

Audit Report No. 3, 2001–2002

Administration of Taxation Rulings

Australian Taxation Office

Introduction

Background

- 2.1 A significant element of the Australian Taxation Office's (ATO's) administration of the taxation law is the provision of interpretative advice on taxation issues to taxpayers. The provision of taxation advice is particularly important given Australia's self-assessment taxation system, which relies heavily upon taxpayers having a good understanding of the taxation law in order to fulfil their taxation obligations.¹
- 2.2 A key mechanism used by the ATO to disseminate the Commissioner of Taxation's (the Commissioner's) interpretative advice on the Australian taxation law is taxation rulings. Taxation rulings were first introduced by the ATO in 1982. The taxation rulings system was refined further in 1992 to allow the ATO to give certain parts of the advice it was already giving, in a legally binding form (ie public rulings and private rulings). Private

¹ ANAO, Audit Report No. 3, *The Australian Taxation Office's Administration of Taxation Rulings*, 2001–2002, Commonwealth of Australia, p. 13.

rulings became reviewable by the Administrative Appeals Tribunal or the courts.²

- 2.3 Since that time, the ATO has created a number of other categories of taxation rulings to aid the provision of interpretative taxation advice to taxpayers.³
- 2.4 In the calendar year 2000, the ATO issued 133 public rulings, 102 product rulings and 89 779 private rulings.⁴

The ANAO audit

- 2.5 In Audit Report No. 3, *The Australian Taxation Office's Administration of Taxation Rulings, 2001–2002*, the topic of rulings is of interest because of its significance to the effective functioning of the tax system. Taxpayers should be able to rely on applicable taxation rulings to assess their liability. For them to do so, it is imperative that taxation rulings are clear and unambiguous, comply with the taxation law, and are consistent with existing tax rulings.⁵
- 2.6 The objective of the audit was to report to Parliament on the operation of the ATO's administration of taxation rulings and, where appropriate, make recommendations for improvements having regard to efficiency and effectiveness, consistency and fairness for taxpayers, and good corporate governance.⁶

Audit findings

- 2.7 Inter alia, Audit Report No. 3, 2001–2002, *The Australian Taxation Office's Administration of Taxation Rulings* found that:
- without taxation rulings systems, taxpayers would face a less certain, and probably more costly, environment in meeting their tax obligations;
 - the ATO has invested a large amount of resources in a comprehensive public rulings system which includes control measures that promote the production of public rulings of high technical quality. However, there is scope to improve the

2 *Taxation Laws Amendment (Self-Assessment) Act 1992*

3 ANAO, Audit Report No. 3, 2001–2002, p. 13.

4 ANAO, Audit Report No. 3, 2001–2002, p. 14.

5 ANAO, Audit Report No. 3, 2001–2002, p. 45.

6 ANAO, Audit Report No. 3, 2001–2002, pp. 45–6.

collection, analysis and use of performance information relevant to public rulings;

- the mechanisms in place for public rulings substantially provide for consistent and fair treatment for taxpayers;
- the administrative processes for private rulings have operated poorly in many respects although the ATO has been improving its private rulings system and continues to do so;
- at the time of the audit, the lack of integration of systems and inadequate systems controls for private rulings undermined certainty, fairness and consistency of treatment for taxpayers;
- the overall management of the public and private rulings systems continues to be an area requiring careful ATO attention; and
- the ATO's corporate governance arrangements in respect of public and private rulings could be improved to achieve greater efficiency and effectiveness.⁷

2.8 The ATO agreed to all 12 audit report recommendations.

The JCPAA's Review

2.9 At the public hearing, the Joint Committee of Public Accounts and Audit took evidence on the following issues:

- timeliness of public rulings;
- clarity of the content of public rulings;
- consistency of private rulings;
- cost of private rulings; and
- improvements to tax rulings administration.

Timeliness of public rulings

2.10 Public rulings are the considered and decided position of the commissioner on the interpretation of the laws relating to income

7 ANAO, Audit Report No. 3, 2001–2002, p. 18.

tax, Fringe Benefits Tax (FBT) and the Goods and Services Tax (GST).⁸

- 2.11 Overall, the ANAO found that the ATO has a well-developed public rulings system. The system draws on the expertise of ATO staff with detailed knowledge of taxation law, industry and community group experts, academics and the general public. The ANAO stated that the ‘...system incorporates control mechanisms that allow the ATO to produce public rulings of high technical quality and the ATO can obtain feedback on the technical quality and clarity of rulings from stakeholders, for example through official ATO public rulings panels and the [National Tax Liaison Group] NTLG’.⁹
- 2.12 The ANAO noted in its audit that while some stakeholders were satisfied with, or complimentary about, the ATO’s topic selection and drafting processes associated with public rulings, some raised concern at the length of time it took the ATO to process and publish some public rulings.¹⁰
- 2.13 The Committee asked the ATO to comment on the timeliness of public rulings.¹¹
- 2.14 In responding, the ATO acknowledged its concern about the timeliness of public rulings and advised that it had been looking closely over the last 12 months at ways to improve the timeliness:

...usually our public rulings are dealing with very controversial and grey areas of the laws.... With some of the public rulings that we put out, we go through a very long consultation process.

