

Chapter 10

TAXPAYERS ASSISTANCE

- . Oral Advice
- . Written Advice
- . TaxPack
- . Information Brochures
- . Written Agreements
- . Other Forms of Advice
- . Role of the Tax Agents and Advisers

10.1 The uncertain nature of taxpayer assistance has been stated in the following terms:

What fate lies ahead for those unfortunate taxpayers who, while swerving to miss the potholes on a narrow road through the hills, crash into the guardrail on a wet and dark night? The likelihood is that rather than have the yellow flashing lights of 'tax assist' greet them, they are more likely to be met by dark suited gentlemen alighting from an unmarked car, with pens poised and charge sheets opened.¹

10.2 The Taxpayer Assistance Group (TAG) of the Australian Taxation Office (ATO) was created in July 1990 to provide quality information, assistance and advice to taxpayers enable them to understand their rights and responsibilities under the law and provide the support necessary for them to discharge their obligations.² The TAG employs approximately 2 000 staff and utilises 10% of the ATO's salary budget.

10.3 The major workloads of the TAG derive from:

- . the handling of public enquiries;
- . the provision of written advice to taxpayers;

1. Martin Crowe, '*National Decisions*', 'More Signposts Needed on Rocky Tax Road', National Australia Bank Limited, November 1992, p. 19.
2. Evidence, vol. 4, p. S868.

taxpayer education; and

management of the problem resolution program.³

10.4 While the primary responsibility for providing advice to taxpayers falls upon the corporate shoulders of the TAG, the role of taxpayer assistance is a corporate objective and therefore the responsibility of all staff of the ATO.

10.5 Of the four primary workload areas listed above, the provision of written advice in the form of Rulings is discussed in Chapter 6, while the operations of the problem resolution units are considered in Chapter 13. The Committee noted the significance of both these forms of assistance to taxpayers and their role in the development and maintenance of a holistic approach to taxpayer compliance.

Oral Advice

10.6 In general, taxpayers seek oral advice from the ATO either through an inquiry over the telephone or by visiting an ATO branch office and seeking assistance at the front counter. Taxpayers may also receive oral advice from officers at shopfronts or in the course of ATO officers making public statements on or through media outlets. Evidence provided by the ATO in 1992 demonstrated the extent of enquiries made by taxpayers and the general workload of those staff responsible for answering taxpayer questions by telephone and at office counters.

3. Evidence, vol. 4, p. S869.

Table 10.1: Inquiry Statistics July 1991 - April 1992

Branch Office	Phone Enquiries	Counter Enquiries
Adelaide	276 868	112 919
Albury/Wodonga	58 907	27 856
Brisbane	272 618	51 424
Canberra	80 279	23 443
Chatswood	197 443	52 242
Dandenong	162 833	43 911
Hobart	81 509	35 905
Melbourne	110 912	178 726
Moonee Ponds	105 779	19 962
Newcastle	136 370	41 785
Parramatta	138 591	42 124
Penrith	102 463	41 092
Perth	263 705	81 517
Sydney	249 761	111 546
Sydney South	151 384	54 655
Townsville	123 147	63 344
Total	2 512 569	982 451

Sources: Evidence, vol. 4, p. S1006; vol. 16, p. S3258.

10.7 The figures in Table 10.1 clearly demonstrate the high volume of taxpayer contacts with the ATO. The figures show that, on average, the ATO (including the Child Support Agency) received around 30 phone calls a minute across Australia. In addition, counter staff responded to one enquirer every five seconds. Given these levels of work it is perhaps not surprising that delays can be experienced by taxpayers seeking to connect by phone with the ATO. Evidence from the ATO indicated that 71% of phone calls were answered within two minutes.⁴ These figures clearly do not account for those taxpayers who are unable to connect with an ATO switchboard in the first instance.

4. Evidence, vol. 16, p. 3258.

10.8 The types of enquiries staff must respond to can be classified under three broad headings:

- . legal (relating to civil actions by the Commissioner);
- . administrative (for example, lodgement dates, return forms); and
- . technical (interpretations of the law).

