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Tax disputes

House of Representatives
Standing Committee on Tax and Revenue

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Chair's foreword

Disputes between taxpayers and the Australian Taxation Office (ATO) are an unavoidable feature of our tax system. This inquiry has come about because stakeholders and taxpayers have expressed deep concern that the ATO does not always use its powers in a judicious manner and does not always treat taxpayers fairly and with respect.

The Committee acknowledges there have been improvements. Over the past four years, the ATO has demonstrated a trend to settle matters earlier. The current Commissioner has embarked on a project of reinventing the ATO. However, the severity of outcomes for some taxpayers convinced the Committee that an inquiry was warranted. The Committee commenced the inquiry in June 2014 with a focus on small taxpayers and individuals and requested the Inspector-General of Taxation (IGT) to conduct a similar inquiry concentrating on large taxpayers and high wealth individuals.

The adverse outcomes in some disputes arise from a combination of factors. These include that the ATO has strong powers, it does not always engage with taxpayers, and there has not been clear separation between the investigative and review functions within the ATO. The risk is that a taxpayer may not have a fair hearing, or at least perceive that this has been the case, until their matter proceeds to the Administrative Appeals Tribunal (AAT). Such a course involves substantial time and expense.

One of the key issues in the inquiry was the degree of separation between auditors (investigators) and objection officers (reviewers). Over the last 20 years, both of these functions have been within the compliance area of the ATO. The Committee received evidence that objection decisions are now less likely to demonstrate independence, or that a taxpayer's matter has been freshly examined.

Recently, objections for entities with a turnover of over $100 million annually have been transferred to the legal area in the ATO. The Committee's recommendations build on this reform. The Committee believes that an additional Second Commissioner should be created that manages objections and appeals and that

there should be stricter controls on communications between auditors and objection officers. This has been a prior recommendation of the IGT.

Another important matter was how the ATO manages cases involving alleged fraud or evasion. The Committee received evidence that ATO officers sometimes allege fraud or evasion without turning their mind to the question of whether fraud or evasion actually exists. The taxpayer then has the burden of proof against an allegation for which the ATO may have had only limited evidence.

Also of concern was the AAT's statement that the ATO sometimes has not turned its mind to whether fraud or evasion occurred by the time a matter has progressed to litigation.

The Committee has made a number of recommendations on this matter. The Committee believes that findings or allegations of fraud or evasion should only be made by an SES officer. The Committee would also like to see the burden of proof on these issues switch back to the ATO once the statutory record-keeping period for taxpayers has expired.

The third key issue in the inquiry was that the ATO occasionally refuses to engage with taxpayers or demonstrate that it is listening to the taxpayer's arguments. Witnesses found this frustrating because they had no option other than waiting for their dispute to progress to objection or the AAT.

The Committee would like the ATO to fully implement a prior recommendation of the IGT, namely that ATO staff should consider whether to conduct direct conferences with taxpayers at multiple points in a dispute. In its response to the IGT in 2012, the ATO stated that it agreed to this approach in its large and more complex compliance work. The Committee believes that the opportunity for engagement should be available to all taxpayers.

The final major inquiry issue I would like to raise is that ATO officers can make unreasonable requests for information from taxpayers, both in terms of volume and deadlines. Taxpayers found this particularly frustrating because they saw it as an unnecessary abuse of power and it would turn a routine aspect of a dispute into a major one. The ATO should apply a minimum of 28 days for all information requests, it should permit some negotiation around them, and it should give reasons for them, typically based on a risk hypothesis.

Many people contributed to this inquiry. I would especially like to thank the previous Chair of the Committee, John Alexander, whose leadership helped establish the Committee and contributed to the quality of the evidence and goodwill during the inquiry.

I would also like to thank the IGT for conducting his review of disputes from the perspective of large taxpayers and high wealth individuals. The IGT's report was

released last month and the Committee has referred to it at various points in this report. Further, the IGT has built up a body of work that the Committee was able to refer to during the inquiry. The Committee has also taken the opportunity to reiterate some of the IGT's prior recommendations.

Finally, I would like to thank my fellow Committee members and the individuals and organisations that assisted the Committee through submissions and giving evidence.

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 does not wish this report to be seen as lessening the ATO's role in collecting revenue legally due. However, there is scope for improvement and full implementation of the Committee's recommendations will produce a fairer tax system, leading to better outcomes for taxpayers and also for the ATO.

Bert van Manen MP
Chair

Membership of the Committee

Chair	Mr John Alexander OAM (to 4/3/15)	
	Mr Bert van Manen (from 10/3/15)	
Deputy Chair	Dr Jim Chalmers	
Members	Mr John Alexander OAM (from 4/3/15)	Mr Angus Taylor
	Ms Terri Butler	Mr Bert van Manen (to 10/3/15)
	Mr Ian Goodenough	Mr Tim Watts
	Ms Clare O'Neil	Mr Matt Williams
	Mr Michael Sukkar	

Committee Secretariat

Secretary	Ms Susan Cardell
Inquiry Secretary	Mr David Monk
Research Officers	Mr Shane ArmstrongMs
	Ms Samantha Leahy
Administrative Officers	Ms Tamara Palmer
	Ms Yvonne Lee

Terms of reference

The Committee is to inquire into and report on disputes between taxpayers and the Australian Taxation Office (ATO), with particular regard to:

- collecting revenues due
- fair treatment and respect of taxpayers
- efficiency, effectiveness and transparency, from the perspective of both taxpayers and the ATO, and
- how the ATO supports the outcomes of efficiency, effectiveness and transparency through the use and publication of performance information.

The Committee is to examine these issues through the following themes:

- small business
- large business
- high wealth individuals
- individuals generally
- the legal framework for disputes, including:
- the model litigant rules
- real time compliance initiatives, including annual compliance arrangements, pre-lodgement compliance reviews, and the reportable tax position schedule, and
- alternative dispute resolution, and
- the governance framework for disputes, including:

- ⇒ the arrangements for and appropriate level of separation between the compliance, investigation, objection and litigation functions, and
- ⇒ comparisons with tax administration bodies overseas.

The Committee may consider and report on these themes individually or group them together.

The Committee may request that the Inspector-General of Taxation undertake aspects of this inquiry under section 8(3)(d) of the Inspector-General of Taxation Act 2003. If the Inspector-General agrees to any such request, then under the Act the Inspector-General would conduct a formal review and provide a report to the Assistant Treasurer for tabling in the Parliament.

List of abbreviations

AAT	Administrative Appeals Tribunal
ADR	Alternative dispute resolution
ATO	Australian Taxation Office
CAANZ	Chartered Accountants Australia New Zealand
CDDA	Compensation for detriment caused by defective administration
DPO	Departure prohibition order
GIC	General interest charge
HWI	High wealth individual
IGT	Inspector-General of Taxation
IPA	Institute of Public Accountants
KPI	Key performance indicator
PS LA	Practice Statement Law Administration
PwC	PricewaterhouseCoopers
SIC	Shortfall interest charge
SME	Small or medium enterprise
TAA	*Taxation Administration Act 1953*

List of recommendations

2 Performance measurement and reporting

Recommendation 1

The Committee recommends that the Australian Taxation Office review its performance reporting measures and:

- develop a measureable key performance indicator of taxpayer perceptions of fairness in tax disputes;
- that this key performance indicator be monitored and reviewed by the Australian Taxation Office executive on a regular basis (at least half-yearly); and
- that the outcomes against such a key performance indicator be reported in the Australian Taxation Office Annual Report.

3 The legal framework

Recommendation 2

The Committee recommends that the Government amend the tax laws and the Australian Taxation Office consider other administrative means by which interest charges would not act as leverage against a taxpayer during a tax dispute.

Recommendation 3

The Committee recommends that the Australian Taxation Office amend its internal and external guidance so that it remits interest where:

- the Australian Taxation Office takes longer than the 60 days available to it to finalise an objection and the taxpayer has acted in good faith; and

- the Australian Taxation Office changes arguments after assessments have been made (such as during an objection or litigation).

Recommendation 4

The Committee recommends that the Australian Taxation Office amend its internal guidance so that findings or suspicion of fraud or evasion can only be made by an officer from the Senior Executive Service.

Recommendation 5

The Committee recommends that the Australian Taxation Office only make allegations of fraud against taxpayers when evidence of fraud clearly exists.

Recommendation 6

The Committee recommends the Australian Taxation Office should ensure that allegations of fraud or evasion are addressed as soon as practicable in an audit or review.

Recommendation 7

The Committee recommends that the Government introduce legislation to place the burden of proof on the Australian Taxation Office in relation to allegations of fraud and evasion after a certain period has elapsed. The change should be harmonised with the record keeping requirements. These periods could be extended, subject to concerns of regulatory costs on business and individuals.

Recommendation 8

The Committee recommends that the Government introduce legislation to require judicial approval for the Commissioner of Taxation to issue a departure prohibition order.

Recommendation 9

The Committee recommends the Australian Taxation Office better engage with taxpayers prior to litigation so that they are aware of what the model litigant rules require, and do not require, of the Australian Taxation Office.

Recommendation 10

The Committee recommends the Australian Taxation Office approach the Australian Government Solicitor to determine if they can provide advice and assistance to the Australian Taxation Office in terms of best practice in complying with the model litigant rules.

Recommendation 11

The Committee recommends that the Government review the Small Taxation Claims Tribunal and determine whether it should continue. If so, there should be a one-off increase to the $5,000 limit to take account of inflation since 1997 and a system introduced so the threshold increases incrementally in future to keep pace with inflation.

4 Readiness to engage

Recommendation 12

The Committee recommends that the Australian Taxation Office implement recommendation 3.5.2 from the Inspector-General's report on alternative dispute resolution for all taxpayers (i.e. considering whether to engage in direct conferences with taxpayers at multiple points in a dispute).

Recommendation 13

The Committee recommends that the Australian Taxation Office give more consideration to taxpayers when making information requests, with priority given to:

- setting timeframes in practice statements, with a minimum of 28 days for all requests;
- giving taxpayers the opportunity to seek an extended timeframe upon receipt of a request; and
- giving reasons for an information request, typically based on a risk hypothesis.

Recommendation 14

The Committee recommends the Australian Taxation Office introduce a triage system for disputes so that, early in a dispute, matters can be escalated to ATO staff sufficiently senior or with the appropriate technical skills to resolve the dispute quickly and effectively. Such decisions should consider taxpayer fairness, among other criteria.

5 Other administrative matters

Recommendation 15

The Committee recommends that, as much as practicable, the Australian Taxation Office should give taxpayers written notice of issues and topics to be raised in section 264 interviews.

Recommendation 16

The Committee recommends that the Australian Taxation Office invite the Commonwealth Ombudsman to advise on improving its compensation processes, including compensation liability and amounts.

6 The governance framework

Recommendation 17

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.

Recommendation 18

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.

Recommendation 19

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).

Recommendation 20

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.

1

Introduction

Preamble

1.1 The general scope of the inquiry and this report is tax disputes. The Ombudsman provided this definition of a dispute to the Committee: 'A disagreement only becomes a dispute when one party cannot live with the consequences of the disagreement and insists on a different outcome.'[1] In other words, while it takes two parties to disagree, it only takes one person to initiate a dispute and the dispute can be genuine, regardless of the other party's views.

1.2 Collecting tax is important job; it can also be a difficult one. The tax laws are complex and attitudes to compliance vary. As a result, disputes are inevitable. As the Ombudsman stated, 'I think most people would agree that compelling anybody to pay more money – whether it is tax, superannuation, a parking ticket, or a speeding fine – can lead to disagreement.'[2]

1.3 Under these circumstances, what needs to happen is that disputes are resolved as quickly and fairly as possible, in full accordance with the law, and that taxpayers and the community have confidence that this is occurring.

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1 Mr Colin Neave, Commonwealth Ombudsman, *Transcript of Evidence,* 24 September 2014, p. 9. Under the *Tax and Superannuation Laws Amendment (2014 Measures No. 7) Act 2015,* the Ombudsman's investigation functions in relation to the Australian Taxation Office are expected to be transferred to the Inspector-General of Taxation (IGT) on 1 May 2015. Therefore, future references to the Ombudsman in this report should be regarded as referring to the IGT, where appropriate.

2 Mr Colin Neave, Commonwealth Ombudsman, *Transcript of Evidence,* 24 September 2014, p. 9.

Role of the Inspector-General of Taxation

1.4 When this inquiry commenced, the Committee resolved to ask the Inspector-General of Taxation (IGT) to conduct an inquiry into tax disputes for large businesses and high wealth individuals. The Committee did this so it could focus on individuals and small to medium enterprises (collectively referred to in this chapter as SMEs). This division also reflects the differing inquiry processes and stakeholder groups.

1.5 On Friday, 27 February 2015, the Assistant Treasurer publicly released the IGT's report. The Committee's report refers to the IGT's document where appropriate. The IGT's report focusses on the governance issue of separation between the Australian Taxation Office's (ATO's) audit and internal review functions. The Committee covers this matter in detail in chapter 6. The views of the Committee and the IGT across the inquiry are broadly similar, including the important governance issue.

1.6 The Committee would very much like to thank the IGT for the assistance he has provided the Committee during the inquiry. This includes his review of tax disputes for large businesses and high wealth individuals, private briefings with the Committee, and the provision of evidence at the biannual hearings with the ATO. The IGT has also assisted the Committee through his work program over the past five years. Reports into objections (2009), compliance approaches to SMEs and high wealth individuals (2011), and the self-assessment system (2012) have given the Committee a solid foundation for its inquiry.[3]

1.7 Finally, the Committee would like to acknowledge the impact that the IGT's report on Alternative Dispute Resolution (ADR) in 2012 has made on tax disputes generally. The Committee notes that the previous Commissioner of Taxation also requested that the IGT undertake the ADR review.[4] Many of the recent reforms made by the ATO can be traced back to this report and the Committee understands that some of the IGT's suggestions, such as in-house facilitators at the ATO, have been very successful.

Inquiry overview

1.8 On 4 June 2014, the Committee adopted the terms of reference provided by the then Acting Assistant Treasurer, Senator the Honourable Mathias

3 The IGT's reports are available at http://www.igt.gov.au/content/reports.asp?NavID=9.

4 IGT, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution: A report to the Assistant Treasurer,* May 2012, p. v.

Cormann. The full terms of reference are detailed at the front of this report.

1.9 The inquiry was advertised by media release, social media, Committee members' websites, and postcards. The Committee sought submissions from relevant Australian Government ministers, legal, accounting, and tax representative bodies, and tax practitioners.

1.10 The Committee received 34 submissions and three supplementary submissions. Seven submissions were confidential. The submissions are listed at Appendix A.

1.11 The Committee held nine public hearings in Melbourne, Sydney, Brisbane and Canberra. This included a teleconference with a witness in Perth. Public hearing details are listed at Appendix B.

1.12 The remainder of this chapter gives an overview of disputes for SMEs and some general observations by the Committee. The other chapters in the report broadly follow the Committee's terms of reference:

- chapter 2 discusses the ATO's key performance indicators for disputes
- chapter 3 examines possible amendments to the legal framework for disputes, including to the general interest charge and allegations of fraud or evasion
- chapter 4 looks at how the ATO can foster early engagement between the parties in a dispute or potential dispute
- chapter 5 considers other administrative aspects of disputes, in particular formal interviews, compensation, and ADR
- chapter 6 covers the degree of separation between the audit (or investigation) function of the ATO against the later processes of objection and litigation

Context of SME disputes

Background

1.13 The Committee's inquiry covered individuals and businesses with a turnover up to $250 million annually. It excluded high wealth individuals,

who control net assets of more than $5 million, and businesses with a turnover of more than $250 million.[5]

1.14 Disputes work differently for different market segments. The issues are different, the amount of tax at stake is different, and so are the resources available to the taxpayer. This does not mean that, because the amounts for SMEs are lower, the disputes are simpler. The Committee received evidence that SME disputes can be very complex.[6]

1.15 The ATO provided the Committee with a breakdown of tax disputes by market for income tax, reproduced in the following table. The plain numbers are the total number of matters in each category. The numbers in brackets are the percentage of matters that have progressed from the previous category. For example, of the total number of returns lodged by small business, 1 per cent will result in adjustments. Of those adjustments, 10 per cent will result in objections. Of those objections, 5 per cent result in cases lodged in the Administrative Appeals Tribunal (AAT) and courts, and so on. The bottom row is the average of these percentages. This is preferable to an average by total, because the latter would be dominated by the individuals' category.

Table 1.1 Income tax disputes, by number and as a percentage of previous category, 2013-14

Market	Returns lodged	Adjustments from audits	Objections	Cases lodged AAT & courts	Cases decided
Individuals	10.8 m	419,189 (4%)	16,498 (4%)	386 (2%)	44 (11%)
Small business	5.4 m	75,398 (1%)	7,705 (10%)	360 (5%)	31 (9%)
Medium business	0.2 m	4,845 (2%)	473 (10%)	75 (16%)	8 (11%)
Not for profit	12,256	743 (6%)	28 (4%)	5 (18%)	4 (80%)
Government	1,579	58 (4%)	8 (14%)	0 (0%)	0 (NA)
Large business	13,901	268 (2%)	118 (44%)	14 (12%)	16 (114%)
Total	16.5 m	500,501	24,830	840	103
Category average		(3%)	(14%)	(9%)	(45%)

Source *ATO, Submission No. 10.3, p. 2.*

1.16 The table shows that a small proportion of disputes travel far and that individuals and small business are the least likely to maintain a dispute. This is consistent with evidence the Committee received that SMEs have a

5 Although the Committee made its decision on the categories, the cut-off amounts are from the ATO. See ATO, *Annual Report 2013-14,* October 2014, pp. 58-59.

6 Mr Chris Wallis, *Submission No. 28,* pp. 15-18.

limit on what they will spend pursuing a matter. For example, for a dispute over $100,000, they are unlikely to spend more than $10,000.[7]

1.17 The table shows that large business is especially likely to object to an adjustment. Their disputes are likely to proceed to a decision by a tribunal member or judge if lodged with the AAT or a court. Not too much importance should be placed on the later columns for not-for-profits because the total numbers are low.

1.18 Mr Michael Croker from Chartered Accountants Australia New Zealand (CAANZ) advised the Committee that, given the lower revenue risk, the ATO usually prefers to develop its expertise for large business and then let that filter down the rest of the organisation.[8] The Committee also heard that, given the smaller sums involved, SME disputes do not attract the most experienced ATO staff, and there is high staff turnover:

> In dealing with small business you are routinely dealing with junior people at the tax office. Some of that reflects the administration structure within the tax office—the pyramid is much flatter and much broader at small business enterprise level and private taxpayer level… Just as staff in an accounting firm or a legal firm want to go to the fashionable areas of work, staff in the tax office want to go to the fashionable areas—and dealing with mum and dad's fish-and-chip shop does not quite cut the mustard when the possibility is to go to large business and international. So we end up with this constant churning of staff. We get no corporate memory at the small end of the tax office.[9]

1.19 In terms of revenue risk, it makes sense for the ATO to allocate its best staff to large business. However, this increases the risk for an SME taxpayer that errors will be made and they will not, in effect, be treated fairly. The Committee received evidence along these lines and heard that staff with less expertise, when faced with a complex transaction, are more likely to conclude that there is questionable conduct.[10] A tax barrister advised the Committee that this can have important consequences for taxpayers:

> … the large corporates and their tax affairs do attract the more talented and more skilled people in the ATO… I think a lawyer would look at a loan from offshore and say, 'Well, that's a good

7 Mr Chris Wallis, *Transcript of Evidence,* 14 August 2014, pp. 35-36.

8 Mr Michael Croker, CAANZ, *Transcript of Evidence,* 18 August 2014, pp. 35-36.

9 Mr Chris Wallis, *Transcript of Evidence,* 14 August 2014, p. 34.

10 Mr Chris Wallis, *Submission No. 28,* p. 19.

> faith attempt to use legal structuring in order to achieve an outcome.' A layperson might look at the loan from offshore and say, 'They are lending money to themselves— that's fraudulent.' I do think the fact that the well-known corporates are dealt with by the more skilled people at the ATO does result in some quite important downstream consequences. In the media we read about Chevron and its supposed transfer-pricing arrangements. If Chevron were a private individual, you would expect to see all of its assets being frozen and its bank accounts being garnished.[11]

1.20 The Committee is mindful that the ATO cannot simply transfer staff and resources to SME audits to address this problem, without affecting the rest of the organisation. The Committee heard that working with the SME market is an important training opportunity for ATO staff.[12] However, the Committee will make suggestions in this report on how current arrangements could be improved to reduce fairness risk for taxpayers.