Sometimes there are difficulties in actually establishing a better view of the law. ...we are seeking to put out a product that provides guidance to taxpayers, that provides a better view of the law that is consistent with the underlying policy of the law. Nevertheless, we acknowledge it, and we are taking action to improve the timeliness of our public rulings processes. We have consulted in particular with external members of our public rulings panels. A number of suggestions made by

8 ANAO, Audit Report No. 3, 2001–2002, p. 52.

9 ANAO, Audit Report No. 3, 2001–2002, p. 70.

10 ANAO, Audit Report No. 3, 2001–2002, p. 56.

11 *Transcript*, 31 May 2002, p. 4.

those members have been incorporated into our processes.¹²

- 2.15 The ATO made the point that in the last two to three years there had been an increased pressure on the public rulings process following the introduction of the GST and a number of other major tax reforms.¹³

Committee comments

- 2.16 The Committee acknowledges the complex taxation matters dealt with and the rigorous review and approval processes employed by the ATO in issuing its public rulings. The Committee notes that the ATO has agreed to articulate the approach it uses to prioritise public rulings and to document how it has applied that approach to determine the priority of topics identified for its public rulings program.

Clarity of the content of public rulings

- 2.17 The ANAO noted that an important source of feedback on public rulings were the courts and tribunals.¹⁴
- 2.18 The Committee drew the ATO's attention to the ANAO's finding that in 28 per cent of AAT decisions and 17 per cent of court judgments, public rulings had been commented on adversely. The Committee asked the ATO what it had done to reduce that figure.¹⁵
- 2.19 The ATO reiterated that public rulings were dealing with controversial issues and grey areas of the law, and that not everyone agreed with the ATO's final decision on issues:

The purpose of the ATO is to put out this advice to assist the community to comply with the tax law. We put out what we consider to be the better view of the law that is consistent with the underlying policy of the law that we are interpreting. Nevertheless, there are always going to

12 *Transcript*, 31 May 2002, p. 4.

13 *Transcript*, 31 May 2002, p. 4.

14 ANAO, Audit Report No. 3, 2001–2002, p. 88.

15 *Transcript*, 31 May 2002, p. 6; ANAO, Audit Report No. 3, 2001–2002, p. 8.

be cases where the courts disagree with our view of the law.¹⁶

- 2.20 The ATO pointed out that some of the adverse comments were not directed at whether the ATO's view of the law was correct or not, but criticised the way in which the ATO articulated what part of a taxation ruling was a public ruling for the purpose of the Taxation Administration Act.¹⁷
- 2.21 The Committee asked the ATO what procedure it employed when, as a result of developing a public ruling or adverse comment from the courts, it became clear that legislation required clarification.¹⁸
- 2.22 In response, the ATO outlined its procedure:
- Where there is a decision of the court which we consider, for example, is not consistent with the underlying policy and rejects our interpretation of the law, that is something that we do bring to the attention of the government to ascertain whether or not the government ...wishes to make any changes to the law in that respect.¹⁹
- 2.23 In response to questioning about the mechanism for informing Parliament of a lack of certainty or clarity in the tax law, the ATO acknowledged that it had no process to report to the Parliament.²⁰

Committee comments

- 2.24 While the views of the courts and tribunals are diverse, the Committee notes the ANAO finding that in court and tribunal comment on public rulings there appears to be a tendency for approving references to increase slightly and disapproving references to decrease slightly.²¹
- 2.25 The Committee encourages the ATO to continue to improve its processes to enhance the clarity and content of public rulings.
- 2.26 The Committee notes that while the ATO has no mechanism for informing Parliament of a lack of certainty or clarity in the tax

16 T Meredith, ATO, *Transcript*, 31 May 2002, p. 6.

17 Meredith, *Transcript*, 31 May 2002, pp. 6-7.

18 *Transcript*, 31 May 2002, p. 7.

19 Meredith, *Transcript*, 31 May 2002, p. 7.

20 P Foster, ATO, *Transcript*, 31 May 2002, p. 7.

21 ANAO, Audit Report No. 3, 2001–2002, p. 89.

law, it reports annually to Parliament and maintains a close relationship with the Parliament through discussions with parliamentary committees on legislation and other matters of concern.

