



Australian Government
Australian Taxation Office

Your case matters 2012

Tax and superannuation litigation trends

1 July 2007 to 29 February 2012

Introduction

Welcome to the inaugural edition of *Your case matters*. *Your case matters* has 2 meanings – both important.

Firstly, as a taxpayer it's important that you can challenge an ATO decision and have it independently considered. Secondly, your case may benefit the community by clarifying how the tax and superannuation laws operate.

Litigation is an essential feature of the tax and superannuation systems, even though the number of litigation cases is very small compared to the number of interactions with these community systems. Because your case matters, it is important that disputes within the tax and superannuation systems are professionally and successfully resolved.

This booklet publishes key data and analysis about Australia's tax and superannuation litigation for the first time. It aims to provide insight into statistical trends in tax and superannuation litigation over recent years.

This analysis is timely. Led by the Australian Government, there is an increasing interest in minimising the cost and impact of litigation by exploring alternative ways of resolving disputes, known as alternative dispute resolution (ADR)¹. Pleasingly, the statistics show a trend of finalising more cases prior to hearing, and also indications that ADR techniques are positively impacting the resolution of disputes. The Inspector-General of Taxation also has a keen interest in dispute resolution and is currently reviewing the ATO's approach to ADR to identify areas for improvement.

There has also been media and stakeholder commentary about tax litigation, raising concerns that recent unfavourable decisions for the ATO, particularly on appeal, may mean the ATO is litigating matters it should have conceded.

The statistics show that the majority of cases are favourable for the ATO. However, win-lose rates are not the only mark of whether a litigation program is effective. Regardless of the outcome, the community benefits through the tribunals or courts clarifying how the law works.

The statistics in this booklet have been markedly influenced by disputes arising from the 'mass-marketed scheme' era, with the decline in cases proceeding to litigation in recent years reflecting the resolution of those disputes.

This booklet is a work in progress. With your feedback, we will continue to refine our analysis. In future booklets, we also plan to add other aspects of tax and superannuation litigation, such as debt recovery and administrative law litigation.

¹ See *A Strategic Framework for Access to Justice in the Federal Civil Justice System*, the Full Report of the Access to Justice Taskforce, Australian Government, Attorney-General's Department, September 2009.

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97% of tax and superannuation objections made in 2010–11 were resolved at objection stage and another 2% were resolved prior to hearing.

03 Tribunal litigation

Most taxpayers seeking independent review (80%) chose tribunals to litigate their issue.

04 Court litigation

There were about 270 tax and superannuation court cases in progress in 2010–11.

05 Test case litigation

There were 12 test case decisions in 2010–11. 8 clarified the law. The other 4 decisions resulted in the government announcing a change in a law.

06 Legal costs

The ATO spends around \$81 million per year on legal costs which includes tax and superannuation litigation and other legal services.

01 Overview of litigation

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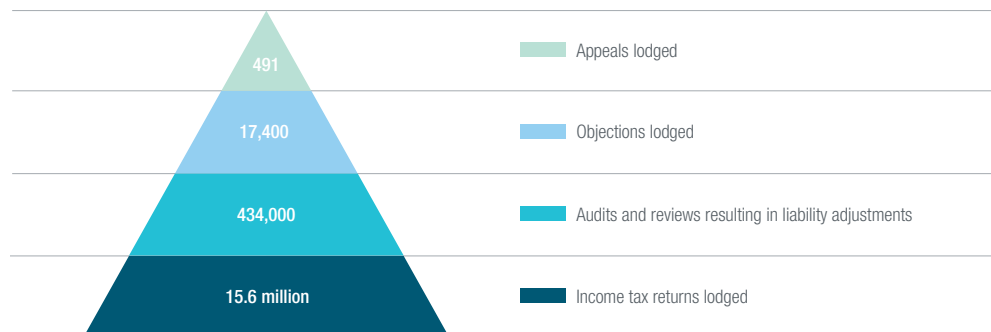
AT A GLANCE

Litigation is a small but very important part of the tax and superannuation systems. It involves a very important right for taxpayers to have ATO decisions independently reviewed.

The Australian tax and superannuation systems are self-assessment systems, so most of the 47 million forms submitted every year are not adjusted by the ATO. Of the forms lodged in the 2010–11 income year, only about 24,000 taxpayers objected to their liability.

Most taxpayer objections, nearly 17,400 (72%) are objections to income tax assessments. This is a tiny fraction (0.005%) of the 15.6 million income tax returns lodged. About 72% (around 12,500) of these objections arose directly from ATO's audit and review activities.