10.9 To enable the ATO to track the most frequently occurring enquiries, the ATO has been developing a system to record the nature of each enquiry.⁵ On the basis of current information monitoring, the ATO has been able to prepare systematic responses to those issues most affecting taxpayers. In evidence the ATO indicated such monitoring had provided the basis for the preparation of:

- . TaxPack information;
- . decision support systems for enquires staff;
- . a touch screen technology pilot;
- . voice messaging system for telephone enquires; and
- . public education activities.⁶

10.10 Where staff provide advice to taxpayers orally, the ATO reviews the quality of the advice through supervisors monitoring the conversations. In addition, staff may receive written examinations, undergo training and have their advice considered in the light of taxpayer feedback.⁷ All programs of review are conducted in accordance with a quality assurance program which was agreed between the ATO and the Public Sector Union (PSU) under clauses 9.1-9.4 of the Modernisation Agreement.⁸

5. Evidence, vol. 16, p. S3238.

6. Evidence, vol. 16, p. S3239.

7. Evidence, vol. 16, p. S3240.

8. Tax Office Modernisation Agreement, An Agreement between the Treasurer and the Commissioner of Taxation on the one hand and the Australian Public Sector and Broadcasting Union (PSU) on the other in respect of officers and employees of the ATO.

10.11 Although ATO policy encourages inquiry officers to identify themselves when dealing with taxpayers, the security concerns of staff may mean that the formal policy is not followed. This is particularly the case in respect of the inquiry officers of the Child Support Agency.⁹ Advising officers, in accordance with standard practice, provide their full name when answering telephone enquiries.

10.12 As previously noted, the ATO has been developing an enquiry monitoring system. The NIGEL modernisation project has been piloted and trialled.¹⁰ The object of this computer development is the establishment of a facility to statistically record both the number and type of inquiries received. The Committee noted that, with the development of such systems, the ATO should be able to provide taxpayers and callers to the Child Support Agency with a reference code for all oral inquiries. In this way the caller will at least be acknowledged and have a reference point for any future complaint regarding the advice that was provided.

10.13 The Committee considered the ATO's oral advising program in terms of:

- . access;
- . quality and accuracy;
- . consistency; and
- . status.

10.14 Criticisms contained in several submissions to the Committee centred on time delays and accessibility difficulties in obtaining ATO advice via the telephone. These criticisms included the difficulty of obtaining advice from a skilled and knowledgeable officer and the inordinate delay experienced in making contact with the relevant officer. The Committee was cognisant of the practical difficulties in responding orally to technical questions and the organisational challenge of ascertaining the nature of problems raised by taxpayers and channelling those inquiries to the most suitable officer. In the Committee's view, efficiency dictated that an enquiry be relayed to responsible officers capable of advising the taxpayer in the first instance. Re-direction of calls was inconvenient, inefficient and frustrating for taxpayers.

9. Evidence, vol. 16, p. S3242.

10. Evidence, vol. 16, p. S3238.

10.15 In the Committee's opinion, the development of specialist cells illustrated an organisational response to these difficulties which could be further utilised within the ATO. Through the identification of specialist technical officers in various locations, the ATO had developed an identifiable pool of officers capable of providing timely guidance and advice to taxpayers in respect of specific issues. Access was thus facilitated although the efficiency of the resource was reduced by the failure to dedicate these officers to working only within the cell. Moreover, taxpayer contact and access was somewhat limited. The quality, consistency and status of advice provided by the cells derived from their very existence as specialist bodies. Evidence from taxpayer representatives supported the continued development of the specialist cells concept.¹¹ The Committee considered greater taxpayer access would be beneficial.

10.16 Through a concentration on the organisational arrangements within the ATO, the Committee concluded that a better response facility for taxpayers' oral requests could be established. Given the large number of requests for information received by the ATO, the Committee acknowledged it was likely that access difficulties would continue. Nevertheless, the Committee considered these difficulties could be minimised by expeditious allocation of enquiries and facilities to allow calls, not immediately answered, to be acknowledged and responses provided within a definite time frame. Thus, the Committee considered that the ATO should develop organisation charts defining those officers responsible for specific enquiries. These charts should be made available to those telephone reception staff responsible for feeding calls to relevant officers and should be regularly updated. Calls which were not answered by the relevant officer, due to the officer being previously engaged, would be either placed in a queuing device or the caller's details recorded. Where a call was recorded, the taxpayer would be entitled to a response within 24 hours.