Consistency of private rulings

- 2.27 Private rulings, or Private Binding Rulings (PBRs) were introduced in 1992. A PBR is the Commissioner's written opinion on the way in which the tax laws apply to an income tax or FBT arrangement a taxpayer has entered into, or proposes to enter into, after 1 July 1992. Unlike public rulings which can address a number of arrangements for a number of taxpayers in a single ruling, PBRs address specific arrangements that are proposed, or have been entered into or completed by a particular taxpayer. Accordingly, the matters covered by a PBR are specific to the rulee, tax law, year of income and arrangement dealt with in the ruling.²²
- 2.28 The audit found that the ATO's IT systems were a key weakness in the production and management of private rulings and the poor performance of these disparate systems has had a detrimental impact on the controls over the processes and the subsequent management of private rulings.²³
- 2.29 The audit report stated that without a comprehensive, up to date precedential database, it would be difficult for the ATO to ensure that decisions taken in older PBRs were consistent, where necessary, with those being considered in respect of newer PBRs. The report noted that PBRs could be issued from numerous exit points and, in the absence of compensating controls, having numerous exit points decreased the control the ATO had in relation to the issue of legitimate PBRs.²⁴
- 2.30 The Committee asked the ATO what changes to IT systems and other systems had been made to allow for greater consistency in issuing private rulings.²⁵

22 ANAO, Audit Report No. 3, 2001–2002, p. 98.

23 ANAO, Audit Report No. 3, 2001–2002, p. 22.

24 ANAO, Audit Report No. 3, 2001–2002, pp. 110, 111.

25 *Transcript*, 31 May 2002, p. 5.

- 2.31 In reply, the ATO advised the Committee that in an area of law where there was no PBR precedent in existence, it now required a PBR request to be forwarded to one of a number of identified centres of expertise. Formerly, this process had been followed only in relation to new business tax reform law:

[The centres] will be in full production and operational by the end of June. That is causing anything where there is not a precedent to come to a smaller group of experts. So that helps us a lot on consistency. Where there is a precedent, and that precedent can be identified by a unique identifier, our business line operatives must be able to sight that precedent before they can give advice.²⁶

- 2.32 The ATO stated that its aim was to build the database of precedents (called ATO interpretative decisions) both for the use of its staff and the guidance of the community. To the latter end, the database has been placed on the *ATOassist* website.²⁷
- 2.33 In response to further questioning, the ATO advised the Committee that it had placed approximately 1300 interpretive decisions on the database.²⁸

Committee comments

- 2.34 The Committee notes that as part of the Provision of Advice (PoA) project, it has made alterations to existing IT systems to allow a unique identifying number to be assigned to each PBR. The Committee also notes the ANAO's view that the sequential numbering of PBRs will go some way to improving the controls associated with issuing PBRs from numerous exit points.²⁹
- 2.35 The Committee agrees with the ANAO that the test for the ATO is whether the procedures it has implemented to control the production of high quality PBRs result in a more efficient and effective PBR system.

26 Foster, *Transcript*, 31 May 2002, p. 5.

27 M Bond, ATO, *Transcript*, 31 May 2002, p. 5.

28 Bond, *Transcript*, 31 May 2002, p. 6.

29 ANAO, Audit Report No. 3, 2001–2002, p. 112.

Cost of private rulings

- 2.36 During its audit, the ANAO sought to obtain performance information concerning the overall performance of the PBR production process. This information included the total cost of issuing PBRs. The ATO was unable to determine the total costs associated with providing PBR services:
- The principal cost in producing PBRs is the direct staff time spent drafting, reviewing and publishing PBRs. The ATO does not have a system to identify the number of ATO staff that have these PBR responsibilities.³⁰
- 2.37 The Committee asked the ATO whether it could provide information on the range of costs incurred in producing PBRs.³¹
- 2.38 The ATO replied that while it was not able to provide the information currently, it had accepted the ANAO's recommendation and part of its systems development, due to come on stream late in 2002, would enable it to capture the costs of a private ruling.³²
- 2.39 The ATO later advised the Committee that the second phase of system development would enable costing of public (including product) rulings.³³

Corporate governance

- 2.40 The audit report stated that good corporate governance would require a robust system of internal controls, including accurate and comprehensive sources of procedural guidance, vigorous checks on the quality of rulings made and effective training of staff to ensure that they have appropriate skills and experience. The audit found that the ATO's performance against these criteria was mixed.³⁴
- 2.41 The Committee asked the ATO what its response had been to the criticism in the audit report that sources of procedural guidance

30 ANAO, Audit Report No. 3, 2001–2002, pp. 114–15.

31 *Transcript*, 31 May 2002, p. 11.