Diagram 1.1 Snapshot of income tax 2010–11²



Most taxpayer litigation³ (68% in 2010–11) concerns challenges to their income tax assessments.

In the same year, other litigation initiated by taxpayers involved:

- goods and services tax (18%)
- superannuation (12%)
- fringe benefits tax (1%)
- excise (1%).

Most taxpayers who seek independent review prefer the tribunals (80% in 2010–11) – for more information see Section 3. Tribunal review can be less expensive than courts and can also be confidential.

Most appeals to the tribunals and courts are finalised prior to hearing (61% in 2010–11), see figure 1.1.

The majority of decisions by the tribunals and courts are favourable to the ATO (65% in 2010–11), see figure 1.2.

The number of cases in the tribunals and courts has declined as mass-marketed scheme-related matters have been finalised. In 2010–11, there were around 1,000 cases in progress, see table 1.1.

2 This is a snapshot of activity during 2010–11. Some of the activity will relate to previous years but it gives a good idea of the relative scale of activities.

3 These statistics do not include other litigation by the ATO, in particular debt litigation which involves a significant number of cases. *Commissioner of Taxation Annual report 2010–11*, pp 107–108.

TRENDS 1 JULY 2007 TO 29 FEBRUARY 2012

Figure 1.1 Appeals (courts and tribunals)

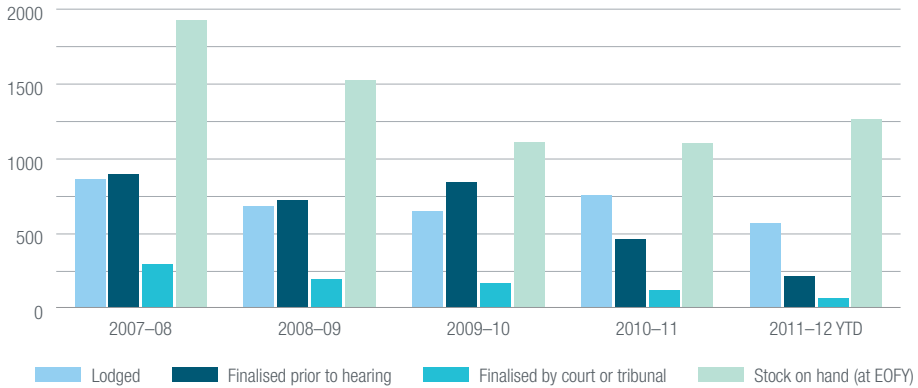


Figure 1.2 Decision results (courts and tribunals)



Table 1.1 2010-11 Litigation in progress

2010-11 Litigation in progress	Number	%
Administrative Appeals Tribunal and Small Taxation Claims Tribunal	814	75
Federal Court	228	21
Full Federal Court	36	3
High Court	7	<1
Total	1085	100

02 Resolving tax and superannuation disputes

AT A GLANCE

We aim to minimise disputes through strategies such as pre-filling information in tax returns. We also aim to resolve disputes as early as possible across all aspects of our work.

Of the 465,000 adjustments made as a result of tax and superannuation audit and review activities undertaken in 2010–11, about 19,300 (4%) resulted in objections.

Most disputes are resolved well before litigation. In 2010–11, 24,255 taxpayers objected against their tax assessment, around 97% of these disputes were finalised at objection stage, and another 2% finalised prior to hearing, see figure 2.1 and 2.2.

Alternative dispute resolution (ADR)

Use of formal ADR is becoming more common in tax and superannuation disputes. This is consistent with wider reforms in the Commonwealth civil justice system⁴, and with the ATO's obligation to act as a model litigant⁵. These approaches include mediation, conciliation, case appraisal and evaluation by an independent party.

Conciliation is the most commonly used technique (57% of tax cases) in the Administrative Appeal Tribunal (AAT). Since 1 July 2008, there have been 235 AAT cases that used these approaches and 94 (40%) were resolved. A further 35 (15%) were partially resolved. Most of the remaining 45% were later resolved or ADR was useful in narrowing the issues for a hearing.

Mediation is the most frequently used ADR technique in the Federal Court. In 2010–11, 18 tax matters were referred for mediation: 16 to internal Federal Court mediators and 2 to external mediators such as barristers. 5 of the 16 cases referred to internal mediators have been completed, of which 4 have been resolved.

When the ATO can settle

The Commissioner's statutory responsibilities as the administrator of the tax and superannuation laws restrict how far the ATO can go in settling disputes. Generally the ATO cannot negotiate liability on a commercial basis – we must settle on a principle basis (that is, what is the tax liability) except in certain limited circumstances under the Code of Settlement Practice. This requires balancing the obligation to collect taxes with the obligation to administer the tax and superannuation system in an efficient and effective way.