Most disputes resolve satisfactorily ...

1.21 As Mr Andrew Mills from the ATO stated, the ATO conducts tens of millions of transactions and few result in disputes.[13] Similarly, most disputes are resolved satisfactorily. The Committee held an accountants' roundtable in Sydney with a group of practitioners that specialised in small business, all of whom agreed with the following point:

> We have been in practice since the early 1970s. I have to say that, in all that time, we have had very positive relationships with the ATO. Instances of disputes are very minor and infrequent. In most cases, they have been able to be resolved quite efficiently. As a practitioner dealing with the ATO on a day-by-day basis, we have some issues with communications, case management, approach and procedure, but, as I said, they are minor and infrequent issues… I am quite happy to praise them in probably 99 per cent of cases.[14]

1.22 Other witnesses agreed that most disputes are properly handled. The Ombudsman stated that, 'generally speaking, the tax office treats those

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11 Mr John Hyde Page, *Transcript of Evidence,* 29 October 2014, p. 9.

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

13 Mr Andrew Mills, ATO, *Transcript of Evidence,* 29 November 2014, p. 1.

14 Mr Brian Hrnjak, GHR Accountants & Financial Planners, *Transcript of Evidence,* 18 August 2014, p. 1. Mr Alan Bentwitch, Bentwitch & Co., and Mr Peter Sullivan, LCD & Co. Accounting Services, made similar comments, p. 1.

who come to it fairly.'[15] Mr David Hughes from Small Myers Hughes commented, 'the current Commissioner of Taxation is doing a very good job, as are the majority of ATO officers.'[16] Dr Niv Tadmore from the Tax Institute provided a related observation that, 'we have not seen the Commissioner going after a business in order to get it down.'[17]

1.23 In addition, the Committee received consistent evidence that the ATO's performance is improving. The Ombudsman advised the Committee that complaints overall to the Ombudsman in 2013-14 were down 24 per cent on the previous year.[18] CPA Australia's submission stated that the change across the ATO was substantial and reduced costs for taxpayers:

> As an overall comment we strongly believe that the Commissioner should be commended for the recent performance of the Australian Taxation Office (ATO) in resolving tax disputes through negotiation and the use of Alternate Dispute Resolution (ADR) processes. This has involved a considerable paradigm shift by all parties and our members note that its roll-out across all market sectors including SMEs has typically led to the more expeditious resolution of disputes by the ATO.
>
> It should be noted that the rollout of ADR processes is a crucial development as our members find that the vast majority of cases concerning SMEs do not involve a 'test case' involving technical issues… Moreover, for all but the most aggressive of taxpayers, avoiding litigation is both the most desirable and economically sensible outcome.[19]

1.24 The Tax Institute, the Institute of Public Accountants (IPA), and the Law Council of Australia made similar comments to the Committee.[20]

… but some do not

1.25 The Committee received evidence that, once the ATO decides a taxpayer has an outstanding liability, the balance of power in SME disputes is very much in favour of the ATO. This balance of power exists at the legal,

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

16 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 15.

17 Dr Niv Tadmore, Taxation Institute, *Transcript of Evidence,* 14 August 2014, p. 13.

18 Commonwealth Ombudsman, *Submission No. 14,* p. 3.

19 CPA Australia, *Submission No. 7,* p. 1.

20 The Tax Institute, *Submission No. 11,* p. 1; Mr Tony Greco, IPA, *Transcript of Evidence,* 14 August 2014, p. 6; Law Council of Australia, *Exhibit No. 2,* p. 3.

commercial, and emotional levels and raised the question of whether taxpayers withdraw from disputes due to attrition.[21] Mr Tony Fittler from HLB Mann Judd stated:

> … our concern is the fact that there is a lot going in the commissioner's favour and not much in the favour of the taxpayer. The taxpayer, when they are faced by an audit, is involved in cost and concern about their situation. If the matter ultimately goes to assessment, immediately they are in a position where they need to object, quite often within a short time frame, and also the tax becomes due.
>
> While there is a practice of deferring recovery of tax, provided you pay 50 per cent, quite often that is a difficult position to be in if you are an individual or a small business. It is a substantial sum of money and the difficulty there is that, even while the matter is going on, interest is accruing at the rate of, essentially, penalty rates—9.69 per cent currently. So the matter is escalating and there is really no pressure on the commissioner for the matter to be resolved quickly… The small-business taxpayer does not have the resources, is emotionally attached and, I guess, has other pressures on them as well.
>
> When there is a tax assessment raised, one of the issues is how you get financing. The first thing you will be asked for in seeking financing is a copy of what you owe the tax office, so that immediately becomes a limitation on borrowing. There is collateral damage. It brings into account personal relationships, what you tell your family and other obligations where you have borrowed from friends and family.[22]

1.26 The Committee accepts that the ATO needs strong powers to administer the tax system. The question is how these powers are applied and the checks and balances that exist to ensure that the legally correct amount of tax is paid, while taxpayers feel that they are being treated fairly and with respect.

1.27 The Committee heard that, under current laws and systems, it is too easy for the ATO's powers to be misapplied.[23] Similarly, the Committee heard

21 Mr Gary Kurzer, *Transcript of Evidence,* 18 August 2014, p. 47.

22 Mr Tony Fittler, HLB Mann Judd, *Transcript of Evidence,* 18 August 2014, p. 1.

23 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 15.

that a taxpayer's audit experience depends almost entirely on the auditor.[24]

1.28 Specific claims about ATO conduct made to the Committee during the inquiry include:

- bullying and unprofessional conduct
- a refusal to apologise
- raising trivial points late in an audit after a taxpayer successfully rebuts the initial ATO position
- behaving like 'zealots'
- reneging on informally agreed settlements
- pressuring taxpayers into settling
- a presumption of guilt and that the taxpayer is hiding something
- that audits are conducted like 'fishing expeditions' rather than with a specific focus
- refusing to meet a taxpayer or their representatives
- giving insufficient time to respond to requests whilst delaying the ATO's responses.[25]

The costs can be high

1.29 The costs of conducting a dispute with the ATO can be very high. The Committee heard from a retired builder, Mr Grahame Pilgrim, who stated that his $500,000 liability (including penalties and interest) was reduced to $100,000. Mr Pilgrim stated that the dispute had a substantial negative effect on both his marriage and his business:

> We went from 2007 through to 2010. The whole of our life was put on hold. My business suffered because I did not know from one day to the next whether I was going to be in business–I didn't know if the ATO was going to send me bankrupt. It cost me my

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

25 Mr Rob Salisbury, *Submission No. 21,* p. 3; Mr Chris Wallis, *Submission No. 28,* p. 22; Mr Andre Spnovic, BDO, *Transcript of Evidence,* 24 September 2014, p. 3; Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 15; Commonwealth Ombudsman, *Submission No. 14,* p. 7; Mr Colin Neave, Commonwealth Ombudsman, *Transcript of Evidence,* 24 September 2014, p. 10; Mr Wayne Graham, *Transcript of Evidence,* 1 October 2014, p. 5; Mr Ian Hashman, *Transcript of Evidence,* 24 September 2014, p. 5; Mr Richard Wytkin, *Transcript of Evidence,* 29 October 2014, p. 4.

> business and also my marriage, that part of it… I spent months backwards and forwards with the ATO, disputing the facts with my figures. That is why they reduced it back to that amount of money.[26]

1.30 Ms Judy Sullivan from PricewaterhouseCoopers (PwC) advised that taxpayers have committed suicide at the conclusion of a tax dispute:

> I am sure you will be hearing from a number of taxpayers about the emotional toll of these sorts of things. I have had clients in the past who have committed suicide after coming out the other end of an audit for a very serious allegation that was in fact settled. There is stress on families because of the length of time and things like that. You see a lot of marriage break-ups and emotional stress from these sorts of allegations.[27]

1.31 Disputes also cost a substantial amount in advisers' fees, especially if a matter is to proceed to the AAT. At the accountants' roundtable in Sydney, the Committee heard that many taxpayers will withdraw their claim if their objection fails, rather than proceed to the AAT, because the costs exceed the amount of tax in question. The alternative is to simply avoid legal arrangements that have some risk.[28]

1.32 Mr Ian Hashman advised the Committee that his series of disputes with the ATO cost him $250,000 in advisers' fees. The ATO withdrew its claim before the matters proceeded to the AAT.[29]

1.33 The ATO is well aware that tax disputes can have a severe effect on taxpayers. The Commissioner stated, 'We do know that delays in dispute resolution have real, physical and sometimes paralysing impacts for business and individuals.' He also stated that he is reforming the ATO by 'putting our clients at the centre of everything that we do.'[30]

1.34 The ATO has also apologised for its conduct in some disputes. Second Commissioner Andrew Mills stated, 'For those who have been adversely affected by our poor handling of their disputes, I would like to extend my sincere apologies.'[31]

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26 Mr Grahame Pilgrim, *Transcript of Evidence,* 16 October 2014, p. 22.

27 Ms Judy Sullivan, PwC, *Transcript of Evidence,* 18 August 2014, p. 29.

28 Mr Brian Hrnjak, GHR Accountants & Financial Planners, Mr Peter Sullivan, LCD & Co. Accounting Services, Mr Alan Bentwitch, Bentwitch & Co., *Transcript of Evidence,* 18 August 2014, p. 43.

29 Mr Ian Hashman, *Transcript of Evidence,* 24 September 2014, p. 5.

30 Mr Chris Jordan, Commissioner of Taxation, *Transcript of Evidence,* 16 July 2014, p. 1.

31 Mr Andrew Mills, ATO, *Transcript of Evidence,* 26 November 2014, p. 1.

Committee comment

1.35 The Committee's main finding from the inquiry is that some taxpayers have not been treated fairly by the ATO during their tax dispute. Although the frequency is low, the consequences for taxpayers can be severe and taxpayers have limited recourse when this happens. The Committee believes that changes to the tax laws and ATO practices are warranted, in addition to the reforms that the Commissioner is already undertaking.

1.36 One of the causes of the lack of fair treatment is that taxpayers are occasionally assessed as a higher revenue risk than they are in actual fact. This can include cases where a taxpayer does owe tax, but the ATO over-estimates the liability and/or imposes excessive penalties and interest.

1.37 Further, it appears that the ATO can misinterpret a taxpayer's willingness to challenge an ATO decision. The Ombudsman stated, 'I cannot emphasise enough that auditors need to listen to the issues because the disagreement may be a call for help, rather than an attempt to hide.'[32] Further, there are insufficient checks and reviews when these events occur.

1.38 The stakes can be high in a tax dispute. Unfortunately, much of the thinking in a dispute revolves around who is right. Given that many disputes revolve around highly technical issues,[33] and there is a great deal of uncertainty, this is not a constructive approach. The ATO would be better served by ensuring that its actions stand up to scrutiny, regardless of who is legally successful.

1.39 The Committee notes that improved perceptions of fairness assist taxpayer compliance. They are also important to individual taxpayers. Mrs Sarah Blakelock from the law firm McCullough Robertson stated to the Committee, 'Resolving disputes is a journey, and taxpayers need to go along the journey in the same way as the ATO needs to go along the journey.'[34] Not all taxpayers will be satisfied with the outcome of their dispute, but they have the right to be satisfied that they had a fair go.

1.40 The ATO has already embarked on reforms that will improve the tax system and the taxpayer experience. Mr Neil Olesen from the ATO stated that industry bodies are giving them positive feedback:

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32 Mr Colin Neave, Commonwealth Ombudsman, *Transcript of Evidence,* 24 September 2014, p. 9.

33 Mr Graham Halperin, *Transcript of Evidence,* 14 August 2014, p. 18.

34 Mrs Sarah Blakelock, McCullough Robertson, *Transcript of Evidence,* 24 September 2014, p. 10.

> They can see the direction in which we are heading, they can see what we are trying to do and they are saying to us across the table like this, 'Your people at the front line are in fact starting to get it.' That is encouraging feedback to hear from them. I absolutely accept we have more work to do, but the strongest thing they said to us only two weeks ago was, 'We can see that your people in the field on the front lines understand the direction you are going in and we can see the changes in behaviours starting to take effect.'[35]

1.41 The Committee is confident that the ATO can enhance its current reform program through the recommendations in this report and build a fairer tax system.

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

2

Performance measurement and reporting

Background

2.1 The Committee's fourth term of reference addresses the use of performance measurement and reporting:

> How the ATO supports the outcomes of efficiency, effectiveness and transparency through the use and publication of performance information.

2.2 The development and use of Key Performance Indicators (KPIs) by government agencies has been an area of interest for the Parliament over the last few years. The Joint Committee of Public Accounts and Audit has twice conducted reviews into reports of the Auditor-General,[1] making recommendations to improve the preparation of agency KPIs and to promote their use, ensuring they are relevant, measureable, and reportable against outcomes.[2]

2.3 The Australian Taxation Office's (ATO's) Strategic Intent[3] currently outlines 12 major KPIs.

- community and key stakeholder engagement and satisfaction with ATO performance

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1 Australian National Audit Office, Audit Report No. 28 (2012–13) *The Australian Government Performance Measurement and Reporting Framework - Pilot Project to Audit Key Performance Indicators*, Audit Report No. 21 (2013-14) *Pilot Project to Audit Key Performance Indicators*.

2 Joint Committee of Public Accounts and Audit, *Review of Auditor-General's Report Nos 11 to 31 (2012-13)*.

3 Australian Taxation Office, *ATO Strategic Intent*, July 2014.

- number of customer service interactions delivered through our multi-channel environment
- proportion of businesses and individuals registered in the system
- proportion of businesses and individuals that lodge on time
- proportion of liabilities paid on time by value for each of the major tax revenue types
- adjusted average cost to the individual taxpayers of managing their tax affairs
- net cost to collect $100
- earlier resolution of disputed cases
- ratio of collectable debt to net tax collections
- GST gap as a proportion of GST revenue
- operating within budget
- employee engagement compared to Australian Public Service Commission (APSC) state of the service

Key Performance Indicators relating to disputes

2.4 In its first appearance before the Committee, the ATO was asked how its KPIs relating to the quality of dispute resolution were to be measured. The ATO replied that it was looking at trends over time, examining where cases were settled within the dispute process. Further, it noted that, more broadly, the ATO was looking for more immediate, qualitiative feedback from those involved in disputes with the ATO.[4]

2.5 The Committee asked about publication of this material, and was advised that the ATO published a document called *Your Case Matters*, which would report on these measures, and information on the issue of performance measurement was also published within the ATO's *Annual Report*.[5]

2.6 The Committee then returned to the issue of KPIs relating to disputes and fairness at its final public hearing in Canberra, asking whether there were macro-level KPIs that the ATO was judged on relating to fairness. Ms Debbie Hastings replied that there were KPIs around fairness and the

4 Ms Debbie Hastings, ATO, *Transcript of Evidence,* 16 July 2014, p. 4.

5 Ms Debbie Hastings, ATO, *Transcript of Evidence,* 16 July 2014, p. 4.

time taken to resolve a dispute, and that this fairness was judged by the taxpayer, who was independently surveyed. Ms Hastings also noted that the surveyor was 'independent of the objection team.'[6]

2.7 The Committee then asked Mr Andrew Mills, Second Commissioner, Law, whether his KPIs included fairness, and whether KPIs relating to disputes were considred at ATO management meetings. Mr Mills replied that there was internal quarterly reporting on a range of KPIs, and that the issue of disputes was discussed 'quite a lot' at monthly meetings over the last year.[7]

2.8 Mr Neil Olesen clarified the process:

> It is worth saying that there are layers of governance inside the organisation. So, in [Debbie Hastings's] world, they will be talking about disputes every month in detail. When Debbie gets together with Andrew at that next layer, they will talk about it less frequently but, nevertheless, it will be a significant part of the conversation. The ATO executive that Andrew and I sit on, it naturally becomes a lesser part of the conversation because we are looking at the entire system, nevertheless, it features significantly in the measures we have with our performance. If you look at our plan and you look at one of the 12 key KPIs we have I am pretty sure I have one that is focused around disputes and the timeliness of disputes.[8]

2.9 The Committee noted that the KPI relating to the issue of fairness was a broader one than that of the timeliness of disputes, and asked the ATO to clarify that, beyond timeliness, there was no specific KPI that focused on disputes. The ATO agreed that this was correct at the top level of the organisation.[9]

2.10 The Inspector-General of Taxation (IGT) discussed this issue in his report into tax disputes. The report noted that the KPIs in the Corporate Plan are 'largely quantitative in nature and not directed at the qualitative and taxpayer experience aspects of such feedback. The IGT also stated, 'There is a need for the ATO to better understand its own performance from the perspective of the taxpayer.'[10]

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6 Ms Debbie Hastings, ATO, *Transcript of Evidence,* 26 November 2014, pp. 8-9.

7 Mr Andrew Mills, ATO, *Transcript of Evidence,* 26 November 2014, p. 9.

8 Mr Neil Olesen, ATO, *Transcript of Evidence,* 26 November 2014, p. 9.

9 Mr Andrew Mills, ATO, *Transcript of Evidence,* 26 November 2014, p. 10.

10 IGT, *The Management of Tax Disputes: A report to the Assistant Treasurer,* January 2015, pp. 104, 107.

2.11 Mr Neil Olesen acknowledged the importance of perceptions of fairness in promoting taxpayer compliance:

> We are deeply interested in fairness because we understand that, in the tax system, if people have a misperception of how the system operates, if they think it operates unfairly, that is a no-no in tax administration. That gets people thinking, 'Well, if it's unfair, I don't want to participate in it'. We understand deeply and, indeed, as part of the work we are doing we are trying to change the organisation and we have to address community perceptions around fairness and, in fact, address any issues around actual fairness where they might arise. It is a huge part of the thinking we are doing at the moment and how we look at our organisation.[11]

2.12 Mr Olesen also stated that changes in the large business and high wealth individuals sector, and the promotion of alternative dispute resolution were acknowledgements by the ATO of the importance in improving fairness in disputes.[12]

2.13 The Committee then asked whether the ATO planned to have a KPI on dispute fairness reviewed and regularly discussed by ATO senior management. The Committee was advised that this was planned, with the Committee then asking whether this would be included in the key KPIs reviewed by the ATO executive on a regular basis. The ATO agreed that this would be the case.[13]

Committee comment

2.14 The Committee found the discussions with the ATO relating to KPIs on fairness difficult to understand. There was a distinct lack of clarity in what KPIs the ATO had, and how it worked with them.

2.15 The Committee acknowledges that the ATO has worked to address perceptions of fairness, but notes that dispute fairness is an issue buried fairly deeply in the ATO's corporate reporting and management structure, and that it should be more prominent.

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11 Mr Neil Olesen, ATO, *Transcript of Evidence,* 26 November 2014, p. 10.

12 Mr Neil Olesen, ATO, *Transcript of Evidence,* 26 November 2014, p. 10.

13 Mr Neil Olesen, ATO, *Transcript of Evidence,* 26 November 2014, p. 11.

2.16 Accordingly, the Committee believes the ATO should address this issue as a matter of priority.

Recommendation 1

2.17 **The Committee recommends that the Australian Taxation Office review its performance reporting measures and:**

- **develop a measureable key performance indicator of taxpayer perceptions of fairness in tax disputes;**
- **that this key performance indicator be monitored and reviewed by the Australian Taxation Office executive on a regular basis (at least half-yearly); and**
- **that the outcomes against such a key performance indicator be reported in the Australian Taxation Office Annual Report.**

2.18 The Committee will continue to monitor KPIs relating to fairness in disputes in its regular hearings into the ATO Annual Report, and looks forward to seeing how the ATO addresses taxpayer perceptions of fairness in the disputes process.

