appeals area. It notes the reservations of the ATO that an appeals function headed by a new Second Commissioner may lead to the Commissioner acting as an ‘umpire’ in internal ATO disputes, but does not find this argument convincing. The Committee does not conceive that two Second Commissioners would not be able to resolve any differences in their interpretations of the law (drawing on similar legal experts) before escalating a matter to the Commissioner himself. The Committee also notes the comments of the IGT, namely that if uncertainty persists at a

high level within the ATO on a legal matter, then it can be fast-tracked to litigation and/or referred to Treasury for legislative change.<sup>94</sup>

## **Recommendation 20**

- 6.131 **The Committee recommends that the Government establish a new position of Second Commissioner - Appeals, reporting to the Commissioner of Taxation to head up the new Appeals area within the Australian Taxation Office.**
- 6.132 The Committee notes the comments made by witnesses and submitters about the support the ATO would need to provide to any new appeals area, and encourages the ATO to consider these comments carefully. The ATO will need to build a culture of independence in this area, and ensure it is staffed with employees with the appropriate expertise, and supported as it develops.
- 6.133 The Committee believes that the ATO is a well run, highly professional organisation, and that the vast majority of disputes are handled in an appropriate and fair manner. The Committee believes that full implementation of its recommendations contained in this report will produce a fairer appeals system, leading to better outcomes for taxpayers and also for the ATO.

**Bert van Manen**  
**Chair**

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94 IGT, *The Management of Tax Disputes: A report to the Assistant Treasurer*, January 2015, p. 76.