For example, settlement may be appropriate if the cost of litigating is out of proportion to the possible benefits, including the prospects of success and the likely award of costs. On the other hand, it would generally be inappropriate to settle where the outcome would be contrary to policy reflected in the law or would involve inconsistent treatment for taxpayers.

In 2010–11, 304 disputes were settled under the Code of Settlement Practice involving \$747 million reduction in tax liabilities, see figure 2.3.

4 Outlined in *A Strategic Framework for Access to Justice in the Federal Civil Justice System*, see footnote 1.

5 Under the *Legal Services Directions*, Australian Government, Attorney-General's Department, 2005.

TRENDS 1 JULY 2007 TO 29 FEBRUARY 2012

Figure 2.1 Tribunal cases finalised prior to hearing

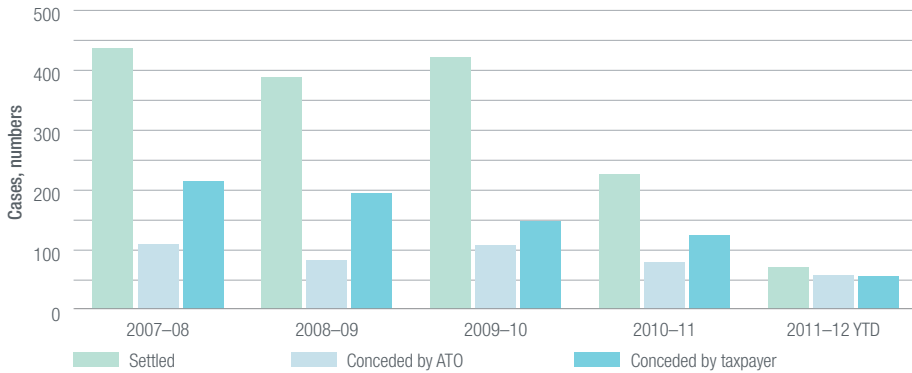
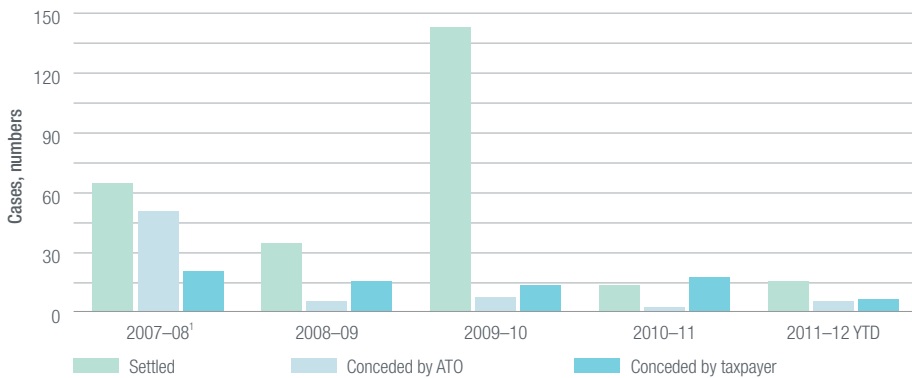
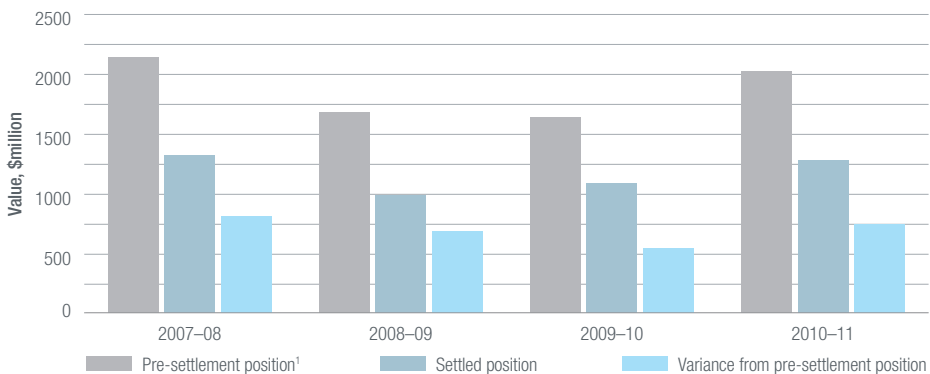


Figure 2.2 Court cases finalised prior to hearing



¹ The large number of cases conceded by ATO were 33 related matters associated with one case in a particular company group and another 7 cases dealt with an offshore superannuation scheme.