32 Bond, *Transcript*, 31 May 2002, p. 11.

33 ATO, Submission No. 14, p. 2.

34 ANAO, Audit Report No. 3, 2001–2002, p. 169.

for public and private rulings were inadequate because of incomplete manuals and dispersed guidance.³⁵

- 2.42 In response, the ATO noted that its advice manual had been updated to include process improvements to date:

It has been linked to our relative practice statements, which are our instructions to staff, and to procedural materials. It is now available in electronic form. It is supported by an electronic alert facility, so that staff can be quickly advised of changes to practices and processes.³⁶

- 2.43 The ATO advised the Committee that it now had a process in place to continuously enhance the manual and maintain its currency.³⁷

Improvements to taxation rulings administration

- 2.44 The Committee sought information from the ATO about a number of initiatives it had in place, including the role of the Professional Excellence Forum and the resourcing and priorities of a new branch created within the ATO to facilitate the ATO's improvement program.³⁸

- 2.45 The ATO stated that as suggested by the ANAO, it was using the Professional Excellence Program to ensure that it remained focused on delivering outcomes. The forum members are senior tax officers, members of the business community (including the small business community) and private sector tax professionals:

...the Professional Excellence Forums have been in existence for some time. We are using [the forum] as the vehicle to make sure that we carry through the things that we have to improve as a result of the report.³⁹

- 2.46 In relation to its new branch, the ATO advised that it gave a stronger focus to the development and maintenance of the

35 *Transcript*, 31 May 2002, p. 16; ANAO, Audit Report No. 3, 2001–2002, p. 169.

36 Meredith, *Transcript*, 31 May 2002, p. 16.

37 Meredith, *Transcript*, 31 May 2002, p. 16.

38 *Transcript*, 31 May 2002, pp. 8, 9.

39 Foster, *Transcript*, 31 May 2002, pp. 3, 9.

infrastructure for technical decision making, especially the binding advice area:

... we basically have three arms in the branch. The first arm looks at work practice and process. We are trying to make sure that there are some core practices and processes in place so that we can have a corporate control over the production of rulings and other things.

The second stream looks at the technology side. ... we have basically done some work on our systems already. We have made them more integrated, as the ANAO wished, and we are taking further steps now to improve those systems once more. The third stream is a stream that has, in some ways, two roles. There is a resource of eight or nine who are purely involved in publishing private rulings....

The other important role which we are currently resourcing, now that we have got better systems and have the ATO interpretive decisions on a database and have the public register of private binding rulings,...[is] the ability to start trawling that information to see what trends...are showing up. We might use that to improve compliance practices...⁴⁰

2.47 The Committee sought assurance from the ATO on its ability to meet the challenge of putting the PoA initiative in place as comprehensively and expeditiously as intended.⁴¹

2.48 The ATO advised the Committee that it had great confidence that it could meet the challenge. It noted that a lot of the work had already been done: better systems were in place to capture information, stronger databases had been established, and professional accreditation had been put in place to ensure that people authorising rulings had the appropriate skills and qualifications:

We are going further with systems improvement. We are going further with [the] corporate approach to setting precedent...with centres of expertise et cetera...

...additional resources for new branches [has been sought and obtained]. We have got a very high priority

⁴⁰ Bond, *Transcript*, 31 May 2002, pp. 2, 9-10.

⁴¹ *Transcript*, 31 May 2002, p. 15; ANAO, Audit Report No. 3, 2001-2002, pp. 22-3.

in our IT system-build plans...and [we are] subjecting ourselves to a large degree of external reporting back through [the Professional Excellence Forum].⁴²

- 2.49 The ATO told the Committee that while there had been incremental improvements since 1992 when private rulings were introduced, the issue had never had the internal degree of importance and emphasis that it had now.

Committee comments

- 2.50 The Committee is pleased with the focus of the ATO on getting the rulings system working as it should and on the priority the issue appears to have within the ATO.
- 2.51 The Committee acknowledges the cooperative approach of the ATO and praises its willingness to move forward on issues brought to its attention. The Committee also notes the positive view of the ANAO in relation to the ATO's response to the audit process, the constructive approach it is taking in addressing some major issues and its implementation of both ANAO and Sherman report recommendations.⁴³

42 Bond, Foster, *Transcript*, 31 May 2002, p. 15.

43 The Sherman review was prompted by the intense public and parliamentary interest which followed the laying of charges against a former senior executive of the ATO involved in providing private rulings, and media criticism of aspects of the private rulings system. (Sherman T., *Report of an Internal Review of the Systems and Procedures relating to Private Binding Rulings and Advance Opinions in the Australian Tax Office*, August 2000)