3

The legal framework

Introduction

3.1 This chapter covers the main legal issues raised during the inquiry. At its core, the legal framework for tax disputes is simple. The Commissioner of Taxation takes a range of actions, including making assessments, determinations, and notices. If a taxpayer does not agree with the decision and wishes to take it further, then they may lodge a written objection with the Commissioner.[1]

3.2 Not all of the Commissioner's actions are subject to objection. For example, a taxpayer cannot object to some of the Commissioner's decisions in relation to interest or penalties.[2]

3.3 The default time period for lodging an objection is 60 days. However, time periods of two years or four years can also apply in special circumstances.[3]

3.4 If a taxpayer misses the objection deadline, they may still lodge the objection and ask the Commissioner to consider it as if it had been lodged on time. Further, the Commissioner has a general discretion to extend these periods. If the Commissioner does not grant an extension, the taxpayer can apply to the Administrative Appeals Tribunal (AAT) for a review of the decision.[4]

3.5 Broadly, the Commissioner is required to consider the objection within 60 days. The Commissioner can request additional information, which

1 Sections 14ZL and 14ZU of the *Taxation Administration Act 1953.*

2 Taxation Institute, *Submission No. 11,* p. 7.

3 Section 14ZW of the *Taxation Administration Act 1953.*

4 Sections 14ZW and 14ZX of the *Taxation Administration Act 1953.*

extends the deadline until 60 days after the request is met. A taxpayer can give a written request to the Commissioner that the objection decision be made. If this has not occurred within 60 days of the notice, then the Commissioner is taken to have disallowed the objection.[5]

3.6 Taxpayers can appeal the Commissioner's objection decision, in the great majority of cases to the AAT. For certain types of income tax remission decisions, it is to the Federal Court only. The application to the AAT must be made within 60 days of the objection.[6] In these forums, the member or judge can re-make the decision.[7]

3.7 Many of the fairness concerns raised in the inquiry come from the enforcement and procedural mechanisms that surround objections and appeals. It is these that the chapter is concerned with.

An ADR concept in the law

Background

3.8 The Committee received evidence during the inquiry that the Australian Taxation Office (ATO) has become more willing to negotiate on points with a commercial approach, especially for large taxpayers.[8] This raised the question of whether a greater readiness to negotiate, or use alternative dispute resolution (ADR), should be reflected in the legislation. The Tax Institute raised the issue as follows:

> Introducing a legislative right of early engagement which can be triggered by the taxpayer. Such a legislative mechanism could formally require the Commissioner to engage in ADR at the request of the taxpayer, rather than him only doing so by virtue of his internal policies. We acknowledge that further consideration would be required as to how the legislation should describe the time at which this right of early engagement would be available.[9]

5 Section 14ZYA of the *Taxation Administration Act 1953.*

6 Sections 14ZZ and 14ZZC of the *Taxation Administration Act 1953.*

7 Mr Philip Hack SC, AAT, *Transcript of Evidence,* 16 October 2014, p. 5.

8 For example, Mr Tony Greco, IPA, *Transcript of Evidence,* 14 August 2014, p. 6.

9 The Tax Institute, *Submission No. 11,* p. 7.

3.9 CPA Australia made a related suggestion, namely that ADR should be mandated as part of the objection process.[10]

3.10 The Committee notes that, at present, there appear to be no provisions in the tax laws that refer to ADR. However, the ATO does have a practice statement that encourages staff to use ADR during disputes. The statement notes that ADR may not always be appropriate, such as when:

- it is early in the dispute and the key issues have not yet crystallised
- resolution would require departure from an established ATO precedential view
- there is a clearly identified public benefit in having the matter judicially determined
- the matter is straightforward
- there is a genuine concern that the case involves fraud or evasion.[11]

Analysis

3.11 The Committee raised this topic and ADR generally with some witnesses. The key point that came out of the discussions was that ADR is only effective when both parties approach it constructively. A tax barrister, Mr Chris Wallis, stated:

> … I do not think anybody should be allowed anywhere near ADR until they have done the legwork, because otherwise it is a waste of time and an abuse of the process.[12]

3.12 A tax practitioner, Mr Richard Wytkin, expressed a similar concern, in particular that mandating the ATO to participate in ADR could be gamed by some taxpayers as a way of delaying a dispute.[13]

Committee comment

3.13 The Committee is strongly supportive of ADR in tax disputes, as well as the ATO improving its engagement with taxpayers more generally. However, the Committee is also mindful that ADR has some costs

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10 CPA Australia, *Submission No. 7,* p. 2.

11 ATO, *Alternative Dispute Resolution (ADR) in ATO disputes,* PS LA 2013/3, 20 August 2013, paras 9, 18.

12 Mr Chris Wallis, *Transcript of Evidence,* 14 August 2014, p. 37.

13 Mr Richard Wytkin, *Transcript of Evidence,* 29 October 2014, p. 4.

associated with it and that, if a taxpayer does not wish to constructively engage in the process, it would not be an effective use of public funds.

3.14 A legislative approach is not appropriate here and the Committee makes no recommendation.

Extending the time to lodge an objection to pursue ADR

Background

3.15 The default time for a taxpayer to lodge an objection in relation to a decision of the Commissioner is 60 days. In his 2012 report on ADR, the Inspector-General of Taxation (IGT) noted that the legislation only allows taxpayers to request an extension for the time to make an objection *after* that time has expired. A taxpayer may wish to engage in ADR, but doing so would probably mean that the time for them to lodge an objection would expire by the time that process was complete.[14]

3.16 The IGT recommended that the Government consider amending the tax laws so that the ATO can grant an extension to the period for lodging an objection *before* the lodgement period has expired. In its response to the ADR report, the ATO responded that this is a matter for Government.[15]

3.17 PricewaterhouseCoopers (PwC) advised the Committee that, in September 2011, a stakeholder had registered a request through the Tax Issues Entry System to legislate along these lines. The request was declined. The reason given was that the system is currently operating as intended.[16]

3.18 During the inquiry, a number of stakeholders supported the proposal.[17]

Analysis

3.19 Taxpayers have a choice. Firstly, they can lodge an objection, and then request ADR. However, it might look unusual to request ADR with an objection outstanding, and the dispute may evolve to the extent that the

14 IGT, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution: A report to the Assistant Treasurer,* May 2012, p. 96.

15 IGT, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution: A report to the Assistant Treasurer,* May 2012, p. 97.

16 PwC, *Submission No. 23,* p. 16.

17 Taxation Institute, *Submission No. 11,* p. 7; Law Council of Australia, *Exhibit No. 2,* p. 12; Mr Philip Hack SC, AAT, *Transcript of Evidence,* 16 October 2014, p. 4.

objection needs to be amended. It could also be a waste of the taxpayer's time and money to prepare an objection that might not be needed.

3.20 The alternative is for the taxpayer to engage in ADR, miss the objection deadline, and then hope that the Commissioner exercises their discretion to accept it late. Procedurally, this makes more sense, because both the ATO and the taxpayer are likely to expend less resources overall through engaging in ADR. The drawback is that the taxpayer must accept some risk.

3.21 The Committee put this issue to the ATO, who responded that they already take into account a taxpayer's willingness to engage in ADR in deciding whether to extend the objection deadline:

> There already exists the ability for the commissioner to grant an extension of time to lodge an objection. I think what perhaps the Inspector-General may have been considering is whether or not our application of those provisions was taking into account requests for alternative dispute resolution—and clearly we would.[18]

3.22 The Committee notes that, although there was consistent support for the proposal, no witness brought forward examples of where the ATO did not grant an extension. In his ADR report, the IGT stated that the ATO accepts a large number of late objections.[19]

Committee comment

3.23 The Committee supports the IGT's recommendation in principle. All legislative amendments or administrative changes that promote ADR are worthy of consideration. However, it appears that, in practice, it is unlikely that a taxpayer will engage in ADR, miss the objection deadline, and have their request rejected for an extension of time to lodge an objection.

3.24 The Committee acknowledges that there is consistent stakeholder support for the proposal. However, evidence was not presented that there is a problem that warrants legislative amendment. The Committee also accepts that taxpayers would like additional comfort in their dealings with the ATO. But given the lack of evidence of an abuse of process, the Committee is reluctant to recommend legislative change for a problem

18 Mr Andrew Mills, ATO, *Transcript of Evidence,* 16 July 2014, p. 13.

19 IGT, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution: A report to the Assistant Treasurer,* May 2012, p. 96.

that only exists in theory. The Committee would prefer to prioritise other matters.

Interest charges

Background

3.25 Two interest charges apply on tax debts. The shortfall interest charge (SIC) is the base interest rate plus 3 per cent; the base interest rate is a 90-day Bill rate supplied by the Reserve Bank of Australia.[20] The IGT describes its application as:

> Where the liability was self-assessed incorrectly and there was a shortfall in tax paid, however, once the correct liability was determined the tax was paid by the due date of the amended assessment …[21]

3.26 The general interest charge (GIC) applies to other tax debts, but is the base interest rate plus 7 per cent.[22] The IGT has described two circumstances where it applies:

> Where the liability was self-assessed correctly but not paid by the due date of the original assessment …
>
> The liability was self-assessed incorrectly and there was a shortfall in tax paid, however, once the correct liability was determined the tax was not paid by the due date of the amended assessment …[23]

3.27 The interest charges operate to prevent taxpayers using the ATO as a source of cheap finance and not to disadvantage taxpayers who pay their debts on time. The SIC was introduced following Treasury's review of self-assessment in 2004. The consensus during the review was that it was unfair to taxpayers to be subject to such a high rate of interest without them knowing that the debt existed.[24]

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20 Section 8AAD and section 280-105 of Schedule 1 of the *Taxation Administration Act 1953.*

21 IGT, *Review into improving the self-assessment system: A report to the Assistant Treasurer,* August 2012, p. 118.

22 Section 8AAD of the *Taxation Administration Act 1953.*

23 IGT, *Review into improving the self-assessment system: A report to the Assistant Treasurer,* August 2012, pp. 118-19.

24 The Treasury, *Report on Aspects of Income Tax Self-Assessment,* August 2004, pp. 49-57.

3.28 Interest charges accrue as a matter of law. The flexibility lies in the Commissioner's discretion to remit them. For GIC, there are different criteria, but the Commissioner can always remit if it would be fair and reasonable, or otherwise appropriate, to do so. The main criterion for remitting SIC is that it would be fair and reasonable to do so.[25]

3.29 The ATO has issued a number of practice statements on remitting interest. The SIC or GIC for shortfall periods will generally be remitted when:

- the ATO exceeds benchmarks for starting or completing an audit
- the ATO does not action a case for 30 days
- taxpayer delay is out of their control, such as through a natural disaster or serious illness
- a taxpayer needs extra time to collect information, and this is warranted.[26]

3.30 An important administrative innovation is that the ATO will remit GIC for the taxpayer if both sides agree to enter into a 50/50 arrangement. Broadly, if a taxpayer pays half the principal tax up front, then the ATO will 'remit 50 per cent of the GIC which would otherwise accrue in the event that the taxpayer's dispute is unsuccessful.'[27] In evidence, the ATO stated that this arrangement was more commonly used for large liabilities.[28]

3.31 The IGT has not conducted a specific review on interest charges, but has commented on them as they have arisen throughout his work program. The Committee raises two matters from IGT reports.

3.32 The first is that, in his review into objections, the IGT recommended that the ATO should remit GIC where a taxpayer has acted in good faith and the ATO has taken longer than the statutory 60 day period to finalise the objection. The ATO rejected this recommendation, stating that it takes into account all the facts of a case to appropriately address ATO delay and does not see value in a pre-determined formula.[29]

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25 Section 8AAG and section 280-160 of Schedule 1 of the *Taxation Administration Act 1953.*

26 ATO, *Remission of shortfall interest charge and general interest charge for shortfall periods,* PS LA 2006/8, 28 August 2014, paras 47-79.

27 ATO, *Collection and recovery of disputed debts,* PS LA 2011/4, 23 December 2014, para. 28.

28 Mr Andrew Mills, ATO, *Transcript of Evidence,* 26 November 2014, p. 5.

29 IGT, *Review into the underlying causes and the management of objections to Tax Office decisions: A report to the Assistant Treasurer,* April 2009, pp. 17-18.

3.33 The IGT discussed another issue in his review of compliance activities for small and medium enterprises (SMEs) and high wealth individuals. This was in relation to a change in argument by the ATO after an assessment has been amended. In other words, if the ATO changes a taxpayer's liability for a particular reason, and then afterwards changes this reason, then the taxpayer should have GIC remitted because they would not have been responding to the pertinent arguments. The IGT's specific recommendation was that this policy should be included in an ATO booklet for taxpayers and the ATO agreed.[30] However, the Committee is not aware of this policy occurring in current ATO material.

3.34 The main issue raised during the inquiry was that, during a dispute, the GIC can keep accumulating and effectively becomes leverage in favour of the ATO against the taxpayer. Mr Tony Fittler from HLB Mann Judd noted there is little incentive on the ATO to resolve a dispute quickly, which prompted the comment, 'there is a lot going in the Commissioner's favour and not much in favour of the taxpayer.'[31]

Analysis

3.35 The rationale for the interest charges is to level the playing field between taxpayers and between a taxpayer and the Commonwealth. In this sense, the interest charges should operate so that a taxpayer is no better or worse off by deferring payment of tax. However, it is clear that they also fit within the mechanisms and incentives that promote taxpayer compliance. The 50/50 arrangements are an example of this; the ATO is prepared to reduce the GIC for a taxpayer who will reduce the risk to the revenue.

3.36 Currently, the system works on the basis that full interest applies, with the opportunity for the ATO to reduce it if there is taxpayer compliance (for example, 50/50 arrangements) or if there is unfairness. Evidence to the Committee was that the 50/50 arrangements were not practical to smaller taxpayers because it was often difficult for them to manage their cash flow. Further, the raising of a tax liability impacts on their ability to borrow and may also impact lending covenants.[32] However, the

30 IGT, *Review into the ATO's compliance approaches to small and medium enterprises with annual turnovers between $100 million and $250 million and high wealth individuals: A report to the Assistant Treasurer,* December 2011, pp. 17-18.

31 Ms Judy Sullivan, PwC, *Transcript of Evidence,* 18 August 2014, p. 25; Mr Tony Fittler, HLB Mann Judd, *Transcript of Evidence,* 18 August 2014, p. 1.

32 Mr Tony Fittler, HLB Mann Judd, *Transcript of Evidence,* 18 August 2014, p. 1.

Committee heard that taxpayers usually received fair treatment from the ATO at the end of a dispute in remitting GIC.[33]

3.37 Mr Michael Bersten from PwC advised the Committee that one of the problems with applying full interest by default is that the system appears to be focussed on non-compliant taxpayers, rather than the general population:

> The policy behind the imposition of interest in the law, which is actually reflected in many countries—it is not just Australia—is designed to put a price on taxpayers and their cooperation with revenue authorities. It is to say, 'The longer you take, the longer it's going to cost you.' The problem we have here is that it is very general. The 95 per cent of taxpayers are trying to do the right thing, and that is the statement the current commissioner has been making. For the five per cent who are not doing the right thing, we are getting a rule which is defined around the five per cent, not the 95 per cent.[34]

3.38 Mr Bersten suggested that the ATO should publish clearer standards about appropriate time frames for both ATO and taxpayer actions. Although there is currently some guidance, PwC argued that there was still too much uncertainty involved.[35]

3.39 The Committee notes that the IGT's recommendations about remitting GIC for overdue objections and changes in ATO argument are examples of PwC's suggested approach.

3.40 During the inquiry, the Committee raised the practical difficulties of interest charges with the ATO and whether there should be any provisions for 'stopping the clock'; that is, there could be circumstances where GIC would no longer accumulate, rather than it initially building up and the Commissioner then remitting it. The ATO responded that these concerns were reasonable and that the proposal 'should be examined.'[36]

Committee comment

3.41 The Committee supports the concept that taxpayers should pay interest where they do not meet their tax obligations on time and supports the use of interest charges in the tax system. In an ideal world, the interest charges

33 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 20.

34 Mr Michael Bersten, PwC, *Transcript of Evidence,* 18 August 2014, p. 25.

35 Mr Michael Bersten, PwC, *Transcript of Evidence,* 18 August 2014, p. 25.

36 Mr Andrew Mills, ATO, *Transcript of Evidence,* 26 November 2014, p. 5.

would seamlessly operate to equalise the position of taxpayers and the Commonwealth.

3.42 However, in practice the interest charges can be a 'huge pressure point for taxpayers.'[37] The Committee concludes that this occurs because the system is designed around non-compliant taxpayers, reducing the ATO's options for encouraging compliance.

3.43 The Committee very much appreciates that the ATO has agreed that the interest charges should be examined. The Committee notes that there is a range of actions that could be taken at both the legislative and administrative levels. Options include:

- PwC's proposal that the ATO publish clearer standards about appropriate time frames for both ATO and taxpayer actions to guide remission decisions
- converting all interest charges to the SIC rate and relying on the penalty provisions to address taxpayer conduct, with the possibility of reviewing them in this light
- making the SIC rate the default position and giving the ATO the ability to raise the rate based on taxpayer conduct
- the ATO communicating with taxpayers during a dispute to give a commitment to remit interest, based on the taxpayer's conduct or the circumstances of the case
- a formal 'stop the clock' provision in the legislation to be triggered by the ATO.

3.44 The Committee understands this is a complex area that has implications for taxpayer incentives and compliance. It may be that the current legislation is the best that can be managed under the circumstances and that improvements will be administrative. Nonetheless, the Committee supports a review and thanks the ATO for its support on this proposal.

37 Ms Judy Sullivan, PwC, *Transcript of Evidence,* 18 August 2014, p. 25.

Recommendation 2

3.45 **The Committee recommends that the Government amend the tax laws and the Australian Taxation Office consider other administrative means by which interest charges would not act as leverage against a taxpayer during a tax dispute.**

3.46 In the interim, the Committee believes that the ATO can implement the IGT's recommendations in relation to remitting GIC for overdue objections and changes in ATO argument. These are common sense suggestions that are fair to taxpayers. In the vast majority of these cases, there would be no doubt that remitting the GIC would be the right thing to do.

3.47 The Committee appreciates that, in a small number of circumstances, full remission may not be warranted having regard to all the facts of a case. But the Committee believes that remitting the GIC across the board is nonetheless the preferable outcome because it shows the ATO's commitment to treating taxpayers fairly, which is a goal in its own right in tax administration.

Recommendation 3

3.48 **The Committee recommends that the Australian Taxation Office amend its internal and external guidance so that it remits interest where:**

- **the Australian Taxation Office takes longer than the 60 days available to it to finalise an objection and the taxpayer has acted in good faith; and**
- **the Australian Taxation Office changes arguments after assessments have been made (such as during an objection or litigation).**

Fraud and evasion

Background

3.49 Under the tax laws, the ATO can reconsider a taxpayer's affairs after issuing the notice of assessment, subject to time limits. For income tax, the

ATO can issue an amended assessment. The default time limit is four years, but this is generally reduced to two years for individuals and small business entities. For indirect taxes, the Commissioner can only recover underpaid amounts four years after notice. The major exception to these limits is where the Commissioner forms the view that there has been fraud or evasion. In this case, there is no time limit.[38]

3.50 The aim here is that, if a taxpayer has engaged in fraud and evasion, they should not be able to take advantage of a limitations period. Treasury's review of self-assessment (ROSA) in 2004 stated that almost all respondents to the discussion paper agreed that 'people who engage in calculated behaviour to evade tax should remain permanently at risk.'[39] This is fine in principle. However, the quality and quantity of records decreases over time. Taxpayers are only required to retain their records for five years, and for taxpayers with simple affairs, this is reduced to two years.[40]

3.51 The ATO has issued guidance on fraud and evasion. Having reference to the case law, it defines fraud as 'making false statements knowingly, recklessly or without belief in their truth, to deceive the Commissioner.' It defines evasion as a 'blameworthy act or omission on the part of the taxpayer.'[41]

3.52 The guidance also states that the ATO decision maker must personally form the opinion that fraud or evasion has occurred. Executive Level 2 officers are authorised to make the determination (one level below the Senior Executive Service).

3.53 Obviously, a finding or allegation of fraud or evasion is a serious matter in its own right. But the open-ended time frame for reconsidering a taxpayer's affairs also has important implications for taxpayers. The ATO's guidance makes clear that ATO officers need to carefully form their opinion in these cases:

> Fraud and evasion are both serious matters, never lightly to be inferred. The opinion that there has been fraud or evasion in relation to an assessment is therefore to be formed carefully and advisedly by senior officers in accordance with this practice

38 Section 170 of the *Income Tax Assessment Act 1936* and para. 105-50 of Schedule 1 of the *Taxation Administration Act 1953*.

39 The Treasury, *Report on Aspects of Income Tax Self-Assessment,* August 2004, p. 31.

40 For example, where income comprises no more than salaries, bank or government interest, or dividends from a company listed on the Australian Stock Exchange. See ATO, *Shortened Document Retention Periods (Individuals with Simple Tax Affairs) Determination 2006,* SDR 2006/1.