Figure 2.3 Registered settlements



¹ The ATO's pre-settlement position is the amount the ATO imposed or would have imposed but for the settlement. It is the amount of tax liability, including appropriate remission of penalties and the general interest charge (GIC), that we would raise if a settlement was not reached.

03 Tribunal litigation

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AT A GLANCE

Most taxpayers seeking independent review of ATO decisions choose a tribunal⁶ (80% in 2010–11). About 74% (over 800) of tax and superannuation litigation cases in progress at the end of 2010–11 were tribunal cases, see figure 3.2.

This is not surprising as tribunal review is intended to be a low cost and less formal review process, and it can also be confidential⁷.

The number of tribunal cases declined steadily between 2007–08 and 2009–10 as mass-marketed scheme-related cases were finalised.

They increased in 2010–11 and this year, in part reflecting increased ATO compliance activity (data matching, cash economy benchmarking, and refund integrity) as well as excess contributions tax continuing to be contentious, see figure 3.1.

Most taxpayer applications to a tribunal concern their income tax assessments (64% in 2010–11).

In the same year, other applications to a tribunal initiated by taxpayers involved:

- goods and services tax (18%)
- superannuation (12%)
- fringe benefits tax (2%)
- excise (2%).

Most taxpayer applications are finalised prior to hearing (57% in 2010–11). Taxpayers concede their cases more than the ATO, see figure 2.1. However so far this year the number of ATO and taxpayer conceded cases has evened. The most common reason for the ATO conceding a case is that fresh information has been provided by the taxpayer. This indicates improved communication earlier between tax officers and taxpayers and their advisors could further minimise disputes and resolve them earlier.

In 2010–11, about 24% of taxpayer applications resulted in a tribunal decision and most of these decisions were favourable to the ATO (76%), see figure 3.3.

6 The Administrative Appeals Tribunal (AAT) or the Small Taxation Claims Tribunal.

7 Section 35, *Administrative Appeals Tribunal Act, 1975* allows the tribunal, in some circumstances, to keep confidential the name or address of a party or witness, or other information that it holds. It can also order that a hearing be in private, or that a written decision not be made public.

TRENDS 1 JULY 2007 TO 29 FEBRUARY 2012

Figure 3.1 Summary of trends

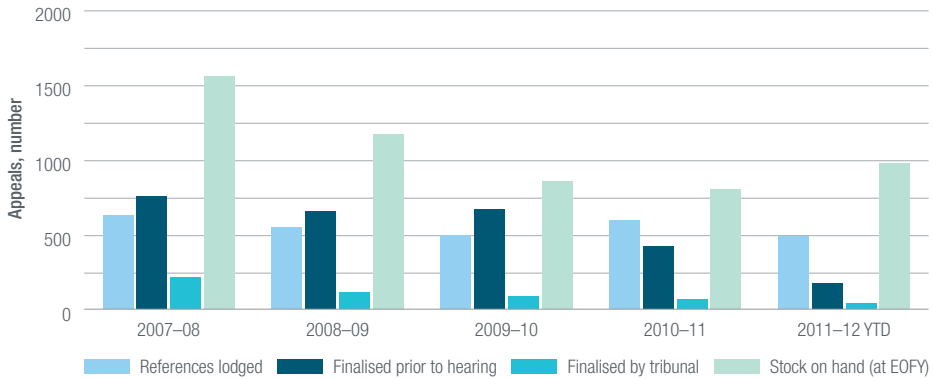


Figure 3.2 Stock on hand (GST and excise are combined as excise is less than 20 cases per FY)