10.17 Development of client managers and the 'one stop shop' organisational arrangement was noted by the Committee. Both projects provided taxpayers with ATO facilities capable of handling a multitude of problems directly relevant to an individual taxpayer. The Committee welcomed such developments as appropriate responses to taxpayer needs but considered more general arrangements needed to be provided for the bulk of the taxpayer population. In particular, the Committee considered access to advice from the ATO should not require a significant cost to the taxpayer. The Committee has concluded that the ATO should establish 008 telephone lines for all taxpayer enquiries. The Committee notes that the ATO has used 008 lines on occasions in the past for the purposes of providing information 'hotlines' and considers the extended use of the numbers for all taxpayer enquiries would greatly reduce taxpayer complaints regarding delays. In this way, moreover, responsibility for achieving an economic advising system would be placed unambiguously on the ATO.

11. Evidence, vol. 3, p. S567; vol. 7, p. S1066; vol. 1, p. 222, vol. 2, p. 538, vol. 3, p. 651.

the Australian Taxation Office introduce, as a standard throughout their branch networks, 008 telephone numbers for taxpayer contact and information.

10.19 Quality and accuracy of advice, whether provided orally or in writing, will ultimately depend on the quality of staff providing the advice, the ability of the organisation to establish mechanisms for checking consistency and technical accuracy, and the quality of information available to officers for passing on to taxpayers.

10.20 The Committee noted the development of computer assisted decision making programs, in particular, the ATO's Client Help and Service program. This program was aimed at improving the enquiry service through the provision of tools for staff to deliver accurate, consistent and timely advice.¹² The Committee also observed the use of a decision support facility during its inspection of the Parramatta branch office in May 1992. When taken together with the development of a tax technical information database, the use of direct computer linked communications with tax agents and the development of voice messaging technology, the Committee considered the level of service to taxpayers should improve markedly in the short to medium term. Such an improvement was considered to be clearly necessary given research reported in the ATO's submission.¹³

10.21 While the Committee considered the ATO was taking steps to improve the basis of the advice provided to taxpayers by telephone, it was concerned that such advice was provided too often in a manner which failed to have regard to the consequences for taxpayers. The Committee recognised the risk for both the ATO and taxpayers in such an informal mechanism. The Committee was aware of instances in which advice provided orally by the ATO was later determined to be incorrect and not followed up by the ATO.¹⁴ Also, through the reinterpretation of Rulings the ATO had caused taxpayers financial suffering.¹⁵ While taxpayers may be able to rearrange their affairs, this will often be at a significant cost. Certainty of outcomes needs to be a guiding principle for all ATO advice.

12. Evidence, vol. 4, p. S778.

13. Evidence, vol. 4, p. S781.

14. Evidence, vol. 7, p. S1106.

15. Evidence, vol. 7, pp. S1098-105.

10.22 The Committee has concluded that taxpayers who receive oral advice from the ATO should be able to rely upon that advice if it is confirmed in writing. Moreover, taxpayers should have the right to have any advice sought confirmed in writing within a reasonable time period. The Committee notes that only legislative change could cause the ATO to be bound by its advice. While this course is not considered appropriate, the Committee believes the ATO should, as a matter of principle, agree to follow any advice it provides in writing to taxpayers.

10.23 The Committee therefore recommends that:

- . the Australian Taxation Office publicly commit itself to follow all advice provided in writing to taxpayers;
- . where taxpayers seek oral advice from the Australian Taxation Office, they be advised of their right to request confirmation of that advice in writing; and
- . where a taxpayer requests written confirmation of oral advice from the Australian Taxation Office, the taxpayer receive a written response no later than ten working days after the oral advice has been provided.

10.24 The Committee acknowledges that the ATO should be required to adhere to its advice only to the extent that the advice is predicated on information provided by the taxpayer. Furthermore, the ATO should require that advice on taxation implications of taxpayer arrangements be sought by way of a private Ruling in those cases where the taxpayer intends to rely upon that advice.

Written Advice

10.25 ATO advice on technical issues is generally provided by the Advising Branch of the TAG. This advice is generally in the form of Rulings although Advising staff are not the only staff in the ATO involved in the preparation of Rulings. The work of this branch is discussed more directly in Chapter 6.