41 ATO, *Fraud or evasion,* PS LA 2008/6, 8 December 2012, paras 15, 17.

> statement and other Tax Office procedures, bearing in mind the weight Parliament has placed on the benefit of certainty for taxpayers. Amended assessments based on fraud or evasion are expected to be very much the exception to the rule. The making of an amended assessment based on fraud or evasion would normally be justified only if action to amend the assessment has been prevented by the fraud or evasion or prompted by its disclosure.[42]

3.54 The IGT reported on this issue in 2011 in his review of compliance activities for small and medium enterprises and high wealth individuals. Industry expressed concern during the review that suggestions of evasion were sometimes made as leverage to extend the four year review period. The review found that findings of fraud and evasion received scrutiny from senior officers, although suggestions of evasion did not. The IGT recommended that suspicions of evasion should be referred to senior officers and, if confirmed, should then also be referred to a technical panel. The ATO stated that this was already its current process and it would reiterate it to staff.[43]

3.55 Despite ATO guidance and the IGT's comments on the importance of robust processes for fraud and evasion matters, the Committee received consistent evidence during the inquiry that ATO processes were sometimes not robust. The Law Council stated:

> Despite what the ATO does say about this, we are concerned with reports of ATO auditors making allegations of fraud or evasion (particularly in the context of HWIs) to do the very thing PS LA 2008/6 directs ATO staff not to do – to overcome the ordinary statutory time limits. There is a clear perception that allegations of fraud or evasion are becoming less of an exception. Not only do these allegations have the obvious tax consequences, they also raise potential serious criminal consequences for taxpayers.[44]

Analysis

3.56 The evidence during the inquiry often made a number of important points about the operation of the fraud and evasion provisions. The first of these

42 ATO, *Fraud or evasion,* PS LA 2008/6, 8 December 2012, para. 37.

43 IGT, *Review into the ATO's compliance approaches to small and medium enterprises with annual turnovers between $100 million and $250 million and high wealth individuals: Report to the Assistant Treasurer,* December 2011, pp. 57-58.

44 Law Council of Australia, *Exhibit No. 2,* pp. 13-14. See also Mark West, McCullough Robertson, *Transcript of Evidence,* 16 October 2014, p. 13; Taxation Institute, *Submission No. 11,* p. 3.

was that the ATO sometimes does not turn its mind to whether fraud and evasion has occurred. Witnesses who stated this included Mr Philip Hack SC, a Deputy President of the Administrative Appeals Tribunal (AAT).[45] The Committee received a practical example from David Hughes from Small Myers Hughes:

> There have been a slew of letters recently … looking at offshore payments, money that has been received from overseas. These letters are all pro forma. They are identical in every respect. They are computer generated, no doubt. The information is gathered from the bank account records, almost certainly using AUSTRAC information, and automatically generated by computer. Every single one of these letters—and I have seen well over two dozen—states: 'We have formed the view that there has been fraud or evasion and so we are going to extend the period in which we will amend your assessments.' That is, frankly, impossible. There is no way known that a human being has looked at those transactions and positively formed the view, based on evidence, that there has been fraud or evasion.[46]

3.57 The Committee heard two other pieces of evidence that corroborate this. For example, notifications of fraud and evasion from the ATO to taxpayers tend to have little explanation.[47] Further, the ATO generally bundles fraud and evasion together in its claims, when fraud is clearly more severe. This bundling has a significant impact on taxpayers because a claim of fraud is damaging in itself.[48]

3.58 The second issue was that taxpayers face a significant evidentiary burden trying to disprove the ATO's case when much of the evidence no longer exists. The Committee notes that taxpayers are only legally required to hold their records for five years. In this context, Justeen Dormer from Dormer Stanhope stated that, 'It is almost like the taxpayer is set up to fail.'[49] Witnesses commented that the ATO would make an allegation of fraud and evasion with little evidence and then leave it to the taxpayer to disprove it, when they had little evidence due to the passage of time. Lance Cunningham from BDO stated:

45 Mr Philip Hack SC, AAT, *Transcript of Evidence,* 16 October 2014, p. 4. See also Lance Cunningham, BDO, *Transcript of Evidence,* 18 August 2014, p. 6.

46 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 18.

47 Mrs Sarah Blakelock, McCullough Robertson, *Transcript of Evidence,* 16 October 2014, p. 12.

48 Mr Tony Fittler, HLB Mann Judd, *Transcript of Evidence,* 18 August 2014, p. 6; Mr Michael Bersten, PwC, *Transcript of Evidence,* 18 August 2014, p. 28; Ms Justeen Dormer, Dormer Stanhope, *Transcript of Evidence,* 1 October 2014, p. 2.

49 Ms Justeen Dormer, Dormer Stanhope, *Transcript of Evidence,* 1 October 2014, p. 2.

> … I have seen situations where the tax office has not really got any evidence to prove that an amount is assessable or an amount is not deductible; it is just that, unfortunately, the taxpayer has not got really good evidence for their side either. But the tax office still …say that the evidence is not there and, therefore, they put the onus on the taxpayer to prove that it is not income—even though there is no real evidence to say that it is…. They just say, 'We say it is, you prove it isn't.'[50]

3.59 The Committee received some suggestions to address this problem. Dormer Stanhope suggested that the Commissioner should initially prove a prima facie case in relation to fraud and evasion, and then the taxpayer would have the legal burden to show that the assessment was excessive. The firm then suggested that the fraud and evasion period be limited to eight years, with a judge having discretion to extending this period, similar to the statute of limitations.[51]

3.60 David Russell QC brought the Model Taxpayer Charter to the attention of the Committee. It states that the burden of proof on fraud and evasion should lie with the revenue authority because the finding of fraud and evasion is similar to a penal offence. The Charter document provides a comparison on how 37 countries perform against this criterion: 15 are similar to Australia; 19 place the burden on the revenue authority, and there was no data for two.[52] Lance Cunningham from BDO also suggested that the burden of proof could be transferred to the Commissioner where significant time had elapsed and records were sketchy.[53] This is similar to a suggestion made by the Past President of the Tax Institute, Ken Schurgott, who recommended that the burden of proof should switch to the Commissioner when the statutory period for the retention of records has expired.[54]

3.61 The third issue raised during the inquiry was that, in many cases where fraud and evasion is alleged, it is not proven or sustained.[55] Mr Mark West

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50 Mr Lance Cunningham, BDO, *Transcript of Evidence,* 18 August 2014, p. 6.

51 Ms Justeen Dormer, Dormer Stanhope, *Transcript of Evidence,* 1 October 2014, p. 3; Dormer Stanhope, *Submission No. 25,* p. 6.

52 Mr David Russell QC, *Submission No. 33,* p. 2; Michael Cadesky et al, *Exhibit No. 5,* pp. 58, 170 and survey matrix.

53 Mr Lance Cunningham, BDO, *Transcript of Evidence,* 18 August 2014, p. 6.

54 Ken Schurgott, 'Evasion – who should bear the "burden of proof"?' *Taxation in Australia,* August 2012, 47(2), p. 61.

55 Mr Lance Cunningham, BDO, *Transcript of Evidence,* 18 August 2014, p. 6; Mr Michael Bersten, PwC, *Transcript of Evidence,* 18 August 2014, p. 28.

from McCullough Robertson stated to the Committee that cases are often resolved on alternative points:

> In our experience it hasn't been sustained, or the matter gets resolved on other bases, which I suppose is also my comment about tactical in the assessments.[56]

3.62 Finally, the Committee notes PwC's common-sense observation that fraud or evasion is often a gateway matter. When an assessment is over four years old, the only way that the ATO can pursue an issue is when it finds or alleges that the taxpayer engaged in fraud or evasion. In other words, for an aged assessment, a taxpayer's affairs are irrelevant without a finding or allegation of fraud or evasion. PwC expressed concern that the reasoning for the finding is often only made at the end of an audit, when, as a gateway matter, the issue should be resolved early.[57]

Committee comment

3.63 The Committee is concerned that there was a consistent theme throughout the inquiry that findings or allegations of fraud and evasion are made without an ATO officer turning their mind to the question and that they are often not proven or sustained. The Committee notes that the ATO has undertaken to reiterate the correct processes to staff, although this has not yet had an effect in the disputes that practitioners are currently dealing with. The breadth of concerns amongst taxpayers and practitioners suggests to the Committee that further measures are required.

3.64 The Committee believes that the formal finding, or suspicion, of fraud and evasion needs to be elevated within the ATO to ensure that the decision-making process is robust. PwC suggested that ATO officials be required to consult a semi-independent panel on these findings, similar to the General Anti-Avoidance Rules panel.[58] The Committee supports this approach in principle, but notes that it could be overly bureaucratic. The ATO would achieve a similar effect if SES officers made the findings, instead of EL2 officers.

56 Mr Mark West, McCullough Robertson, *Transcript of Evidence,* 16 October 2014, p. 6.

57 PwC, *Submission No. 23,* p. 25.

58 PwC, *Submission No. 23,* p. 26.

Recommendation 4

3.65 **The Committee recommends that the Australian Taxation Office amend its internal guidance so that findings or suspicion of fraud or evasion can only be made by an officer from the Senior Executive Service.**

3.66 The Committee is also concerned about the effect that a mere allegation of 'fraud and evasion' can have on a taxpayer, when the evidence in a particular case might at best support evasion only. The ATO's approach should be to make an allegation of evasion and then only make an allegation of fraud when evidence for fraud clearly exists.

Recommendation 5

3.67 **The Committee recommends that the Australian Taxation Office only make allegations of fraud against taxpayers when evidence of fraud clearly exists.**

3.68 The Committee notes PwC's common sense suggestion that fraud and evasion should be resolved early in an audit to determine whether action on an aged assessment should continue. However, the Committee also notes that some matters can be very complex and that coming to a considered decision on this issue may take time. Therefore, the Committee would like the ATO to address it early in audits where practicable.

Recommendation 6

3.69 **The Committee recommends the Australian Taxation Office should ensure that allegations of fraud or evasion are addressed as soon as practicable in an audit or review.**

3.70 Finally, the Committee notes that a finding or allegation of fraud or evasion has penal connotations and there is an argument that the ATO should have the burden of proof on these occasions. However, the Committee has come to the view that, where a taxpayer has the proper records and been compliant, they should be able to rebut a suggestion of fraud or evasion. This would typically occur during the statutory period for keeping records.

3.71 The Committee is concerned about the taxpayer having the burden of proof after the record keeping period has expired. In a practical sense, the

possibility of a finding or allegation of fraud or evasion means that a taxpayer has a limitless record-keeping period. Given the inimical nature of fraud and evasion to the tax system, the Committee does not support a time limit on the ATO investigating this conduct.

3.72 However, the Committee is attracted to the idea that the burden of proof should switch to the ATO after a certain period of time has expired. This brings some balance back into the framework. It also recognises the costs to business and taxpayers of keeping records for an extended time. A good candidate for the switching point is the statutory period of when a taxpayer is no longer required to retain records. The Committee notes that it may be worth revisiting the limits in this context, subject to the regulatory costs of such a change on taxpayers and business.

Recommendation 7

3.73 **The Committee recommends that the Government introduce legislation to place the burden of proof on the Australian Taxation Office in relation to allegations of fraud and evasion after a certain period has elapsed. The change should be harmonised with the record keeping requirements. These periods could be extended, subject to concerns of regulatory costs on business and individuals.**

Departure prohibition orders

Background

3.74 Departure prohibition orders (DPOs) have their origin in a more comprehensive system where taxpayers were unable to leave Australia without clearing all tax debts. If they left Australia while owing tax, their travel operator became liable for their tax liabilities. As international travel developed, the system became onerous and was scrapped in 1962. The benefits of international travel were considered to outweigh any potential loss to the revenue. Restrictions were re-introduced in 1984, although in a limited form.[59]

3.75 The Commissioner may prohibit a person departing Australia where they have a tax liability and the Commissioner has a reasonable belief that they

59 *Pattenden v Commissioner of Taxation* [2008] FCA 1590, paras 4-6.

should either discharge the liability or make arrangements to discharge the liability before they leave the country. If a person knows they have a DPO, the penalty for leaving Australia is either 50 penalty units or 12 months imprisonment, or both. A taxpayer can apply to the Federal Court or a State or Territory Supreme Court to have their DPO set aside.[60]

3.76 Instead of revoking a DPO, the Commissioner has the option of issuing a departure authorisation certificate to allow a taxpayer subject to a DPO to leave the country. The reasons for issuing the certificate include:

- humanitarian grounds
- the taxpayer is likely to return to Australia
- they are likely to pay their tax debt
- they have provided suitable security.[61]

3.77 The ATO has issued guidance on DPOs. It discusses the legislation and case law, but also makes clear that issuing a DPO is not a routine matter. The guidance states:

> A DPO imposes a significant restriction on the normal rights of tax debtors in that it deprives them of their liberty to travel outside Australia. The ATO recognises the impact of this restriction on a tax debtor's liberty and freedom of movement …
>
> Whilst Part IVA of the TAA is primarily concerned with the protection of the revenue, consideration of the risks to the revenue needs to be balanced with the severe intrusion into a person's liberty, privacy and freedom of movement that a DPO represents.[62]

3.78 DPOs were discussed with Mr David Hughes from Small Myers Hughes. His criticism was that it is too easy for a DPO to be approved, given the ramifications for a taxpayer:

> Certainly there are cases where departure prohibition orders are warranted; however in my view it is far too easy for the commissioner to issue them and far too difficult for the taxpayer to disprove them. There was a genuine argument while the matter was running through the court for the first departure prohibition

60 Sections 14R, 14S and 14V of the *Taxation Administration Act 1953*. A penalty unit is $170. See section 4AA of the *Crimes Act 1914*.

61 Section 14U of the *Taxation Administration Act 1953*.

62 ATO, *Enforcement measures used for the collection and recovery of tax-related liabilities and other amounts,* PS LA 2011/18, 3 July 2014, paras 139, 150.

> order—a genuine argument from the commissioner—that they did not have to be right; they simply had to form the view that the person was disposing of their assets to leave the country. Regardless of whether that view was correct or incorrect, the mere fact of forming the view was sufficient to allow that departure prohibition order to stand.[63]

3.79 Small Myers Hughes' experience came from a case where the ATO inaccurately assessed a taxpayer, who operated an insurance business from Vanuatu, as a tax risk. The tax liability, of at least $6 million, was wrong, and further, the taxpayer had assets in Australia, making them less of a flight risk. The ATO believed that these assets had been disposed of because they had been put up for sale, but in fact had been withdrawn from sale. The taxpayer had the DPO quashed by a court.

3.80 The next day, the taxpayer went to the airport to travel to New Zealand, but was stopped by police because the ATO had applied for a second DPO. The taxpayer went back to court and the ATO withdrew the DPO. Mr Hughes stated:

> We got to court and the commissioner withdrew the second departure prohibition order and the court made comment that it was just as well they had because, had they not, he would consider contempt of court proceedings against the officers who had issued the second departure prohibition order and a jail term would result.[64]

3.81 In 2010, there were media reports that the ATO had issued a DPO to the entertainer Paul Hogan, who had returned to Australia from his residence in the United States to attend his mother's funeral. Mr Hogan's lawyer commented that the DPO was unnecessary because he had retained a significant connection with Australia and that he was already cooperating with the Australian authorities. The media reported that Mr Hogan was allowed to return home after providing security.[65]

3.82 The IGT discussed DPOs in the tax disputes report. The IGT received similar concerns to the Committee about DPOs and gave a recent example of a taxpayer who was delayed in travelling overseas for family reasons, despite engaging with the ATO and offering security for the disputed

63 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 19.

64 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 19.

65 Hannah Low, 'Tax Office stops Hogan leaving,' *Australian Financial Review,* 26 August 2010, p. 6; Hannah Low and Katie Walsh, 'Hogan a "prisoner" in tax case,' *Australian Financial Review,* 27 August 2014, p. 4; Hannah Low, 'Hogan free to leave after ATO deal,' *Australian Financial Review,* 4 September 2010, p. 5.

debt. The IGT suggested that, although the ATO requires a senior official to sign off on a DPO, a more robust process, such as judicial oversight, may be warranted.[66]

Analysis

3.83 Issuing a DPO is a serious event. In criminal law, a penalty involving a reduction of liberty is considered more serious than a financial penalty and this is reflected in the ATO's guidance. Of course, a taxpayer can travel freely within Australia while a DPO is in force. This means the stakes are higher when a taxpayer lives overseas because they are potentially being denied the right to re-join their family.

3.84 The Committee notes that, where a DPO is issued in error, it can take a substantial period of time to be corrected through appeal. In the Small Myers Hughes' case, the DPO was issued in May, the hearings were in July and August, and judgement in October.

3.85 On the other hand, if a taxpayer has a liability and there is a risk of assets being dissipated, then an enforcement mechanism such as a DPO may be warranted. The Committee notes that the arrangements were re-introduced in 1984 after a 20 year period, which the Committee interprets as indicating a need for the provisions. In evidence, Mr David Hughes of Small Myers Hughes stated that DPOs had a place in tax administration.[67]

Committee comment

3.86 The Committee accepts that the ATO should retain the power to prevent a taxpayer leaving the country when there is an outstanding tax liability and there is a substantial risk that the taxpayer will not discharge it. However, the Committee believes that the current restraint on the ATO, namely an appeal to the Federal Court after the event, is insufficient because it is expensive to conduct and, more importantly, involves substantial delay.

3.87 The Committee would like to see more restraint on the ATO in the exercise of the DPO before it is issued. Mr John Hyde Page, a tax barrister, suggested that responsibility for issuing a DPO (and similar enforcement mechanisms) should lie with an agency similar to the Director of Public Prosecutions.[68] Given the effects on individuals' liberty, the Committee supports this sort of reform, although a new agency is not necessarily

66 IGT, *The Management of Tax Disputes: A Report to the Assistant Treasurer,* January 2015, p. 98.

67 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 19.

68 Mr John Hyde Page, *Submission No. 22,* p. 8.

warranted. The Committee prefers the alternative of requiring the ATO to seek judicial approval for a DPO, as suggested by the IGT.

Recommendation 8

3.88 **The Committee recommends that the Government introduce legislation to require judicial approval for the Commissioner of Taxation to issue a departure prohibition order.**

Garnishee notices

Background

3.89 The Commissioner has a broad power to garnish money held on behalf of a taxpayer by a third party. Where a taxpayer has a tax-related liability or related debt, the Commissioner may give written notice to a third party that owes money to the taxpayer. This includes where the third party holds money on account for the taxpayer. The notice is to specify the amount to be paid and when. A copy of the notice must be provided to the taxpayer.

3.90 The third party is to be indemnified for the payment. In other words, the taxpayer cannot sue them. If the third party does not make the payment, they can be convicted of an offence with a penalty up to 20 penalty units. They can also be ordered to pay an additional sum to the Commissioner, not exceeding the original amount.[69]

3.91 The ATO has issued guidance on the exercise of this power. It states that garnishee notices are an effective way of recovering a tax debt, although care must be exercised in their use:

> Collection through third parties by serving garnishee notices is often an efficient and cost-effective way of obtaining payment of outstanding debts. We will use garnishee notices in circumstances where we consider that action to be the most effective method of obtaining payment of a debt.

69 Subdivision 260-A of Schedule 1 of the *Taxation Administration Act 1953.* A penalty unit is $170. See section 4AA of the *Crimes Act 1914.*

> The issue of a garnishee notice is an exercise of a coercive power so care must be taken when exercising this power.[70]

3.92 The main considerations that ATO staff should take into account are:

- the financial position of the taxpayer and steps taken to make payment
- the taxpayer's other debts
- revenue risk due to the taxpayer's actions, such as paying other creditors
- the effect of a garnishee notice on the taxpayer's family or business.[71]

3.93 The guidance suggests some other limitations on garnishee notices. For example, ATO staff are instructed not to garnish more than 30 per cent of salary and wages unless the taxpayer has other income. When a tax dispute is still current, the ATO should consider whether a garnishee notice would have a significantly adverse effect on the taxpayer's ability to continue the dispute.[72]

3.94 The main issue raised during the inquiry was that garnishee notices can be inappropriately issued against taxpayers. A tax barrister, Mr Graeme Halperin, stated that garnishee notices are being used more often and they can have a devastating impact on a small business. Further, they have no judicial oversight:

> It is not like I can get involved in a proceeding where the ATO wishes to freeze assets of a taxpayer who they think is going to dissipate those assets; if they want to get a freezing order, they have to march off to the Supreme Court and go before a judge. The judge will look at affidavit material from both parties in relation to whether he should grant a freezing order. So it is subject to judicial scrutiny; but garnishee notices are not. So, at the end of the day, the ATO issues a garnishee notice to the bank, and, before you know it, your money is gone. You will not necessarily be alerted to this beforehand; you just find out later on that, suddenly, that money that you put in to pay wages or for other working capital expenditure has been seized by the ATO—and there is really nothing you can do about it. There is nothing more certain to bring

70 ATO, *Enforcement measures used for the collection and recovery of tax-related liabilities and other amounts,* PS LA 2011/18, 3 July 2014, paras 100-01.