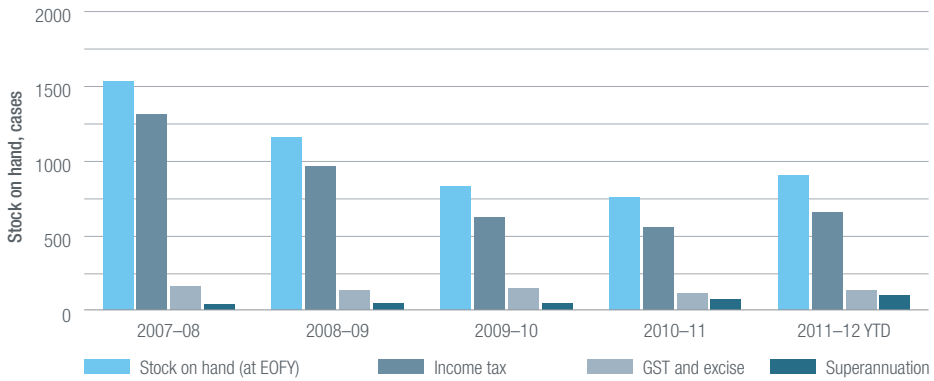
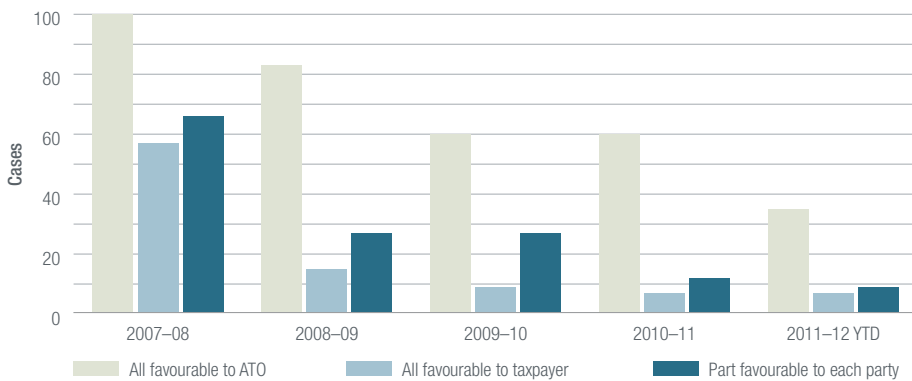


Figure 3.3 Decision results



04 Court litigation

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AT A GLANCE

About 20% of taxpayers seeking independent review of ATO decisions appeal to the court, see figure 4.1. Court cases also include appeals by taxpayers or the ATO from tribunal decisions, or from initial court decisions to higher courts.

Most appeals concern income tax assessments, 72% of litigation in progress in 2010–11, see figure 4.2.

In the same year other litigation in the courts involved:

- goods and services tax (14%)
- superannuation (11%)
- fringe benefits tax (<1%)
- excise (<1%).

At the end of 2010–11, court cases represented 25% (nearly 270) of litigation matters in progress, of which 3% (36) were appeals to the Full Federal Court and less than 1% (7) were appeals to the High Court, see figure 4.2.

The declining number of court decisions in tax and superannuation matters in recent years reflects the finalisation of mass-marketed scheme-related cases, see figure 4.3. In 2008–09, mass-marketed scheme-related cases represented 20% of all court decisions – there have been no cases related to mass-marketed schemes so far this year.

Taxpayer appeals to courts settled prior to hearing peaked at 86% in 2009–10 due to the high level of mass-marketed scheme-related settlements, see figure 2.2. The ATO conceded a significant number of cases in 2007–08, 51 cases, or 37% of cases finalised pre-hearing. Since then, only very small numbers of cases have been conceded by either the ATO or taxpayers, with taxpayers conceding more cases than the ATO, see figure 2.2.

The most common reason for the ATO conceding a case is that fresh information has been provided by the taxpayer. This indicates improved communication between tax officers and taxpayers and their advisors earlier could further minimise disputes and resolve them earlier.

Between 1 July 2007 and 29 February 2012, there have been 282 decisions by the courts, of which 159 (56%) were favourable to the ATO, 95 (34%) were favourable to taxpayers and 28 (10%) were partly favourable to each party, see figure 4.3.

In the past 18 months, decisions favourable to the ATO and favourable to taxpayers has evened. In 2010–11, 21 (46%) were favourable to the ATO and 17 (38%) were favourable to taxpayers. So far this year, the number of favourable decisions to the ATO and taxpayers were even: 10 cases (46%) each.

Partially favourable decisions have ranged between 10% and 15% except in 2008–09 which was exceptionally low, with 2 cases (3%).