10.26 Other than Rulings, the ATO seeks to provide written assistance to taxpayers through a number of formal and semi formal publications including:

- . TaxPack
- . information brochures; and
- . written advice.

10.27 As a general rule, the Committee considers the ATO should be bound by all written information provided to the general public or to a specific taxpayer. While the Committee recognises that information provided in a general format needs to be made subject to qualifications, it believes the ATO has a specific responsibility to provide accurate advice at all times.

10.28 The Committee recommends that:

- . the Australian Taxation Office adopt as a corporate standard the obligation to assess taxpayers in accordance with information contained in publications released by the Office; and
- . all publications released by the Australian Taxation Office contain a statement detailing the right of taxpayers to rely upon the information contained in the publications.

10.29 Publications which are specifically designed to apply for a given financial year need to limit the binding certification specifically to that particular year. The Committee recognises that requiring the ATO to be bound by its publications would necessitate regular reviews of the relevance of publications. Indeed, the Committee considers ATO publications should, as a general rule, be reviewed according to a regular program of scrutiny to ensure they are always relevant, accurate and appropriate to taxpayer needs.

TaxPack

10.30 Originally introduced for taxation returns relating to the 1989-90 taxation year, the TaxPack was designed to give ordinary taxpayers all the

information they needed to complete their tax returns.¹⁶ Evidence to the Committee supported the general concept of the TaxPack.¹⁷ However, it was suggested to the Committee that TaxPack had become intimidating to taxpayers because of its size and the number of questions now contained within it.¹⁸ The ATO indicated that part of the TaxPack's size had been due to the inclusion of advertisements and the amount of advertising has been reduced. In 1992 advertising worth just over \$1 million had been included in TaxPack. The total cost of preparation and publishing was around \$5 million, which was estimated to be less than the cost of individually distributing return forms.¹⁹

10.31 TaxPack was not intended to cover every taxpayer circumstance possible, but rather to provide a base for the preparation of returns by average wage and salary earners. The Committee has found the concept of a TaxPack to be valuable as an aid to the preparation of simple tax returns. However, as the 'average' taxpayer's circumstances have become more complex, the nature of TaxPack has altered similarly. The Committee has concluded that the concept of a TaxPack should be retained. However, the target market for the TaxPack needs to be reviewed and the level of information and detail contained in the pack revised accordingly. The Committee considers TaxPack should be used both as a source of information and guidance as well as a base resource document. That is, the TaxPack should indicate avenues of information for those taxpayers whose affairs are not simple, basic and uncomplicated. While TaxPack should continue to include the basic return forms, the information contained in the pack should be limited.

10.32 The Committee recommends that:

the Australian Taxation Office review the strategic use of TaxPack and develop the concept as a primary document, indicating available alternative sources of information in relation to specific industries, taxpayers and provisions of the *Income Tax Assessment Act 1936*.

16. Evidence, vol. 4, p. S778.

17. Evidence, vol. 1, p. 185; vol. 2, p. 577; vol. 4, p. 1028.

18. Evidence, vol. 3, p. 663.

19. Evidence, vol. 4, pp. 1407-8.

Information Brochures

10.33 In making the above recommendation the Committee noted the importance such a strategic development would have for the production of technical brochures. The Committee was impressed with developments in this area evidenced during the Committee's inspection of the Adelaide branch office in June 1992. Expansion of taxpayer specific brochures and guides was considered to be beneficial for taxpayer compliance. Moreover, cooperation by industries, employers, professional associations, unions and community organisations in the development of such guides was regarded as being both potentially efficient and capable of improving ATO - taxpayer relations. It was noted that a process for the certification of guides prepared by such bodies would be necessary. The Committee concluded the ATO should consider and evaluate such a system.

10.34 All information brochures are prepared with given target groups in mind.²⁰ Targeting both taxpayer segments and specific problems has enabled the ATO to specialise its information program. Such targeting was considered by the Committee to be efficient and an appropriate response. However, the Committee was cognisant of the difficulties of specialisation where taxpayers were not a generic group. It considered all ATO publications should specify avenues of access to more comprehensive advice and assistance. Such avenues should be more than mere references to general counter enquiries. The identification of relevant contact points including specialist cells and national office staff should be carried out as part of the ordinary development of information brochures.