71 ATO, *Enforcement measures used for the collection and recovery of tax-related liabilities and other amounts,* PS LA 2011/18, 3 July 2014, para. 102.

72 ATO, *Enforcement measures used for the collection and recovery of tax-related liabilities and other amounts,* PS LA 2011/18, 3 July 2014, paras 108, 112.

> a taxpayer to their knees, particularly a small business, than taking away their working capital.[73]

3.95 Similar complaints were raised with the Committee by Agape Ministries, BDO and Mr Ian Hashman. In Mr Hashman's case, he stated that his difficulties were exacerbated by the ATO declining to communicate with his advisers.[74]

3.96 A judicial example was the *Denlay* case where the ATO issued a garnishee notice against a taxpayer who was involved in litigation against the Commissioner. The Federal Court quashed the notice because the ATO had failed to take into account important criteria, including the merits of the Denlays' appeals and the effect the notice would have on their ability to pursue the appeals.[75]

Analysis

3.97 The ATO's position on garnishee orders is that it rarely uses them for individuals and small businesses, and that it only does so when there are significant risks involved. Further, it is open to alternative means of payment such as instalments:

> In most lower-risk cases, we defer active recovery action until after the dispute has been resolved. We actively manage cases where the debt is greater than $1 million, the taxpayer is either in the large market or is a high wealth individual, or where there are significant revenue or other risks. These cases generally constitute about 10-15% of all disputed debts where there is a formal dispute. In other words, payment is not actively pursued for most individuals and small businesses until after the dispute is resolved …
>
> Where the level of risk necessitates action to secure payment of the debt before the resolution of a dispute, the following options are considered as an alternative to legal recovery action:
>
> - payment of the whole debt in full upon demand
> - payment of the whole debt by instalments
> - payment of 50% of the disputed debt in a lump sum with the balance being paid by instalments

73 Mr Graeme Halperin, *Transcript of Evidence,* 14 August 2014, p. 21.

74 Agape Ministries, *Submission No. 34,* p. 5; Mr Lance Cunningham, BDO, *Transcript of Evidence,* 18 August 2014, p. 5; Mr Ian Hashman, *Transcript of Evidence,* 24 September 2014, p. 2.

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

- payment of 50% of the disputed debt together with the provision of acceptable security
- provision of acceptable security for the whole debt
- provision of financial documents to substantiate that payment of the disputed debt would cause serious hardship.[76]

3.98 The evidence from stakeholders during the inquiry was mixed. Although many practitioners expressed concern about the use of garnishee notices, others had a different view. One adviser, Mr Richard Wytkin, suggested that 'a lot of the time it is the client's fault for not doing something about his debt.'[77]

3.99 Mrs Sarah Blakelock from McCullough Robertson noted that garnishee notices were 'an important and useful tool … for securing the revenue' and accepted that giving prior warning to a taxpayer was often not practicable when there was a revenue risk. Further, it was difficult to generalise about these cases because each one turned on its own facts. The firm suggested that the ATO should better engage during compliance activities to reduce the chance that it would need to rely on recovery proceedings.[78]

3.100 The Committee notes the Ombudsman's observation that the ATO is less ready to engage with taxpayers as a dispute progresses to litigation.[79]

Committee comment

3.101 On balance, the Committee has decided not make a recommendation. The Committee recognises the importance of being able to issue garnishee notices in a timely way to manage revenue risk. Further, the ATO offers taxpayers flexibility in how they meet their debts. However, the Committee is also concerned that garnishee notices have sometimes been used inappropriately and this has caused hardship or injustice to taxpayers.

3.102 The ATO should be able to better manage its fairness risk if it improves its engagement with taxpayers and their advisers. As a dispute progresses, it may appear that there is less to be gained from engagement. However, the Committee believes that engagement is still warranted and that demonstrating engagement with a taxpayer is one of the best ways the

76 ATO, *Submission No. 10,* p. 33.

77 Mr Richard Wytkin, *Transcript of Evidence,* 29 October 2014, p. 4.

78 Mrs Sarah Blakelock, McCullough Robertson, *Transcript of Evidence,* 16 October 2014, p. 11.

79 Commonwealth Ombudsman, *Submission No. 14,* p. 10.

ATO can demonstrate that it has dealt fairly with a taxpayer, or taxpayers generally. This topic is discussed further in the next chapter.

Model litigant rules

Background

3.103 The model litigant rules are based on the idea that the Crown, with its significant resources and stewardship role, should observe certain standards in litigation. An early expression of this view is from a High Court case in 1912:

> The point is a purely technical point of pleading, and I cannot refrain from expressing my surprise that it should be taken on behalf of the Crown. It used to be regarded as axiomatic that the Crown never takes technical points, even in civil proceedings, and *a fortiori* not in criminal proceedings.
>
> I am sometimes inclined to think that in some parts—not all—of the Commonwealth, the old-fashioned traditional, and almost instinctive, standard of fair play to be observed by the Crown in dealing with subjects, which I learned a very long time ago to regard as elementary, is either not known or thought out of date. I should be glad to think that I am mistaken.[80]

3.104 This principle has been codified in the *Legal Services Directions 2005* made under the *Judiciary Act 1903.* The directions cover a range of issues, including the model litigant rules. In relation to being a model litigant, the key requirements are:

- dealing with claims promptly
- considering ADR before litigating and participating fully and effectively when it occurs
- not requiring the other party to prove a matter that the Commonwealth knows to be true
- not taking advantage of a litigant that has few resources

80 Griffith CJ, *Melbourne Steamship Company v Moorehead* [1912] HCA 69.

- not pursuing appeals unless the Commonwealth believes it has reasonable prospects for success, or it would be in the public interest.[81]

3.105 An important component of the rules is that they do not bestow any rights or enforceable remedies on a taxpayer or parties outside the Commonwealth. Section 55ZG of the *Judiciary Act 1903* states that enforcement is a matter for the Attorney-General. Non-compliance with the rules can only be raised in a proceeding by the Commonwealth. In practice, this means that a taxpayer may have a well-founded belief that the ATO is not complying with the rules during litigation, but this of itself will not affect the outcome of their case.

3.106 The issue in the inquiry was the claim that the ATO regularly breaches the model litigant rules. Mr David Hughes from Small Myers Hughes stated:

> I would suggest that the model litigant rules are not hard-and-fast rules that the commissioner adopts, or that litigation people within the commissioner's office would adopt, in every single case. In fact, it is a bit of a running joke amongst practitioners that the model litigant rules are more often disobeyed than they are observed.[82]

3.107 The Committee heard about two types of cases where the ATO tends not to comply with the model litigant rules. The first was that it does not participate in mediations fully and effectively.[83] The second was that it requires taxpayers to prove all the facts necessary to overturn the Commissioner's decision, when often many of these could be conceded.[84]

3.108 The courts have occasionally criticised the conduct of the ATO, or its representatives, with reference to the model litigant rules. In *Phillips,* the Federal Court found that the ATO had disobeyed its directions, leading to excessive delay. The Court found for the taxpayer on this basis, and then noted that the ATO's conduct did not meet the standards that might be expected of a model litigant.[85] Similar comments have been made in other cases.[86]

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81 Paras 2 and 5 of Appendix B of the *Legal Services Directions 2005.*

82 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 21.

83 Ms Justeen Dormer, Dormer Stanhope, *Transcript of Evidence,* 1 October 2014, p. 1; Mr John Hyde Page, *Transcript of Evidence,* 29 October 2014, p. 10.

84 Ms Judy Sullivan, PwC, *Transcript of Evidence,* 14 August 2014, p. 27.

85 *Phillips, in the matter of Starrs & Co Pty Limited (In Liquidation) v Commissioner of Taxation* [2011] FCA 532, para. 8.

86 For example, *LVR (WA) Pty Ltd v Administrative Appeals Tribunal* [2012] FCAFC 90, paras 41-42; *Deputy Commissioner of Taxation v Clear Blue Developments Pty Ltd (No 2)* [2010] FCA 1224, para. 48.

3.109 However, in *Huynh,* the AAT noted that the ATO had acted in the spirit of being a model litigant by filing some documents with the Tribunal that were of assistance to the taxpayer.[87]

3.110 The Productivity Commission recently released a report on access to justice that included discussion about the model litigant rules for all Australian jurisdictions. It noted reviews which had found that the rules have been 'reasonably effective' in modifying how the Commonwealth conducts litigation. The Productivity Commission also suggested that compliance approached 100 per cent in the Crown Solicitors' offices and the Australian Government Solicitor (AGS). Compliance mechanisms are currently based on self-reporting, which the Commission did not regard as adequate. It recommended that litigants be able to formally complain to the Ombudsman where they perceived a breach of the rules.[88]

Analysis

3.111 The Committee sought some advice from the ATO about its compliance with the rules. The ATO stated that, between 1 July 2007 and 31 December 2012, there were 47 claims made that the ATO had breached the model litigant rules. Five of these related to external solicitors and the rest to ATO staff. The ATO noted that only six breaches were confirmed and these were all in relation to ATO staff. There was no pattern or trend to the breaches.[89]

3.112 The ATO's evidence suggests that ATO compliance with the rules is reasonable. A tax barrister, Mr John Hyde Page, did not think that the ATO's conduct as a litigant was problematic, even if it was open to the allegation that it asked litigants to prove matters that they knew were true:

> The ATO has a practice of including in its pleadings in court cases and in the AAT a boilerplate that says, 'We put the taxpayer to proof on everything except that which is expressly admitted in this pleading.' That boilerplate is always there. Having said that, I never really see it playing much of a part in the determination of tax disputes. I think usually the issues are reasonably well defined in Part IVC appeals. I do not regard there as being any huge issue there, at least based on what I have seen…

87 *Huynh and Anor and Commissioner of Taxation* [2008] AATA 305, para. 16.

88 Productivity Commission, *Access to Justice Arrangements,* Report No. 72, September 2014, pp. 429-42.

89 ATO, *Submission No. 10.3,* p. 1.

> I think the ATO, at least in some respects, is a more diligent and conscientious litigant than a lot of private sector litigants.[90]

3.113 The Committee considers what may be occurring is that taxpayers expect the ATO will make concessions or litigate in a benevolent manner. However, the ATO has no obligation to do this. The model litigant rules state that they do not 'prevent the Commonwealth and its agencies from acting firmly and properly to protect their interests'.[91] Further, litigation is complex and the Federal Court has declined to criticise the ATO where it believed that it was entitled to test the evidence or spent time and resources covering a range of contingencies.[92]

3.114 CPA Australia commented to the Committee that the ATO does not communicate to taxpayers before litigation about what the model litigant rules require of it. Further, the Ombudsman noted that communication from the ATO tends to fall away as litigation draws near.[93] The evidence corroborates the argument that taxpayer expectations are not being managed.

Committee comment

3.115 Arguably, a taxpayer's legal representatives should be advising them about the scope of the model litigant rules. But since much of the criticism is directed at the ATO, the Committee believes that it has an interest in managing taxpayer expectations. The solution is to respond to the Ombudsman's observation and better engage with taxpayers as litigation draws near.

Recommendation 9

3.116 **The Committee recommends the Australian Taxation Office better engage with taxpayers prior to litigation so that they are aware of what the model litigant rules require, and do not require, of the Australian Taxation Office.**

3.117 Considering the information provided by the ATO, the Committee accepts that it largely complies with the model litigant rules. However, the Committee would like to see the ATO achieve a 100 per cent compliance

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90 Mr John Hyde Page, *Transcript of Evidence,* 29 October 2014, p. 10.

91 *Legal Services Directions 2005,* Appendix B, p. 24.

92 *Clark v Commissioner of Taxation* [2010] FCA 415, paras. 164, 168; *Heran v Commissioner of Taxation* [2006] FCA 110, para. 3.

93 CPA Australia, *Submission No. 7,* p. 3; Commonwealth Ombudsman, *Submission No. 14,* p. 10.

rate, similar to the AGS. The Committee believes that the ATO could benefit by approaching the AGS to determine if there were practices or systems it could adopt to improve compliance, even if this were done on an informal basis.

Recommendation 10

3.118 **The Committee recommends the Australian Taxation Office approach the Australian Government Solicitor to determine if they can provide advice and assistance to the Australian Taxation Office in terms of best practice in complying with the model litigant rules.**

3.119 Finally, the Committee notes the Productivity Commission's recommendation for more formal compliance mechanisms in relation to the model litigant rules. This broader topic is outside the scope of the Committee's inquiry. However, the Committee supports it in principle because it would give stakeholders more assurance about compliance.

Scope of appeals from the AAT

Background

3.120 Under section 44 of the *Administrative Appeals Tribunal Act 1975,* a person may appeal a decision of the AAT to the Federal Court on a question of law. This is the usual pathway for appealing a decision of the AAT.[94]

3.121 During the inquiry, Mr John Hyde Page, a tax barrister, raised the issue of whether appeals to the Federal Court should also consider questions of fact.[95] During evidence, he stated that some of the factual findings in tax matters, such as fraud or evasion, were so serious that appeals on those issues should also be allowed:

> Since the formation of the Administrative Appeals Tribunal, appeals from the AAT to the Federal Court have always been restricted to questions of law. In that sense it is by legislative design, but that has always been the treatment that anybody going to the AAT with some sort of administrative question that they are seeking to have reviewed will get. However, where one is dealing

94 Attorney-General's Department, *Submission No. 30,* p. 3.

95 Mr John Hyde Page, *Submission No. 22,* p. 8.

> with, in some cases, exceptionally large amounts of money and matters that do touch upon whether there has been fraudulent conduct or intentional disregard of the law, I do think it is necessary to make an exception for tax cases and I do think there should be appeals on questions of fact.[96]

Analysis

3.122 As this chapter discusses, fraud and evasion was one of the major issues in the inquiry. Therefore, the Committee asked the Attorney-General's Department to advise on whether taxpayers should be able to appeal to the Federal Court on questions of fact.

3.123 The Department stated that it did not support extending the grounds of appeal to the Federal Court. Its reasons were:

- a court's primary focus is on enforcing and declaring the law, rather than fact-finding
- the AAT is suited to fact-finding because it is not bound by the laws of evidence and can investigate issues
- the AAT has Members that are skilled in tax law, including some Federal Court judges who hold appointments to the AAT
- it would expand the workload of the Federal Court and require additional resources
- taxpayers achieve finality earlier
- the Administrative Review Council considered this proposal in 1997 and rejected it.[97]

Committee comment

3.124 The Committee accepts that the AAT can make serious factual findings about a taxpayer. However, the Committee does not prefer the alternative of allowing appeals to the Federal Court on matters of fact. This is due to the increased cost and complexity, as well as the observation that the Committee did not receive evidence that errors of fact consistently occur at the AAT.

3.125 Therefore, the Committee makes no recommendation for change.

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96 Mr John Hyde Page, *Transcript of Evidence,* 29 October 2012, p. 7.

97 See generally Attorney-General's Department, *Submission No. 30.*

Small Taxation Claims Tribunal

Background

3.126 The AAT has two forums for hearing reviews of taxation decisions: the Taxation Appeals Division (TAD); and the Small Taxation Claims Tribunal (STCT). Where the amount of tax in dispute is $5,000 or over, the matter goes to the TAD. The STCT deals with the remainder.[98] The $5,000 threshold has not changed since the STCT was created in 1997.[99]

3.127 The processes in the STCT are designed to be quicker and simpler for taxpayers than in the TAD. The fees for the two jurisdictions are increased every two years under a statutory formula.[100] Importantly for taxpayers, there is an $800 difference in the application fee between the two jurisdictions. A comparison of them is below.

Table 3.1 Comparison of the Taxation Appeals Division and the Small Taxation Claims Tribunal

Process	TAD	STCT
Dispute amount	$5,000+	Less than $5,000
General application fee for taxpayers	$861	$85
Hardship application fee for taxpayers	$100	NA
Referral to ADR if the AAT thinks it will assist	may occur	must occur
Time period for ATO to lodge documents	28 days	14 days
Usual number of pre-trial conferences	2	1
Notice period before conferences	6+ and 12+ weeks	4 weeks
Statement of agreed facts	14 days before 2nd conference	7 days before hearing
Parties can explicitly request mediation	No	Yes
ATO lodging statement of facts it does not dispute	No	Yes
Parties lodging a certificate prior to hearing	Yes	No

Sources *AAT, General Practice Direction, March 2007; AAT, Small Taxation Claims Tribunal Practice Direction, March 2000; AAT, Direction under section 37(1AB) of the AAT Act for matters in the Taxation Appeals Division; Part IIIAA of the Administrative Appeals Tribunal Act 1975; AAT, 'Information about application fees,' viewed at http://www.aat.gov.au/FormsAndFees/Fees.htm on 3 February 2015.*

3.128 In 1999, the Ralph Review of Business Taxation argued that there should be a shift away from adversarial procedures in resolving disputes in favour of greater engagement and use of ADR. It also suggested that current processes for deciding small disputes were too involved compared

98 Sections 24AB and 24AC of the *Administrative Appeals Tribunal Act 1975.*

99 Schedule 1 of the *Law and Justice Legislation Amendment Act 1997.*

100 Regulations 19A and 19B of the *Administrative Appeals Tribunal Regulations 1976.*

with the amounts at stake and that the quicker processes of the STCT could be more widely used through lifting the $5,000 threshold:

> There is a compelling argument for extending dedicated, streamlined arrangements for dealing with taxation matters where the amount of tax in dispute is small (up to, say, $50,000 rather than the current $5,000). In the absence of such arrangements, disputes can drag on for long periods and involve costs both to the taxpayer and to the government (not the least in the form of administrative costs) out of all proportion to the amount at issue.[101]

3.129 An academic paper in 2012 argued that the $5,000 threshold has become much smaller in real terms since 1997 due to inflation and economic growth. It argued that the threshold should be increased to $10,000 or $15,000.[102]

Analysis

3.130 The Committee raised this topic with witnesses during the inquiry. There was some industry support for increasing the $5,000 threshold, at the very least to keep pace with inflation.[103]

3.131 However, Mr Philip Hack SC, a Deputy President of the AAT, had a different perspective. He suggested that the STCT should be abolished because it gave taxpayers false hope and that time and effort is usually required to properly adjudicate a dispute, even if the amount involved is small:

> It is a burden that oftentimes holds out false hopes that people will be able to resolve their disputes very quickly. Sometimes even very minor disputes take a long time to thrash out the ground work. One notable example that happens all the time concerns tax debt release applications, which are dealt with in that tribunal. They are cases where people invariably want to present vast amounts of material about their personal circumstances. It takes people a long time to do that, and meeting a deadline of 84 days

101 Review of Business Taxation, *A Tax System Redesigned: More certain, equitable and durable,* July 1999, p. 147.

102 Binh Tran-Nam and Michael Walpole, 'Access to tax justice: How costs influence dispute resolution choices,' 2012, *Journal of Judicial Administration,* vol. 22, pp. 3-28.

103 Mr Tony Greco, IPA, *Transcript of Evidence,* 14 August 2014, p. 8; Mr Michael Croker, CAANZ, *Transcript of Evidence,* 18 August 2014, p. 11.

> from lodgement to finalisation in those sorts of cases is unrealistic.[104]

3.132 An accounting practice made a similar comment, noting that prosecuting a case at the AAT could still be expensive, despite there being less than $5,000 in dispute.[105]

3.133 Mr Hack argued that the processes under the TAD were sufficiently flexible to handle small disputes.[106]

Committee comment

3.134 The Committee appreciates the intent behind the Ralph Review's desire to expedite the resolution of tax disputes by allowing more disputes to be dealt with at the STCT. However, the Committee also notes that a tax dispute for a small amount can be a complex matter. The Committee received further evidence to this effect, which was discussed in chapter 1.