TRENDS 1 JULY 2007 TO 29 FEBRUARY 2012

Figure 4.1 Summary of trends

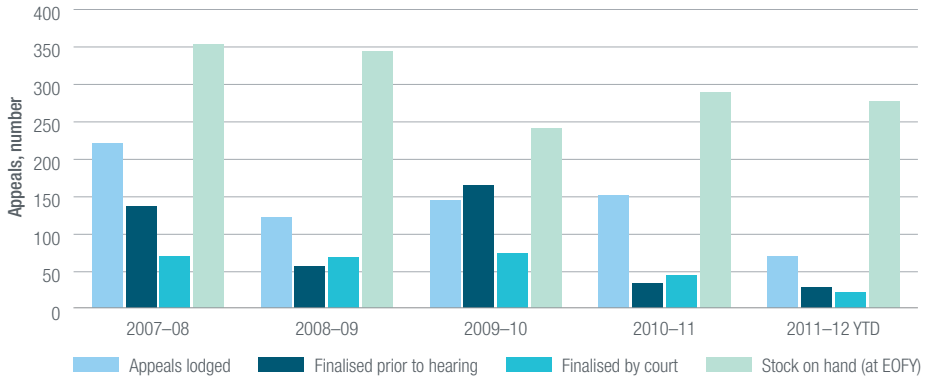
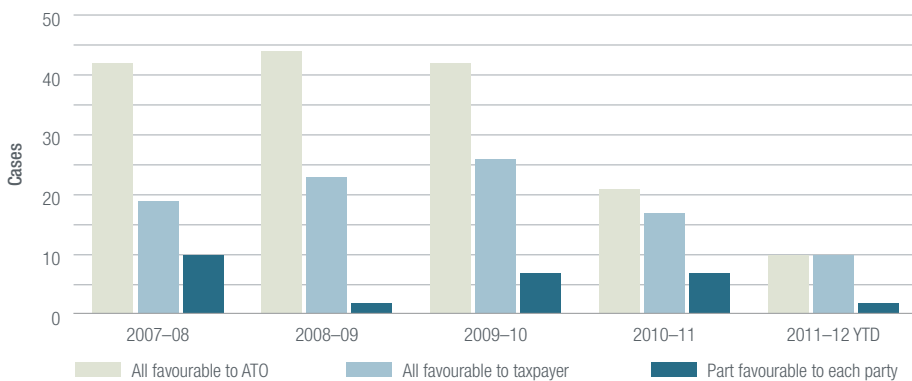


Figure 4.2 Stock on hand (GST and excise are combined as excise is less than 10 cases per FY)



Figure 4.3 Decision results



05 Test case litigation

Since the mid-90s, taxpayers have been able to apply for test case funding of their litigation expenses where the case raises issues of uncertainty or contention about how the tax and superannuation laws operate that may be of significant community interest.

In 2009–10, there were slightly more applications received compared to other years accompanied by a spike in declined cases, see figure 5.2.

Unfortunately, some test cases do not proceed and are finalised prior to hearing. In the past 5 years, 6 cases were finalised prior to hearing: 4 were withdrawn by the taxpayer, 2 conceded by the ATO and 1 settled, see figure 5.1.

There is no particular pattern of favourable or unfavourable in the test case decisions, see figure 5.3.

An important measure of success is whether the law was clarified. The 12 test case decisions in 2010–11 have resulted in the law being clarified in 8 cases (67%) and the government has announced law changes in respect of the other 4 decisions.

The Test Case Litigation Panel has 5 members – 3 external accounting and legal professionals, and 2 senior ATO officers (who are the Chair and Deputy Chair). The panel provides independent advice on the merits of applications for test case funding and on the significance of the issues to the community, see figure 5.2.

In some cases, the Chair or Deputy Chair determines applications without referral to the panel (11 cases in 2010–11). This includes where an urgent decision on funding is required or where a case falls clearly within a funding policy. It includes most matters where the ATO has sought special leave to appeal to the High Court and appeals on adverse AAT decisions to the Federal Court.

The main reasons for declining applications are that they were either:

- likely to be determined by applying established legal principles to facts
- not of significance to a substantial section of the public
- cases where the applicant was attempting to gain a benefit not intended by the law.

TRENDS 1 JULY 2007 TO 29 FEBRUARY 2012

Figure 5.1 Total applications for test case funding

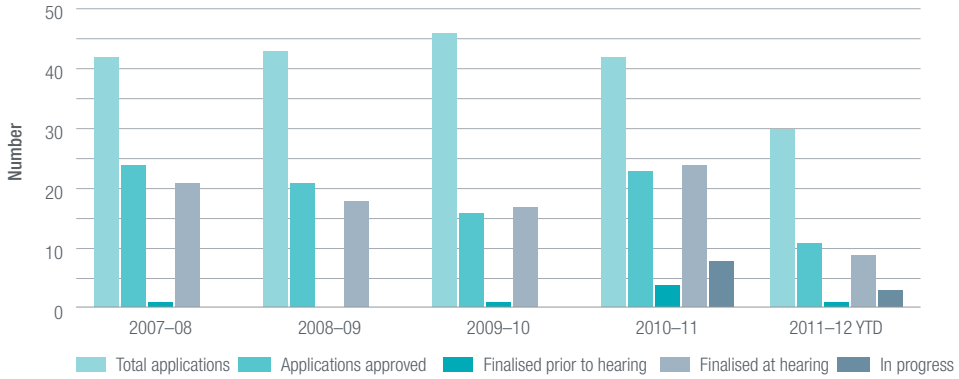


Figure 5.2 Applications for test case funding considered by the test case litigation panel

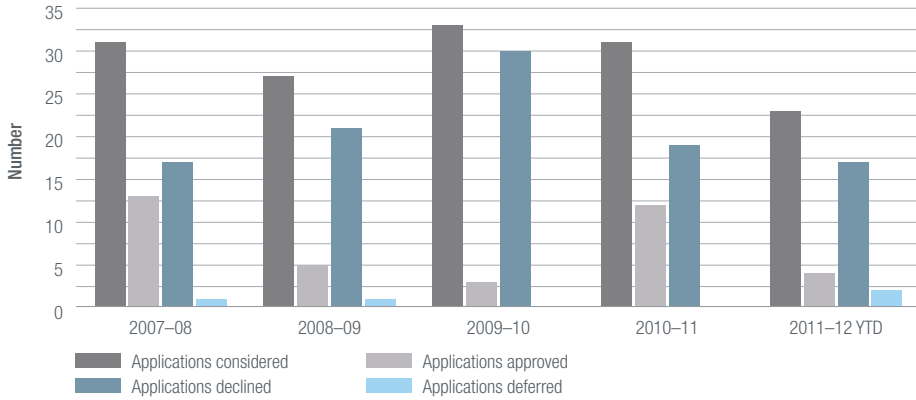
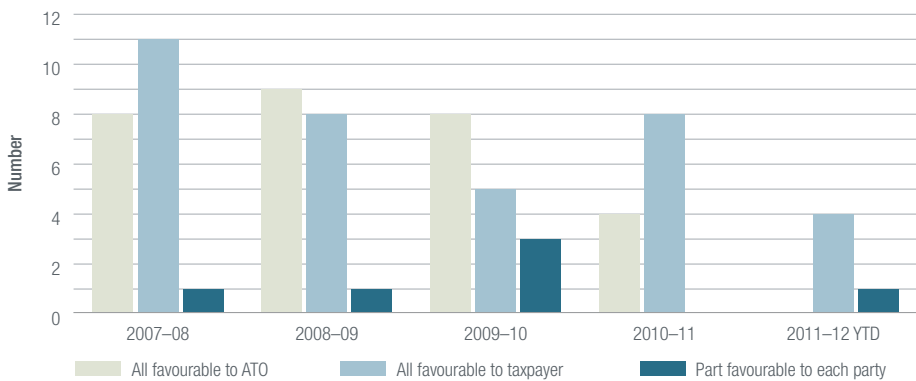


Figure 5.3 Test case results



06 Legal costs

Litigation is expensive, so we continue to seek to resolve disputes as early as possible.

This section only refers to the ATO's legal costs as we do not have information on taxpayers' costs or those of the tribunals and courts. Also, these costs include other legal services work. We have not been able to do a precise breakdown of tax and superannuation litigation costs, so these statistics are just a broad indicator.

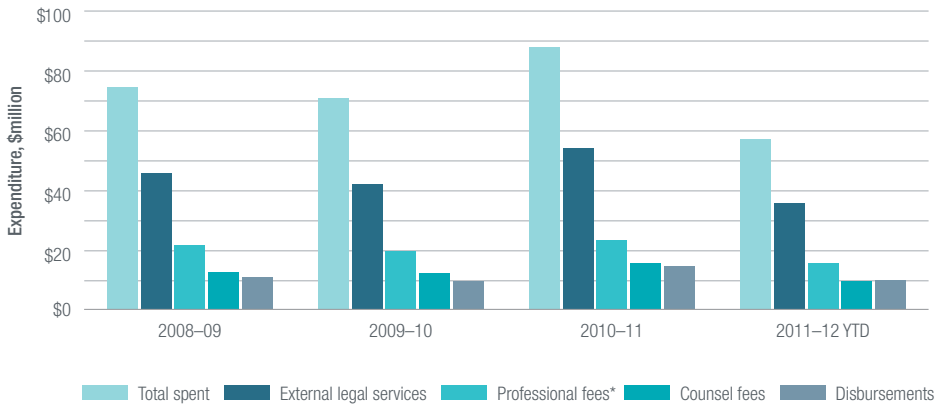
The ATO engages external legal providers for litigation and legal advisory work in relation to revenue collection, tax and superannuation law interpretation, and non-tax law matters such as employment law and freedom of information. Tax Practitioners Board legal services expenditure is also included.