3.135 Therefore, the Committee does not make any recommendation to greatly increase the $5,000 threshold for the STCT. Rather, the Committee believes there is value in deciding whether the STCT should continue. If so, it should be put on a more sustainable footing through increasing its threshold to adjust for inflation since 1997, and then applying a mechanism whereby the threshold increases over time. If the AAT can increase its application fees every two years, then a similar arrangement should apply to the threshold.

Recommendation 11

3.136 **The Committee recommends that the Government review the Small Taxation Claims Tribunal and determine whether it should continue. If so, there should be a one-off increase to the $5,000 limit to take account of inflation since 1997 and a system introduced so the threshold increases incrementally in future to keep pace with inflation.**

104 Mr Philip Hack SC, AAT, *Transcript of Evidence,* 16 October 2014, p. 1.

105 Mr Brian Hrnjak, GHR Accountants & Financial Planners, *Transcript of Evidence,* 18 August 2014, p. 45.

106 Mr Philip Hack SC, AAT, *Transcript of Evidence,* 16 October 2014, p. 3.

4

Readiness to engage

The importance of early engagement

4.1 During the inquiry, the Committee often heard comments that the other side did not properly engage during a dispute, leading to increased cost and stress. Ms Judy Sullivan from PricewaterhouseCoopers (PwC) summarised this general position as follows:

> The relationship between taxpayers, the ATO and their advisors is the key to early resolution of tax disputes. That involves two-way transparency and early engagement on what the dispute is about and what the ATO's concerns actually are… It is in everyone's interests for the ATO to put the cards on the table as to what the dispute is about so both sides can agree what additional information is both relevant and required and how to approach any areas of uncertainty.[1]

4.2 The Committee received evidence on how previously intractable disputes were resolved quickly through direct discussion, especially when a taxpayer has access to the right people in the ATO:

> I think the senior people at the ATO are very good, very easy to talk to and can be quite sensible. The question is getting to them… Maybe they are too busy; maybe it is somebody else blocking the way, saying, 'We don't regard this as sufficiently important to escalate it to that level.' I have had a matter where the audit was very protracted, it went on for many years, then an assistant commissioner became involved and in one meeting we got it

1 Ms Judy Sullivan, PwC, *Transcript of Evidence,* 18 August 2014, p. 20.

> resolved—one meeting. How much expense would have been saved for the revenue and the taxpayer if that assistant commissioner had been brought in 12 months or two years beforehand?[2]

4.3 Early engagement also allows the ATO and taxpayers to work through issues before a dispute escalates and becomes more formal, time consuming and expensive. Mr Christopher Budd stated that his recent experience of a dispute was more preferable than previous occasions because he was able to work through the issues with the ATO, rather than progressing to the Administrative Appeals Tribunal (AAT).[3]

4.4 The ATO advised the Committee that it is moving towards earlier engagement with taxpayers, including a 'pick up the phone' theme.[4] The ATO stated:

> We are working to implement the strategies in our Dispute Management Plan. The aim of early assessment and resolution is to achieve resolution of disputes as early as practicable, reducing the costs of managing disputes to taxpayers, the community and the ATO. The early assessment and resolution initiative encourages case officers to make direct communication with taxpayers and their advisers at the earliest possible stage of the dispute, and to change from a 'letter writing' approach to simple and direct communication. We also recognise that earlier engagement with taxpayers, preferably in person, provides the best opportunity to resolve disputes at the earliest possible stage. We recognise that listening to taxpayers directly and hearing their version of events can be very useful in clarifying issues in dispute and evidentiary issues.[5]

4.5 As discussed in chapter 2, the ATO has adopted 12 strategic indicators. One of these is that disputes are resolved earlier.[6] ATO settlement statistics support this shift, reproduced in the following table. In 2010-11, 52 per cent of settlements occurred at the objection stage or earlier. This has now increased to 76 per cent. Conversely, there has been a marked decrease in settlements during litigation, from 47 per cent in 2010-11 down to 23 per cent in 2013-14. Recent change is evident, but it is also clear that change has been ongoing, with 2011-12 an improvement over 2010-11.

2 Mr Graeme Halperin, *Transcript of Evidence,* 14 August 2014, p. 24.

3 Mr Christopher Budd, *Submission No. 29,* pp. 1-2.

4 ATO, *Submission No. 10,* p. 29.

5 ATO, *Submission No. 10,* p. 13.

6 ATO, *ATO strategic intent: Reinventing the ATO,* July 2014, p. 13.

Table 4.1 Stage at which settlement occurred (%)

Stage	2010-11	2011-12	2012-13	2013-14
Pre-audit	3	6	7	5
Audit	28	33	42	42
Objection	21	24	23	29
AAT	43	21	24	18
Federal Court	4	15	4	5
Other	0	1	0	0

Source *IGT, The Management of Tax Disputes: A report to the Assistant Treasurer, January 2015, p. 59. AAT refers to the Administrative Appeals Tribunal.*

4.6 Stakeholders in the inquiry agreed that the ATO had started to change the way it engaged with taxpayers and their advisers and was more prepared to negotiate and to look at settlements on a commercial basis.[7] However, there was less evidence that this had filtered down to the SME sector.[8] It appears that ATO resources and innovations in general tend to be focussed on large corporates and that SMEs need to wait before the new practices filter down to them.[9]

4.7 From February 2014, the ATO conducted a pilot for early engagement with small business. The key features are:

- telephoning a taxpayer before the audit letter is issued
- a face to face meeting to discuss the audit.[10]

4.8 In the 2012 report on alternative dispute resolution (ADR), the Inspector-General of Taxation (IGT) recommended that the ATO should consider having direct conferences with taxpayers at various stages in a dispute. Recommendation 3.5.2 stated that the ATO should:

> … amend its compliance procedures to require ATO officers to consider, and if appropriate engage in, direct conferences with taxpayers at each of the following points in time:
>
> - when the parties have reached agreement as to the facts, or agreement to disagree on contentious factual matters;
> - prior to issuing a position paper or reasons for decision;

7 Mr Philip Hack SC, AAT, *Transcript of Evidence,* 16 October 2014, p. 2; Mr Michael Flynn, The Tax Institute, *Transcript of Evidence,* 14 August 2014, p. 9; CPA Australia, *Submission No. 7,* p. 2.

8 The Tax Institute, *Submission No. 11,* p. 4; Law Council of Australia, *Exhibit No. 2,* p. 2.

9 Mr Michael Croker, CAANZ, *Transcript of Evidence,* 18 August 2014, p. 10; Mr Lance Cunningham, BDO, *Transcript of Evidence,* 18 August 2014, p. 6.

10 ATO, *Submission No. 10.2,* p. 6.

- following the lodgement of an objection; and
- at any other point in time at which the parties agree that a case conference would be beneficial.[11]

4.9 CPA Australia made a similar suggestion to the Committee.[12]

4.10 In its response to the IGT's report, the ATO stated that it agreed 'to on-going engagement with taxpayers during our large and more complex compliance activities'.[13]

Committee comment

4.11 The Committee is pleased the ATO has agreed to the IGT's recommendation on direct conferences and ongoing engagement at various stages of a dispute. However, the Committee notes that the ATO did not commit to improve engagement with SMEs.

4.12 Given the direction in which the ATO is now moving, the Committee anticipates that the Inspector-General's recommendation will be implemented for the SME sector as well. The Committee recommends direct conferences and engagement at various stages of a dispute be considered for all taxpayers.

Recommendation 12

4.13 **The Committee recommends that the Australian Taxation Office implement recommendation 3.5.2 from the Inspector-General's report on alternative dispute resolution for all taxpayers (i.e. considering whether to engage in direct conferences with taxpayers at multiple points in a dispute).**

Listening to taxpayers

4.14 A common complaint raised during the inquiry is that the ATO does not listen or respond to taxpayer arguments, or that it only does so once ATO

11 IGT, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution: A report to the Assistant Treasurer,* May 2012, p. 42.

12 CPA Australia, *Submission No. 7,* p. 2.

13 IGT, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution: A report to the Assistant Treasurer,* May 2012, p. 42.

legal personnel become involved.[14] Mr David Hughes from Small Myers Hughes stated to the Committee:

> My concern and that of the many SME owners that I represent is that there are still too many ATO officers whom I would describe as zealots and who seem to approach their duties as auditors or objection officers or debt collectors as though all self-employed people or business owners are tax cheats and should not be believed.
>
> …In too many cases that I see, an ATO auditor will form a very early conclusion about the bona fides of a taxpayer. After that view is formed, no amount of evidence or legal submissions can convince some auditors that amended assessments should not issue to increase the amount of tax payable.[15]

4.15 Some of the other claims made during the inquiry about the ATO were:

- 'digging-in' or intransigence
- auditors becoming emotionally invested
- not being prepared to accept that a taxpayer could be right on a matter of fact
- bringing up trivial issues late in an audit after the taxpayer rebuts the initial ATO position.[16]

4.16 Mr Matthew Wallace from BDO advised the Committee that one of the reasons this conduct occurs is that there is no incentive in the legislation or ATO systems for ATO staff to engage earlier.[17]

4.17 Notwithstanding this, the Committee endorses the comments of Mr Mark West, McCullough Robertson, that the ATO should operate 'with respect for everyone rather than assuming that there is something that they are not dealing with.'[18]

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14 Mr Chris Wallis, *Submission No. 28,* p. 10.

15 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 15.

16 Mr Chris Wallis, *Transcript of Evidence,* 14 August 2014, p. 35; Mr Ian Hashman, *Transcript of Evidence,* 24 September 2014, p. 3; Mr Matthew Wallace, BDO, *Transcript of Evidence,* 18 August 2014, p. 2; Mr Rob Salisbury, *Submission No. 21,* p. 4; Mr Tony Fittler, HLB Mann Judd, *Transcript of Evidence,* 14 August 2014, p. 3; Mr Stephen Madz, *Transcript of Evidence,* 14 August 2014, p. 18; Mr Alan Bentwitch, Bentwitch & Co., *Transcript of Evidence,* 18 August 2014, p. 40. Mr Chris Wallis, *Submission No. 28,* p. 22.

17 Mr Matthew Wallace, BDO, *Transcript of Evidence,* 14 August 2014, p. 4.

18 Mr Mark West, McCullough Robertson, *Transcript of Evidence,* 16 October 2014, p. 7.

4.18 It is clear that, from time to time, a taxpayer will be providing the ATO with full, accurate information, even though this may not be apparent to the ATO. The Committee is of the view that the ATO needs to ensure that its actions stand up to scrutiny and that it listens to taxpayers, regardless of whose position is technically correct.

Taxpayers withholding information

4.19 The ATO made a counter claim in relation to the engagement issue, namely that taxpayers often withhold information from the ATO, making the ATO's job more difficult, as well as incurring greater costs for all parties. The Commissioner stated:

> … I have had articles pointed out to me where there have been tax conferences or seminars where people write papers or get up and actually say, 'Don't worry about the audit stage; just humour them; hold back.'… 'Wait until you get to the objection stage, and then you will get the law people, you'll get the smarter ones.' That is just not the right process. That is what we are actually actively trying not to do. Hence, it is reflected that we go, 'Okay; here's a whole lot more information.' Some people think, 'I hope they go away.' Then they get an assessment and then they will go to their adviser at that point, and it is only at that point that the adviser says, 'Actually, you should have told them this, this and this' … When I first saw this, I said, 'How come we've got so many objections being allowed? That is not good.' But actually we can show that, with a lot of those, we are hearing information for the first time, people are engaging advisers for the first time.[19]

4.20 This comment provoked a strong response from tax practitioners, who argued that they would never provide such advice to a client. Doing so would increase the risk that a taxpayer might not be viewed as compliant and it would reduce the chances of the ATO exercising discretion in favour of the taxpayer.[20]

4.21 The Committee heard it is possible that advisers provide too much information to the ATO in an effort to be seen to be compliant. Further, a

19 Mr Chris Jordan, Commissioner of Taxation, *Transcript of Evidence,* 16 July 2014, p. 10.

20 For example, Mr Michael Flynn, The Tax Institute, *Transcript of Evidence,* 14 August 2014, p. 15; Mr Michael Bersten, PwC, *Transcript of Evidence,* 18 August 2014, p. 20; Mr Alan Bentwitch, Bentwitch & Co., and Mr Peter Sullivan, LCD & Co. Accounting Services, *Transcript of Evidence,* 18 August 2014, p. 42.

taxpayer or adviser who is inexperienced may not understand what the ATO is really after. A tax barrister, Mr Graeme Halperin, stated:

> What there is not—and, unfortunately, this is probably something you only get from experience—is an understanding of the significance of what you need to gather up and provide when you are complying with an obligation. I do not think it is because people are deliberately withholding information. My experience has been that tax agents are generally trying to find every opportunity to comply, hoping not to get the ATO angry. Sometimes they provide information that is completely irrelevant, only because they are desperately trying to placate the ATO for their client.[21]

4.22 However, tax practitioners acknowledged that, on occasion, information is not provided early enough to the ATO and that a significant proportion of objections are allowed because information was provided after an assessment was issued. Witnesses put this down to various factors, such as human nature, a lack of conflict management experience by the taxpayer or adviser, and that the ATO does not engage earlier or appropriately.[22]

4.23 The Committee accepts that there will always be some taxpayers who are tardy in providing information. This issue was also referred to by Mr Philip Hack SC, a Deputy President of the AAT.[23] Nonetheless, the Committee is of the view that the ATO has some strategies available to it to reduce the late provision of information. These are discussed throughout this chapter.

4.24 The Committee would also note that the ATO has a great deal of experience of taxpayer behaviour and is in a position to learn from this to develop strategies that help improve the flow of information. For example, the ATO advised the Committee that it learnt from its cash economy audits that a key characteristic is that taxpayers provide material information late in the process. The ATO stated that it changed the way it gathers information to prevent this occurring.[24] The Committee welcomes this development and notes that there are other examples where it can

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21 Mr Graeme Halperin, *Transcript of Evidence,* 14 August 2014, p. 19.

22 Dr Niv Tadmore, The Tax Institute, *Transcript of Evidence,* 14 August 2014, p. 15; Mr Graeme Halperin, *Transcript of Evidence,* 14 August 2014, p. 19; Ms Judy Sullivan, PwC, *Transcript of Evidence,* 18 August 2014, p. 24.

23 Mr Philip Hack SC, AAT, *Transcript of Evidence,* 16 October 2014, p. 2.

24 ATO, *Submission No. 10,* p. 28.

change its procedures to encourage the earlier provision of information, which would benefit both the ATO and taxpayers.

Centralisation of ATO expertise

4.25 The Committee asked witnesses whether centralising expertise at the ATO had adversely affected dispute resolution. Michael Croker of Chartered Accountants Australia and New Zealand (CAANZ) replied that centralising tax officers had led to a 'great sense of loss' about losing local expertise and the ability to quickly resolve issues through a local 'go-to' person. He observed that the staffing model now consisted of centralised expertise within certain offices or groups, and that the ATO was now increasingly reliant on the Tax Counsel Network for technical advice.[25]

4.26 Bernard Marks of the Law Institute of Victoria noted one case in which the centralisation of expertise, and the removal of local staff, had led to dealing with many different, geographically dispersed ATO teams.

4.27 Mr Marks recounted the tale of a recent dispute where a taxpayer had already made a settlement offer that was rejected by the ATO. The taxpayer was located in Victoria, and the original decision makers were in Tasmania. Expert advice was provided by officers from South Australia and New South Wales, and the objection was reviewed in Queensland. Mr Marks sought to meet with the reviewer in Queensland to discuss the case and was prepared to finance his own travel. This approach was rebuffed, because there would also be the need to bring in the technical advisors from South Australia and New South Wales at taxpayer expense.

4.28 Mr Marks then succeeded in entering into ADR in Victoria, which involved an Assistant Commissioner. The matter was resolved on the day in favour of the taxpayer. Mr Marks believed that the reviewer had been 'nobbled by someone else, who had been involved with the original decision, who clearly wanted to protect the original decision.'[26]

4.29 The Tax Institute supported the point that centralisation lengthened disputes, observing that it was difficult to arrange face-to-face meetings, which have generally been shown to resolve disputes more quickly.[27]

25 Mr Michael Croker, CAANZ, *Transcript of Evidence*, 18 August 2014, p. 12.

26 Mr Bernard Marks, Law Institute of Victoria, *Transcript of Evidence*, 14 August 2014, p. 30.

27 The Tax Institute, *Submission No. 11*, p. 5.

Lack of transparency

4.30 A number of organisations expressed concern that the ATO does not inform them of its thinking during a dispute, especially in relation to technical matters. The Law Council of Australia described this as a 'perennial concern.'[28] The law firm McCullough Robertson advised the Committee that this can act as a barrier to resolving a dispute because they are not able to respond to the issues:

> The other difficulty which we often come across is that there will be a technical issue which we are wanting to raise with the ATO and there is a lack of transparency in how that technical issue is being dealt with. So as practitioners, we will raise the issue with the ATO officers concerned yet we have a real difficulty in understanding whether that issue actually has been escalated internally within the ATO and also in getting feedback as to whether that issue has been dealt with, by whom it has been dealt with or even any engagement with anyone who is of a high level of seniority in decision making. And that tends to constrain the actual dealing with issues, which means that this particular issue becomes the issue which ends up being litigated in the proceedings.[29]

4.31 Mr Michael Croker from (CAANZ) gave the Committee a similar example where the ATO now places more reliance on data and analytics, stating that the ATO might conduct a great deal of research 'on the quiet' and then unexpectedly confront an adviser or taxpayer with its results, requesting an explanation. Mr Croker stated he would prefer a more collaborative approach where the ATO is confident enough to discuss a business's commercial drivers and motivations.[30]

4.32 The Committee is concerned that, in some circumstances, a lack of transparency can adversely affect a taxpayer's perceptions of fairness. Mr Ian Hashman complained that he was subject to 'audit by stealth' and that the ATO refused to speak to his advisers. Mr Wayne Graham said that the ATO did not tell him what his audit was about or invite him to participate or provide information.[31]

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28 Law Council of Australia, *Exhibit No. 2,* p. 9.

29 Mrs Sarah Blakelock, McCullough Robertson, *Transcript of Evidence,* 16 October 2014. See also PwC, *Submission No. 23,* p. 9.

30 Mr Michael Croker, CAANZ, *Transcript of Evidence,* 18 August 2014, p. 12.

31 Mr Ian Hashman, *Transcript of Evidence,* 24 September 2014, p. 1; Mr Wayne Graham, *Transcript of Evidence,* 1 October 2014, pp. 7, 8.

4.33 In a supplementary submission, the ATO noted that a lack of transparency is one of the key themes in the inquiry.[32] The Committee appreciates that the ATO has picked up on this matter. Some recommendations follow in the next section.

Information requests

4.34 Taxpayers commonly complained of the ATO making large information requests with short deadlines, and then spending six to 12 months with the data before responding to the taxpayer. The Committee also heard that the ATO can request a response to a complex audit within a short time frame. [33] This lack of reciprocity is upsetting for taxpayers and does not promote engagement. In fact, the Law Council suggested that it caused or escalated disputes.[34]

4.35 PwC explained the problem as follows:

> We continue to observe ATO audit teams taking a 'scattergun' approach to information gathering, via extensive and multiple information requests, without transparency or engagement with the taxpayer as to why the particular requests are relevant to specific issues in dispute…
>
> We continue to observe instances of ATO delays during the course of the audit, in circumstances where taxpayers are not afforded the same degree of leniency in ATO imposed timeframes for the provision of information. Nor are reasons for the delays adequately explained. This inconsistency between what the ATO expects and what it does breaches principles of reciprocity, which in turn jeopardises the ATO's stated desire to foster genuine engagement with taxpayers.[35]

4.36 The Committee heard of some variations on this theme. A claim was made of 'drip questioning' where questions are spread over an extended period without progressing the dispute. The other practice claimed was 'ping pong' where the ATO sends out a letter or minor request, or repeats an

32 ATO, *Submission No. 10.2,* p. 3.

33 For example, Matthew Wallace, BDO, *Transcript of Evidence,* 18 August 2014, p. 1; CPA Australia, *Submission No. 7,* p. 2; Mr Graeme Halperin, *Transcript of Evidence,* 14 August 2014, p. 20. Mr Richard Wytkin, *Transcript of Evidence,* 29 October 2014, p. 4.