Last year we spent about \$81 million on these legal costs – about \$34 million on our staff costs and over \$54 million was spent on external legal services. The ATO recovers some legal costs each year. In 2010–11, the total amount of costs recovered was over \$7 million, see figure 6.1.

The decline in costs of test case funding reflects the decline in matters being approved for funding as many applications do not meet the published criteria for receiving test case funding, see figure 6.2.

TRENDS 1 JULY 2008 TO 31 JANUARY 2012

Figure 6.1 Expenditure on legal services
(including provision of advice, litigation and related services)



* Professional fees include fees charged by external legal services providers for the work undertaken by their solicitors.

Figure 6.2 Expenditure on test cases



For more information

Alternative dispute resolution

- The Australian Government outlined its position in encouraging ADR in *A Strategic Framework for Access to Justice in the Federal Civil Justice System*, the Full Report of the Access to Justice Taskforce, Australian Government, Attorney-General's Department, September 2009.
- More information can be found on the Attorney-General Department's website at www.ag.gov.au

ATO's test case litigation program

- For information on the program and how to apply, visit www.ato.gov.au and search for 'Test case litigation program'.
- More information is available in the *Commissioner of Taxation Annual report 2010–11*, pages 108, 177–181.

ATO's Code of settlement practice

- For information on the code, visit www.ato.gov.au and search for 'Code of settlement practice'.
- The ATO has 2 Law Administration Practice Statements (LAPS) regarding settlements:
 - Law Administration Practice Statement PS LA 2007/5 Settlements
 - Law Administration Practice Statement PS LA 2007/6 Guidelines for settlement of widely-based tax disputes.
- LAPS are instructions to tax officers which provide direction and assistance on the approaches to be taken in performing duties involving the application of the laws administered by the Commissioner of Taxation. Although LAPS are written principally for tax officers, in the interests of open tax administration, they are available to the public via the ATO Legal Database on www.ato.gov.au
- Settlements statistics can be found in the *Commissioner of Taxation Annual report 2010–11*, pages 105–106.
- The Dispute resolution sub-committee of the National Tax Liaison Group charter, membership list and minutes are also available on www.ato.gov.au

Model litigant

- The *Legal Services Directions 2005* issued by the Attorney-General apply to 'Commonwealth legal work'. The ATO operates under these Directions which require us to be a model litigant.
- The directions are available on the Attorney-General Department's website at www.ag.gov.au
- More information is available in *Commissioner of Taxation Annual report 2010–11*, page 107.

Administrative Appeals Tribunal (AAT)

- The AAT reviews a wide range of administrative decisions made by the ATO and other government agencies. The AAT aims to provide independent review with as little formality and technicality as possible.
- The AAT includes the Small Taxation Claims Tribunal, which provides quick and inexpensive reviews of some decisions made by the ATO.
- For more information refer to the AAT website at www.aat.gov.au

Federal Court of Australia

- Single judges of the Federal Court hear taxpayer appeals and also most appeals from decisions of the AAT.
- The Full Federal Court hears appeals from decisions of single judges of the Federal Court, and from the Federal Magistrates Court and also some appeals from AAT decisions (for example, where at least 1 of the members of the AAT that gave the decision was a judge).
- For more information refer to the Federal Court of Australia website at www.fedcourt.gov.au

High Court of Australia

- The High Court is the highest court in Australia's court system and the final court of appeal including for tax and superannuation litigation. It decides cases of special federal significance including constitutional challenges.
- To appeal a court decision to the High Court, applicants must apply for special leave to appeal which is heard by 1 or more justices of the court.
- Special leave is granted only where the High Court decides a question of law is raised which is of public importance, is in the interests of justice, or it involves conflicts between courts.
- For more information, refer to the High Court website www.hcourt.gov.au

Disclaimer

The data included in this document covers litigation associated with disputed assessments only. It specifically excludes data associated with debt recovery, freedom of information and administrative law disputes.

This data has been drawn from the ATO's legacy systems pending migration to the new Siebel system in July 2012. The accuracy of this data is therefore reliant on the accuracy of initial allocation of cases to categories, post-closure manual categorisation of some cases, and re-categorisation of cases identified as outliers.

This data is reported in the standard ATO method where one appeal lodged is maintained throughout the process as one case. This therefore does not reflect the multiple individual matters that one case may contain. Other entities may count individual matters as separate cases, and therefore cannot be directly compared with the ATO method of counting.

Feedback

- ▶ Please email your comments to taxstats@ato.gov.au

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