34 Law Council of Australia, *Exhibit No. 2,* p. 7.

35 PwC, *Submission No. 23,* pp. 7, 13.

earlier request, within 28 days of a taxpayer action. It does not progress the dispute, but it allows the ATO to state that it met a performance indicator.[36]

4.37 Other organisations commented that being seen to meet a performance indicator was a reason behind the problem with the timing of information requests.[37] Mr Tony Fittler from HLB Mann Judd stated that this was unfair on businesses:

> One point that I can see on this … is the issue of KPIs. Sometimes what we see is the situation that Lance described, where something has run for a fair period of time and then, all of a sudden, it has to be finished off in three days: 'If you have not provided this information, then I have to close my file on Friday'. Then the next minute you have an assessment, and you might take an assessment that is, actually, just completely wrong. But, unfortunately, you are already then into objection stage.
>
> … So that is one of the things I see with the time thing—yes, we made a decision and, yes, assessment has gone, but there is no fairness because, all of a sudden, the taxpayer has a penalty. Typically, they have a 25 per cent penalty; they have seven per cent GIC. So they have a huge liability, but a KPI was met. I just think that is a huge burden on Australian business.[38]

4.38 Mr Lance Cunningham from BDO suggested that the problem could also be due to workload demands and juggling staff.[39]

4.39 In relation to the wide scope of information requests, Mr Matthew Wallace from BDO advised the Committee that it would be reasonable for the ATO to keep its eye out for additional issues during an audit.[40] The Committee agrees. However, there is a risk that a dispute can become a wide ranging audit. PwC noted that the ATO can make narrow, focussed inquiries while at the same time reserving the right to come back to other issues. It stated:

> The problem stems from the fact that they are trying to make broad-ranging inquiries without actually trying to limit the potential areas of inquiry that they could have. The problem seems to stem from the fact that when they ask very broad-ranging, general inquiries in order to make sure that everything is still on

36 Mr Chris Wallis, *Submission No. 28,* pp. 21-22.

37 CPA Australia, *Submission No. 7,* p. 3; The Tax Institute, *Submission No. 11,* p. 2.

38 Mr Tony Fittler, HLB Mann Judd, *Transcript of Evidence,* 18 August 2014, pp. 4-5.

39 Mr Lance Cunningham, BDO, *Transcript of Evidence,* 18 August 2014, p. 4.

40 Mr Matthew Wallace, BDO, *Transcript of Evidence,* 18 August 2014, p. 4.

> the table, the taxpayer is very reluctant to provide a lot of information without actually hearing, 'What is the problem?' There is no harm in saying, 'This is the area we are interested in and reserve the right to come back and look at other things.' In the absence of saying, 'Why is this required?' then that becomes a problem, and there is intransigence because taxpayers do not want to voluntarily give a wide raft of information which could potentially open up other areas of inquiry which makes the dispute widen. As tax advisers, we are trying to narrow it down to figure out what it is we are fighting about and have a very small channel to deal with that issue.[41]

4.40 PwC advised the Committee that, in some respects, the issue around the scope of information requests should not exist. The ATO, through its risk profiling, has already identified a risk and audit effort can be most usefully directed there. PwC stated that senior ATO management would much prefer that auditors focussed on the risks already identified.[42]

Committee comment

4.41 The Committee regards information requests generally as one of the priority issues from the inquiry and is pleased that the ATO has come to this view as well.[43] The Committee received some common-sense suggestions from Mr Richard Wytkin, a Perth tax adviser, and PwC.[44] The Committee is pleased to endorse their comments, with some minor modifications, as recommendations to the ATO.

Recommendation 13

4.42 **The Committee recommends that the Australian Taxation Office give more consideration to taxpayers when making information requests, with priority given to:**

- **setting timeframes in practice statements, with a minimum of 28 days for all requests;**
- **giving taxpayers the opportunity to seek an extended**

41 Ms Judy Sullivan, PwC, *Transcript of Evidence,* 18 August 2014, pp. 20-21.

42 Mr Michael Bersten, PwC, *Transcript of Evidence,* 18 August 2014, p. 21

43 ATO, *Submission No. 10.2,* p. 3.

44 Mr Richard Wytkin, *Transcript of Evidence,* 29 October 2014, p. 3; PwC, *Submission No. 23,* p. 11.

timeframe upon receipt of a request; and

- **giving reasons for an information request, typically based on a risk hypothesis.**

Escalating early

4.43 Another common complaint during the inquiry was that practitioners found it difficult to escalate issues within the ATO so that they could access either the right technical person or someone sufficiently senior. This often leads to delays, increasing costs for both sides.[45]

4.44 This chapter has given examples of protracted audits being resolved with one meeting with sufficiently senior ATO people. The point put to the Committee was that senior people have more experience and are better able to make judgements about what is important in a dispute and put into perspective the revenue aspects of a dispute. This is less evident in junior staff, who were perceived as being less flexible or less able to focus on areas beyond the revenue. The Ombudsman explained it as follows:

> It is experience with life. If you have very fine young people with terrific education and all the rest of it, but, unless they have seen both sides of the real world, they come up with a slant on something which is not particularly helpful for either party—the complainant or the institution.[46]

4.45 A tax barrister, Mr Chris Wallis, summarised it as 'Without experienced people (on both sides) disputes simply meander on.'[47]

4.46 In the SME sector, it can be difficult to access the right people because junior staff can be reluctant to escalate a matter. At the accountants' roundtable, the Committee heard that larger firms have better access:

> If we request to speak to someone senior, the junior officers tend to get their noses out of joint, and it is very difficult to go up the line. I think the larger firms have an ability to go higher up rather than

45 Mr Mark West, McCullough Robertson, *Transcript of Evidence,* 16 October 2014, pp. 13-14; Mr Colin Neave, Commonwealth Ombudsman, *Transcript of Evidence,* 24 September 2014, p. 9; Mr Philip Hack SC, AAT, *Transcript of Evidence,* 16 October 2014, p. 5; Law Council of Australia, *Exhibit No. 2,* p. 15.

46 Mr Colin Neave, Commonwealth Ombudsman, *Transcript of Evidence,* 24 September 2014, p. 13.

47 Mr Chris Wallis, *Submission No. 28,* p. 18.

> the smaller practitioners. It takes them a while to find their way up the line.[48]

4.47 Tax practitioners argued that it was also important to be able to access the relevant technical people within the ATO early in a dispute. If they come into a dispute later on, there is a risk that they will introduce new technical issues, meaning that the matter has been focussing on the wrong points.[49]

4.48 Advisers would also like to be able to speak directly to ATO technical experts because this can help clarify the technical issues and ensure that they are fully briefed. A tax barrister, Mr Graeme Halperin, stated to the Committee:

> You often get a technical difference of opinion. Junior personnel will come back to you and say, 'That's what we've been told by TCN'—Tax Counsel Network. Well, I would like to speak to the person at the Tax Counsel Network and have a discussion with them…, but they say, 'Sorry, you can't speak to them, they're not part of the dialogue'… I have had matters where the ATO have clearly gone down the wrong track in the material that they are relying upon. It may be that I can alert the technical adviser to other material that they ought to be having regard to rather than the material that may have been referred to them by the junior auditor.[50]

4.49 A variation on this is where an audit starts in relation to one tax, but then becomes an audit into a different tax, for example changing from GST to income tax. The difficulty is that the audit team can remain the same, meaning that the wrong team is conducting the audit. The Committee heard that this mismatch can be continued into the objection phase, where the indirect tax business line is the reviewer in this example.[51] This is obviously unsatisfactory and indicates the importance of a fresh set of eyes being brought to objections.

4.50 During the inquiry, the ATO stated that it had started to address these concerns. It has brought more senior case leaders into compliance cases

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48 Mr Alan Bentwitch, Bentwitch & Co., *Transcript of Evidence,* 18 August 2014, p. 40. Mr Mark West, McCullough Robertson, made a similar comment, *Transcript of Evidence,* 16 October 2014, p. 8.

49 Mr Tony Greco, IPA, *Transcript of Evidence,* 14 August 2014, p. 6; PwC, *Submission No. 23,* p. 9.

50 Mr Graeme Halperin, *Transcript of Evidence,* 14 August 2014, p. 18.

51 Mrs Sarah Blakelock, McCullough Robertson, *Transcript of Evidence,* 16 October 2014, p. 18; Mr Matthew Wallace, BDO, *Transcript of Evidence,* 18 August 2014, p. 2.

from the start, as well as redeploying some legal personnel into the compliance teams.[52]

4.51 CPA Australia made a useful suggestion, namely that a senior ATO decision maker should review a dispute prior to completing the audit, to make strategic decisions about how the matter will be conducted.[53] The law firm McCullough Robertson suggested a triaging system, as did the Ombudsman, who noted that one of the risk factors for a dispute is if senior people are not involved early.[54] Mr Neave stated:

> Very early in the piece, the cases which should receive the most attention with the objective of getting them settled quickly should be identified, and those within an organisation having the power to make a decision should be involved in the decision about whether or not that particular case should be dealt with in a particular way. At one level it is a matter of internal organisation for an office such as the tax office or a large financial institution to make sure that cases are brought to the attention of those who have the power to make a decision and that that decision is made promptly. It is, as you quite rightly point out, a cost saving in the end, because the amount of time which is spent once one gets into the realm of the AAT or any court process is just enormous. Summarising the case takes some very skilled minds, and that can be a very lengthy process as well.[55]

Committee comment

4.52 The Committee would like to see some better systems put in place to manage how SMEs can access valuable ATO resources. Not only would this improve the audit experience for SMEs, but it would demonstrate fairer treatment as well, given that, as the Law Council put it, a taxpayer's access to the right ATO people is currently a matter of insider knowledge, time and money.[56]

4.53 The Committee is pleased to endorse the Ombudsman's suggestion as a way of implementing this. The Committee's observation is that ATO resources appear to be allocated, at least by default, to large corporates. In

52 ATO, *Submission No. 10,* p. 30; ATO, *Submission No. 10.2,* p. 8.

53 CPA Australia, *Submission No. 7,* p. 2.

54 Mrs Sarah Blakelock, McCullough Robertson, *Transcript of Evidence,* 16 October 2014, p. 9.

55 Mr Colin Neave, Commonwealth Ombudsman, *Transcript of Evidence,* 24 September 2014, pp. 10-11.

56 Law Council of Australia, *Exhibit No. 2,* p. 15.

relation to revenue risk, this is appropriate. However, the Committee believes that this reduces the fairness of the system for SME taxpayers.

4.54 Fairness to taxpayers should be a risk that the ATO specifically addresses in its operations. The ATO already takes fairness into account through its compliance model, whereby compliant taxpayers receive reduced penalties and so forth. However, the Committee would like to see the fair treatment of taxpayers elevated to being an ATO goal in its own right. Chapter 2 on KPIs discusses this and has made a recommendation to develop a KPI to measure fairness during tax disputes. Further, the Committee believes that it can be incorporated into other operational areas such as the triaging of disputes.

Recommendation 14

4.55 **The Committee recommends the Australian Taxation Office introduce a triage system for disputes so that, early in a dispute, matters can be escalated to ATO staff sufficiently senior or with the appropriate technical skills to resolve the dispute quickly and effectively. Such decisions should consider taxpayer fairness, among other criteria.**

5

Other administrative matters

Formal interviews

Background

5.1 The ATO has significant evidence-gathering powers. An important provision is section 264 of the *Income Tax Assessment Act 1936.* Notices under the section allow the Commissioner to require a person to provide information that the Commissioner requests or to attend an interview, give evidence, and produce records under that person's custody. The ATO can require that the evidence be given under oath or affirmation. Refusal to take an oath or affirmation is an offence.[1]

5.2 The ATO has published a guide for taxpayers on these interviews. Features of the process include:

- the ATO may bring a lawyer to the interview, such as when the matter is complex or the interviewee plans to bring their lawyer
- the ATO can ask wide-ranging questions
- the interviewee may bring a support person to the interview, but if they have a close connection to the facts, such as participating in transactions of interest, they will be excluded and the interviewee can arrange another support person
- the ATO will usually record the interview and provide the person (hereafter referred to as a taxpayer) with any resulting transcript

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1 Section 8D of the *Taxation Administration Act 1953.*

- the taxpayer can claim legal professional privilege, but not common law rights against self-incrimination.[2]

5.3 A tax barrister, Mr Graeme Halperin, described the effect of such a formal interview on most taxpayers as 'an absolutely harrowing experience.'[3] Mr Matthew Wallace from BDO stated in evidence that the use of formal interviews intimidated taxpayers and that the ATO had other powers it could rely on:

> The concern is that as soon as those powers are relied upon—because there are criminal penalties if those requirements are not complied with—it brings an element of fear and compulsion into the negotiation of an outcome. That makes it difficult for the taxpayer. There are alternatives in that, if any taxpayer provides a false or misleading statement to a tax officer, the taxpayer is still guilty of an offence, but by bringing to bear the section 264 powers, an element of fear and compulsion is brought into the negotiations that would not otherwise be there.[4]

5.4 The Committee also received the complaint that the ATO used formal interviews just before an objection was decided. This provides the ATO with an additional opportunity to question a taxpayer when a matter is expected to be litigated, in the presence of an ATO lawyer who would be involved in the litigation. This would not be permitted in a court of law.[5]

Analysis

5.5 During the inquiry, while there was general acceptance that the interviews were stressful, there was no theme in the evidence that the interview power should be revoked. However, the Committee did receive evidence that the questions could be confusing, especially where technical issues were involved. For example, a taxpayer might be asked whether they did something and give an incorrect answer because they did not distinguish between themselves or a trust or a corporation.[6] Mr Graeme Halperin

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2 ATO, *Guide for taxpayers: Our approach to information gathering,* November 2013, pp. 22-26. Legal professional privilege relates to the confidentiality of communications between a lawyer and their client. Rights against self-incrimination relate to a person not being required to give evidence or produce a document where that would tend to incriminate them.

3 Mr Graeme Halperin, *Transcript of Evidence,* 14 August 2014, p. 21.

4 Mr Matthew Wallace, BDO, *Transcript of Evidence,* 18 August 2014, p. 3.

5 Ms Justeen Dormer, Dormer Stanhope, *Transcript of Evidence,* 1 October 2014, pp. 1-2; Mr John Hyde Page, *Transcript of Evidence,* 29 October 2014, p. 10.

6 Mr Chris Wallis, *Transcript of Evidence,* 14 August 2014, p. 35.

stated to the Committee that taxpayers can give wrong answers to interview questions through not understanding the tax system:

> We are not told about the questions beforehand. I might ask the ATO beforehand: 'What are you going to ask about?' They give you the most broad, general answer which is very, very vague. So you can certainly rest assured that the client is not prepped when they walk into the interview. They are basically taken cold. They are answering a question without really understanding it. Sometimes I will say to the tax officer: 'Can you just restate that question, because I'm not sure that my client really understands what you're getting at.' Because they have not had the opportunity to consider the matter, they will give an answer off the cuff. Then, when they get into court, that answer will be quoted back to them when they give a different answer in the courtroom after having had the opportunity to consider the matter and understand what the ATO was really driving at.[7]

5.6 The Committee is concerned that a taxpayer could be asked a question that they did not understand and then have their answer quoted back at them in court. This breaches fundamental principles of fairness. The idea that a witness needs to understand questions put to them is also reflected in the laws of evidence.[8] The ATO's guidance states that taxpayers should explain in an interview if they do not know or remember the answer to a particular question.[9] However, it appears that, in the heat of the moment, taxpayers' misunderstanding may lead them to answer questions incorrectly.

5.7 We have a complex tax system and the great majority of taxpayers now use advisers. Therefore, it is unclear to the Committee why the ATO would ask taxpayers questions they may not understand when their adviser is more likely to give an accurate response.

Committee comment

5.8 The Committee appreciates that the ATO requires a range of powers to collect information and gives in-principle support to the ATO retaining the legal power to request a person to attend an interview and answer questions. However, the Committee is concerned that, in a complex tax system where the reliance on advisers is institutionalised, taxpayers are

7 Mr Graeme Halperin, *Transcript of Evidence,* 14 August 2014, p. 22.

8 For example, sections 12 to 14 of the *Evidence Act 1995.*

9 ATO, *Guide for taxpayers: Our approach to information gathering,* November 2013, p. 24.

asked questions that they do not understand and then, in some cases, their answers are being quoted back at them in court.

5.9 The Committee accepts that taxpayers are responsible for their tax returns. However, it believes that these interviews can be made fairer to taxpayers and other persons by giving them advance notice issues and topics to be raised.

Recommendation 15

5.10 **The Committee recommends that, as much as practicable, the Australian Taxation Office should give taxpayers written notice of issues and topics to be raised in section 264 interviews.**

Compensation

Background

5.11 Since 1995, the Commonwealth has had a general arrangement for compensating individuals called the Scheme for Compensation for Detriment caused by Defective Administration (CDDA).[10] The scheme is based on sections 61 and 64 of the Constitution, which vest the executive power of the Commonwealth in the Sovereign and is exercisable by the Governor-General on their behalf. Ministers, and officials where authorised, can compensate persons who have suffered loss caused by an agency's defective administration.[11]

5.12 The scheme operates where a person (hereafter referred to as a taxpayer) suffers detriment due to the defective administration of an agency and the taxpayer has no legal recourse. It is a last resort. If a taxpayer has alternative means of obtaining redress from the ATO, then that should be attempted first.[12] Previous guidance referred to a moral obligation to pay

10 Commonwealth Ombudsman, *Putting things right: compensating for defective administration,* Report 11/2009, August 2009, p. 2.

11 Department of Finance, *Resource Management Guide No. 409: Scheme for Compensation for Detriment caused by Defective Administration,* June 2014, p. 3.

12 Department of Finance, *Resource Management Guide No. 409: Scheme for Compensation for Detriment caused by Defective Administration,* June 2014, pp. 2, 4.

compensation, but this has not been carried through to the current policy.[13]

5.13 The Department of Finance has carriage of the policy of the scheme. It defines defective administration as:

- a specific and unreasonable lapse in complying with existing administrative procedures that would normally have applied to the claimant's circumstances; or
- an unreasonable failure to institute appropriate administrative procedures to cover aclaimant's circumstances; or
- giving advice to (or for) a claimant that was, in all circumstances, incorrect or ambiguous; or
- an unreasonable failure to give to (or for) a claimant, the proper advice that was within the official's power and knowledge to give (or was reasonably capable of being obtained by the official to give).[14]

5.14 The Department of Finance provides that the main principle in determining the level of compensation should be 'to restore the claimant to the position they would have been in had defective administration not occurred.' The offer should also be fair and reasonable in the circumstances and the Commonwealth should not use its position of strength to reduce the payment.[15]

5.15 If a taxpayer is not happy with an offer, they may complain to the Ombudsman, who can investigate the complaint under their general powers. The Ombudsman cannot vary a decision, but can make suggestions to the agency or report the matter to the minister, the agency CEO, or the Parliament.[16]

5.16 In 2009, the Ombudsman released a report about the CDDA scheme that focussed on three agencies, including the ATO. The report found that all the agencies in the study had 'well developed systems in place to handle CDDA claims.' However, the report also noted that there was a bias to protecting the revenue:

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13 Department of Finance and Deregulation, *Discretionary Compensation and Waiver of Debt Mechanisms,* Finance Circular No. 2009/09, p. 7.

14 Department of Finance, *Resource Management Guide No. 409: Scheme for Compensation for Detriment caused by Defective Administration,* June 2014, pp. 2-4.

15 Department of Finance, *Resource Management Guide No. 409: Scheme for Compensation for Detriment caused by Defective Administration,* June 2014, p. 9.

16 Department of Finance, *Resource Management Guide No. 409: Scheme for Compensation for Detriment caused by Defective Administration,* June 2014, p. 11.

> A major theme in this report is that, while there is general acceptance by agencies of the CDDA Scheme, there is still a reluctance by agencies to admit error and to approve worthy claims. More can be done within agencies to facilitate greater acceptance of the scheme, its principles and purpose. The impression at times is that the balance between fiscal prudence and justifiable compensation has not been properly struck: the balance is tilted towards protecting government revenue to the detriment of proper assessment of claims. Adverse assumptions are too often made about the unreliability of claimants' accounts; and positive assumptions, unsupported by evidence, are too often made about the reliability of agency actions.[17]

5.17 CDDA payments by the ATO over the past three years are set out in the table below. The average payment is much higher than the median payment, which indicates that the ATO makes a large number of small payments and a small number of large payments.

Table 5.1 CDDA payments, 2011-12 to 2013-14

Year	Unpaid claims	Paid claims	Total Payments ($)	Average Payment ($)	Median Payment ($)
2011-12	172	162	773,857	4,777	571
2012-13	192	147	363,617	2,474	267
2013-14	105	79	841,754	10,655	300

Source *ATO, Annual Reports, 2011-12 to 2013-14, Appendix 6, Compensation Statistics*

Analysis

5.18 The main issue in the inquiry was the claim that either the ATO does not agree to compensation, or the compensation amounts offered were insufficient.[18] The Committee heard of one taxpayer who won a large number of cases against the ATO. He received standard costs and when he lodged a compensation claim the ATO offered him $20,000:

> To give you an example, I had a client who had eight matters through the various levels of courts, including the High Court. He won every single one... But he was still roughly a million dollars out of pocket by the time the legal fees had been reimbursed in

17 Commonwealth Ombudsman, *Putting things right: compensating for defective administration,* Report 11/2009, August 2009, p. 32.

18 Mr Gary Kurzer, *Transcript of Evidence,* 18 August 2014, pp. 48-49; Mr Grahame Pilgrim, *Transcript of Evidence,* 16 October 2014, p. 22.

> part under the standard basis. We put in a compensation claim for that gentleman and were offered $20,000. So there is a massive discrepancy between what people can recover in those situations and what they have actually outlaid.[19]

5.19 The Committee raised the operation of the CDDA scheme with the Ombudsman. Mr Neave stated that he refers taxpayers to the scheme if they have a compensation claim but no legal avenue through which to pursue it. The Ombudsman also stated that he would be able, if asked by the ATO, to comment on any particular offer that the ATO might make to a taxpayer.[20]

5.20 In its submission, the ATO commented on the importance of feedback loops in the context of separating the deciding of objections from audit activity.[21] The Committee notes that the idea of a feedback loop also applies to the CDDA scheme. If the incidence of defective administration increases, then compensation amounts should also increase, sending a signal back to the relevant parts of the ATO. This can be used to improve performance in the long run.

Committee comment

5.21 The evidence to the Committee suggests that, where defective administration has been involved, compensation amounts do not always restore taxpayers to their original position and this situation has occurred for some time. Where this occurs, it is not fair to taxpayers. The Committee is also concerned that this impairs a feedback loop whereby the ATO can measure its performance in dealing with taxpayers fairly.

5.22 The compensation amount, if any, for a taxpayer will depend on the facts of each case. Therefore, the Committee is very pleased that the Ombudsman has offered to assist the ATO in assessing compensation amounts. The Ombudsman has significant expertise in this area and the Committee would like the ATO to invite the Ombudsman to assist.

19 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 16.

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

21 ATO, *Submission No. 10.2,* p. 4.

Recommendation 16

5.23 **The Committee recommends that the Australian Taxation Office invite the Commonwealth Ombudsman to advise on improving its compensation processes, including compensation liability and amounts.**

Alternative dispute resolution

Background

5.24 Alternative dispute resolution (ADR) is a process where parties use an impartial third party, other than the courts, to help resolve their dispute.[22] The main types of ADR are outlined in the table below.

Table 5.2 Types of alternative dispute resolution

Type	Description	Examples
Facilitative	The third party encourages dialogue and helps the parties in dispute work through the issues in a structured manner.	Mediation, facilitation
Advisory	The third party is usually a subject expert who appraises the dispute and proposes solutions.	Case appraisal, conciliation
Determinative	The third party evaluates the dispute, perhaps taking evidence, and makes a determination which would often have legal standing.	Arbitration, expert determination

Source *Attorney-General's Department, Office of Legal Services Coordination, Guidance Note 12, September 2013, p. 7; Allessandra Sgubini et al, 'Arbitration, Mediation and Conciliation: differences and similarities from an international and Italian business perspective,' viewed at www.mediate.com on 4 February 2015.*

5.25 The key difference between ADR and the early engagement discussed in chapter 4 is that ADR requires a third party, whereas early engagement can simply involve the ATO and the taxpayer discussing a review, audit, or dispute. PricewaterhouseCoopers (PwC) stated that early engagement, as opposed to ADR, is preferable in resolving issues[23] and the Committee endorses this statement. A simple conversation can happen earlier and involves less process and cost than ADR.

5.26 A breakthrough in ADR at the ATO occurred with the 2012 report by the Inspector-General of Taxation (IGT). This review was also requested by the ATO. The IGT directed 21 recommendations to the ATO, which agreed

22 Attorney-General's Department, Office of Legal Services Coordination, *Guidance Note 12,* September 2013, p. 1.

23 PwC, *Submission No. 23,* p. 17.

with 14, partly agreed with four, agreed in principle with two and disagreed with one. This last recommendation covered internally separating the objection and litigation functions within the ATO and is discussed in this report in chapter 6.[24]

5.27 The influence of the IGT's report was reflected in the ATO's submissions to the inquiry. Many current or anticipated ATO programs are directly or partly attributable to the IGT's recommendations. Examples are:

- asking teams that audit individual taxpayers to adopt early dispute resolution principles[25]
- in-house facilitators for less complex matters[26]
- feedback surveys for taxpayers involved in ADR[27]
- a Dispute Resolution Charter.[28]

5.28 The ATO has issued a practice statement in relation to ADR. It encourages ATO staff to engage in ADR where there is scope for negotiation within existing policies and there are identified ways in which the dispute can be progressed, such as narrowing the facts in dispute. The guidance sets out a number of instances where ADR would be inappropriate. These are:

- resolution can only be achieved by departure from an established 'precedential ATO view' and there is no material difference between the facts in dispute and the facts which form the basis of the 'precedential ATO view'
- the cost and delay involved in ADR is disproportionate to the likely benefit
- the dispute turns on genuine and fundamental issues of law or is otherwise straightforward and there is a clearly identified public benefit in having the matter judicially determined
- the facts are clear and the application of the law is straightforward, or
- there is a genuinely held concern that the case involves serious criminal fraud or evasion.[29]

5.29 The ATO commissioned the Australian Centre for Justice Innovation at Monash University to conduct an evaluation of ADR. The Centre released

24 Inspector-General of Taxation, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution: A report to the Assistant Treasurer,* May 2012, pp. ii, v.

25 ATO, *Submission No. 10.2,* p. 6; IGT recommendation 4.1 on p. 146.

26 ATO, *Submission No. 10,* p. 18; IGT recommendation 3.6 on p. 44.

27 ATO, *Submission No. 10.2,* p. 9; IGT recommendation 5.4 on p. 95.

28 ATO, *Submission 10.2,* p. 4; IGT recommendation 5.2 on p. 87.

29 ATO, *Alternative Dispute Resolution (ADR) in ATO disputes,* PS LA 2013/3, August 2013, para. 9.

a report in November 2014 covering the period from July 2013 to June 2014 for 118 matters, 92 per cent of which had already progressed to the Administrative Appeals Tribunal (AAT) or Federal Court. It found that over 40 per cent of matters completely resolved during ADR and 25 per cent appeared to resolve afterwards. Some respondents commented on cost savings when a matter was successfully resolved, typically giving an amount of $70,000.[30]

5.30 There was a general acknowledgement during the inquiry that the ATO is now more likely to engage in ADR. CPA Australia stated:

> As an overall comment we strongly believe that the Commissioner should be commended for the recent performance of the Australian Taxation Office (ATO) in resolving tax disputes through negotiation and the use of Alternate Dispute Resolution (ADR) processes. This has involved a considerable paradigm shift by all parties and our members note that its roll-out across all market sectors including SMEs has typically led to the more expeditious resolution of disputes by the ATO.[31]

5.31 However, the problem is that it can still be difficult to convince ATO auditors and other staff to engage in ADR. Mr Graeme Halperin commented that the ATO does not routinely advise taxpayers of their ADR options and an individual involved in the early stages of a dispute 'did not know such a thing existed.'[32] The Committee also heard that, in some instances, the ATO does not fully engage in ADR. Mr John Hyde Page, a tax barrister, stated to the Committee:

> There has been a change. I do not know whether or not you could properly characterise it as a cultural change, but about a year ago in just about every tax dispute that was going on across Australia people started getting phone calls from the ATO saying, 'We want to mediate this.' Some of those mediations have been quite constructive. Some of the others that I have attended, frankly, have just been a waste of time. In one case in particular, the ATO started off the mediation by saying: 'We're here because our policy is we have to be. But, you're a bunch of crooks and we're not going to abandon our assessments.'[33]

30 Tania Sourdin and Alan Shanks, *Evaluating ADR in ATO Disputes: Executive Summary,* Australian Centre for Justice Innovation, Monash University, November 2014.

31 CPA Australia, *Submission No. 7,* p. 1.

32 Mr Graeme Halperin, *Transcript of Evidence,* 14 August 2014, p. 18; Mr Mark Fletcher, *Transcript of Evidence,* 18 August 2014, p. 32.

33 Mr John Hyde Page, *Transcript of Evidence,* 14 August 2014, p. 10.

Analysis

5.32 In terms of increasing the use of ADR, the Committee took evidence that the ATO is undergoing a process of cultural change and that it takes time for this to occur. Mr David Hughes stated, 'if the current commissioner stays for a long tenure, then the culture will change over time.'[34] Mrs Sarah Blakelock and Mr Mark West from McCullough Robertson made similar comments, in particular that ADR is more prevalent in the large market and should eventually filter down:

> There has been quite a significant change in approach over the last maybe two or three years and a significant amount of people have been trained as accredited mediators within the ATO. I am finding that is more often in the public groups and international space—large business rather than in the small to medium enterprise space. It takes a while for these things to filter down.[35]
>
> I have a similar experience that it is still patchy but certainly efforts are being made. I think it still has a way to go to filter all the way down.[36]

5.33 Progress with ADR has been occurring during the inquiry. In a supplementary submission, the ATO stated that it now advises taxpayers about facilitation in GST audit letters before the audit is concluded. This is being expanded to individuals, small business and income tax letters.[37]

Committee comment

5.34 The Committee commends the ATO for making greater use of ADR over the past few years and looks forward to the ATO building on this achievement. The Committee does not believe that a recommendation on this matter is required because the main goal for the ATO is to continue along its current path of increasing the use of ADR.

5.35 Although ADR is much preferred over court proceedings, the Committee would like to reiterate PwC's comment that direct discussion and early resolution in most cases will be more even more advantageous. If taxpayers and the ATO can save $70,000 by resolving a matter through ADR once it has proceeded to the AAT, then the savings in resolving a matter before objection must be substantial as well.

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34 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 16.

35 Mrs Sarah Blakelock, McCullough Robertson, *Transcript of Evidence,* 16 October 2014, p. 12.

36 Mr Mark West, McCullough Robertson, *Transcript of Evidence,* 16 October 2014, p. 12.

37 ATO, *Submission No. 10.2,* p. 6.

5.36 Finally, the Committee recognises the IGT's contribution to these reforms through the 2012 ADR report. The Committee would certainly support the IGT in revisiting this matter at a later date if the IGT thought this was warranted.

6

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.[1]

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

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.[2]

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)[3] recommended that the resources of the Appeals and Review Group be reallocated 'to the performance of internal review within the original

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.'[4] 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.[5]

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.[6]

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.[7]

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.[8] This point was also corroborated by the Law Institute of Victoria.[9]

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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.[10]

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'.[11] Mr Tony Fittler stated that 'when an objection went in it was looked at independently', but that the process now was 'hit and miss'.[12]

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.[13]

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.[14]

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.[15]

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.[16]

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 rather 'it is about whether a fair-minded observer would reasonably suspect bias'[17] (otherwise known as apparent bias). Other witnesses noted the importance of bringing genuine independence to the review process.[18]

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'.[19]

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.[20]

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

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.[21]

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.[22]

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.[23]

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.[24]

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.[25]

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.[26]

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.[27]

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.[28]

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.[29]

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.[30]

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.[31]

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.[32]

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.'[33]

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.[34]

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.[35]

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.'[36]

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.[37]

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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.[38]

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.[39]

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.[40]

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

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.'[41]

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.[42]

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.[43]

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.[44] 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:

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.[45]

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.[46]

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.[47] 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.[48]

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.[49]

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.[50]

6.50 Dr Niv Tadmore 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.[51]

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 Tadmore 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.[52] The Tax Institute's submission argued that this situation was inconsistent with the principle of full and true independence.[53]

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.[54]

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

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

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

52 Dr Niv Tadmore, 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.[55] 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'.[56]

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.[57]

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.[58] 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.[59]

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.[60]

Practices in other jurisdictions

New Zealand[61]

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[62]

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.

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.[63]) 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 tit 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.[64]

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.[65]

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.'[66]

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

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.'[67]

6.73 The Community and Public Sector Union supported the ATO's position on full separation leading to a reduction in feedback loops.[68] 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[69] and expert[70] knowledge. This concern was shared by Mr Richard Wytkin.[71]

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.[72] Additionally, Dr Niv Tadmore 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.[73]

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'.[74]

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.[75]

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.[76]

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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 Tadmore, 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.[77] Some witnesses also suggested that this action should be enshrined in statute.[78]

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.[79]

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.[80]

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.[81] PwC suggested that a new Second Commissioner for disputes should still report to the Commissioner of Taxation.[82]

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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.[83]

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.[84] 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.[85] 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.[86]

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 workface', rather than just being articulated at the top level.[87]

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.[88]

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.[89]

Not a new idea

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

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).[90]

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.'[91]

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

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.[92]

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.[93]

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

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 innundated 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.[94]

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

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

A

Appendix A – List of Submissions

1. BDO Australia
2. HLB Mann Judd Australasian Association
3. Ms Kaye Perkins
4. Australian National Audit Office
5. Institute of Chartered Accountants Australia
6. Civil Liberties Australia
7. CPA Australia
8. Law Institute of Victoria
9. Confidential
10. Australian Taxation Office
    - 10.1 Supplementary Submission
    - 10.2 Supplementary Submission
    - 10.3 Supplementary Submission
11. The Tax Institute
12. Confidential
13. Community and Public Service Union
14. Commonwealth Ombudsman
15. Confidential
16. Confidential

17. Mr Donald Yates
18. Confidential
19. Vanda Gould Chartered Accountants
20. Confidential
21. Mr Rob Salisbury
22. Mr John Hyde Page
23. PWC
24. Mr Mark Fletcher
25. Dormer Stanhope
26. Mr Bernard Marks
27. Mr Ian Hashman
28. Mr Chris Wallis
29. Mr Christopher Budd
30. Attorney-General's Department
31. Signet Lawyers
32. Confidential
33. Mr David Russell QC
34. Agape Ministries International

B

Appendix B – Exhibits

1. John Hyde Page, *Project Wickenby: White Hats at Work, or Witch Hunt?* (provided by John Hyde Page)

2. Law Council of Australia, *Submission to the inquiry by the Inspector-General of Taxation into tax disputes* (provided by the Law Council of Australia)

3. Administrative Appeals Tribunal, *Tax Bar Association of Victoria: Tax Dispute Resolution: The AAT Perspective* (provided by the Administrative Appeals Tribunal)

4. Australian Taxation Office, *Operation Rubix Project Outline* (provided by Dormer Stanhope)

5. Michael Cadesky, Ian Hayes and David Russell, *Towards Greater Fairness in Taxation: A Model Taxpayer Charter: Preliminary Report* (provided by David Russell QC)

6. Australian Taxation Office, *Final ATO 'Fairness in ATO disputes research' questionnaire* (provided by the ATO)

7. Australian Taxation Office, *Freedom of Information request – Operation Winebar* (provided by Andrew Garrett)

8. Australian Taxation Office, *Freedom of Information request - Tier 3 project closure report* (provided by Andrew Garrett)

9. Genesis Global Trading Co Ltd, *Settlement of OenoViva Contracts* (provided by Andrew Garrett)

10. Australian Taxation Office, *Importance of independence in the review process* (provided by the ATO)

11. Australian Taxation Office, *Importance of direct engagement with taxpayers* (provided by the ATO)

12. Australian Taxation Office, *Working together and sharing knowledge* (provided by the ATO)

13. Australian Taxation Office, *Guidelines on the Audit, Objection and Litigation end to end process in PGH* (provided by the ATO)

14. Australian Taxation Office, *Memorandum of Understanding (MOU) between Small Business and Individual Taxpayers (SB/IT) Interpretive Assistance and SB/IT Active Compliance* (provided by the ATO)

15. Australian Taxation Office, *Independent Review of audit position papers – Process and procedures* (provided by the ATO)

16. Australian Taxation Office, *Prepare and conduct audit/ruling team conference* (provided by the ATO)

C

Appendix C – List of Public Hearings

Wednesday 16 July 2014 - Canberra

Australian Taxation Office

Mr Chris Jordan, Commissioner of Taxation

Mr Andrew Mills, Second Commissioner, Law Design and Practice

Mr Neil Olesen, Second Commissioner, Compliance

Mr Michael Cranston, Deputy Commissioner, Private Groups and High Wealth Individuals

Mr Stephen Vesperman, Deputy Commissioner, Small Business/Individual Taxpayers

Ms Debbie Hastings, First Assistant Commissioner, Review and Dispute Resolution

Department of the Treasury

Mr Rob Heferen, Executive Director, Revenue Group

Mr Hector Thompson, General Manager, Small Business Tax Division

Thursday 14 August 2014 - Melbourne

Law Institute of Victoria

Mr Daniel Smedley, Lawyer and Chair, Taxation and Revenue Committee

Mr Bernard Marks, Lawyer and Member, Taxation and Revenue Committee

Mr Jonathan Lambriandidis, Lawyer

The Tax Institute

Mr Michael Flynn, President

Dr Niv Tadmore, Member and Representative

Ms Thilini Wickramasuriya, Tax Counsel

Institute of Public Accountants

Mr Tony Greco, Senior Tax Adviser

Halperin & Co Pty Ltd

Mr Graeme Halperin, Principal

Private capacity

Ms Kaye Perkins

Mr Christopher Wallis

Monday 18 August 2014 - Ryde, Sydney

BDO Australia

Mr Lance Cunningham, National Director, Taxation

Mr Matthew Wallace, National Tax Counsel

PricewaterhouseCoopers

Mr Michael Bersten, Partner

Mrs Judy Sullivan, Partner

GHR Accountants & Financial Planners

Mr Brian Hrnjak, Director

LCD & Co. Accounting Services

Mr Peter Sullivan, Principal

Chartered Accountants Australia and New Zealand

Mr Michael Croker, Tax Australia Leader

HLB Mann Judd Australasian Association

Mr Tony Fittler, Chairman

Bentwitch & Co

Mr Alan Bentwitch, Principal

Private capacity

Mr Laurence Banks

Mr Vanda Gould

Mr Mark Fletcher

Mr Gary Kurzer

Mr Stephen Madz

Mr Robert Sisely

Wednesday 24 September 2014 - Canberra

Claireleigh Holdings Pty Ltd; Clairleigh (Gosford) Pty Ltd

Mr Ian Hashman, Director

BDO Australia

Mr Andre Spnovic, Partner, Indirect Taxes

Wednesday 1 October 2014 - Canberra

Dormer Stanhope

Ms Justeen Kim Dormer, Director

Private capacity

Mr Wayne Graham

Ms Justine Smith

Thursday 16 October 2014 - Brisbane

McCullough Robertson

Mrs Sarah Blakelock, Partner

Mr Mark West, Partner

Administrative Appeals Tribunal

Mr Philip Hack SC, Deputy President

Interhealth Energies Pty Ltd

Ms Joanne Hambrook, Director

Small Myers Hughes

Mr David Hughes, Partner

Private capacity

Mr Grahame Pilgrim

Wednesday 22 October 2014 - Canberra

Community and Public Sector Union

Mr Greg Miller, Tax Section President

Mr Alistair Waters, Deputy National President

Wednesday 29 October 2014 - Canberra

Private capacity

Mr John Hyde Page

Mr Richard Wytkin

Wednesday 26 November 2014 - Canberra

Australian Taxation Office

Mr Andrew Mills, Second Commissioner, Law Design and Practice

Mr Neil Olesen, Second Commissioner, Compliance

Mr Michael Cranston, Deputy Commissioner, Private Groups and High Wealth Individuals

Mr Stephen Vesperman, Deputy Commissioner, Small Business/Individual Taxpayers

Ms Debbie Hastings, First Assistant Commissioner, Review and Dispute Resolution

Department of the Treasury

Mr Rob Heferen, Executive Director, Revenue Group

Ms Kate Preston, General Manager, Small Business Tax Division