Written Agreements

10.35 The ATO does provide advice to taxpayers and their agents which does not fall formally within the definition of a Ruling. Such advice may be given in respect of the entire spectrum of issues covered by the ATO. In the majority of cases, ATO advice of this nature would concern administrative arrangements although technical issues and policy questions may also be covered. Once again, the Committee was concerned at suggestions that advice or agreements provided to taxpayers in writing might not be followed by the ATO.²¹

10.36 The Committee acknowledged that the Commissioner, and the ATO generally, could not be estopped from collecting taxes according to law. The Committee also recognised that the Parliament had the ultimate power to amend the law so as to make ineffectual any prior agreement between the Commissioner and

20. Evidence, vol. 4, p. S780.

21. Evidence, vol. 13, p. S2500.

taxpayers. Nevertheless, the Committee was concerned that the Commissioner could hold out to taxpayers the perception of intending to be bound. In the Committee's opinion, all advice and agreements given or made by the Commissioner and the ATO should either be absolutely adhered to or made subject to a clear statement of the express limitations upon the Commissioner to contract or guarantee performance. In the event that the Commissioner determines it is necessary to not follow the agreements, understandings or commitments given to taxpayers, compensation for losses incurred as a result should be paid by the ATO.

Other Forms of Advice

10.37 In its submission, the ATO outlined a number of additional initiatives it had instigated to provide advice and assistance to taxpayers.²² The Committee noted that these initiatives had been developed principally as a result of a focus on taxpayer segments and the specific needs of those groups. For example, the establishment of key client managers provided a personalised, timely service to those specific taxpayers or their representatives, who represented major revenue earners for the ATO. Such a service has the capacity to break down revenue line demarcations and thereby personalise the response of the ATO to the taxpayer. Nevertheless, such a program would not be appropriate for every individual taxpayer as it would not be efficient nor practical.

10.38 The Committee was provided with evidence of the Tax Help program during its Adelaide inspection. This service is specifically aimed at getting help to taxpayers who, because of race, income, location, age or disability, may not otherwise be able to seek ATO assistance. A network of volunteers, trained by the ATO, assist these taxpayers through the provision of free advice in the preparation of tax returns. Generally the volunteers are of the same general taxpayer group as the taxpayer being assisted. Thus senior citizens assist other senior citizens and non-English speaking citizens are assisted by others with a capacity to communicate in the relevant language. The preparation of guidebooks and brochures in several languages is also a feature of this form of assistance.

10.39 A further example of the program's breadth, with which the Committee was particularly impressed, was the assistance provided to Aboriginal communities. Outreach assistance through visits by ATO officers to remote communities demonstrated a commitment to providing help to all citizens. Continued development and targeting of the program's service was supported by the Committee as a practical commitment to supporting taxpayers in satisfying their obligations. The Committee, however, cautions that such volunteer programs need

22. Evidence, vol. 4, pp. S773-82.

to be reviewed regularly. In particular, the Committee was concerned that taxpayers receive appropriate technical advice and assistance where necessary. The potential for exploitation should be guarded against at all times.

10.40 Material associated with a program for school student education on taxation matters was provided to the Committee. 'The Insiders' and 'The Return of the Insiders' school kits were provided to secondary schools in both 1989-90 and 1991. The Committee noted that options for long-term tax education were being appraised by the ATO.²³ In the Committee's opinion, tax education was a vital ingredient in the future commitment of Australians to the taxation system and a formal program of integrated units throughout secondary and tertiary studies would be advantageous. Such studies should concentrate on both technical and practical issues and involve assistance and practical involvement of ATO staff. The Committee supported the ATO's moves in this area.²⁴

10.41 Other assistance and advice programs noted by the Committee included:

- . the use of display and shopfront services in shopping centres;
- . the production of newsletters on tax technical issues;
- . seminars with industry and taxpayer organisations;
- . record keeping reviews; and
- . publicity campaigns and general promotions.

10.42 Public relations for the ATO cost approximately \$2.5 million in 1991-92 of which 66% was spent on newspaper advertisements.²⁵ The Committee noted the increased significance public relations had received under Commissioner Boucher and the increased profile the ATO had achieved as a result. The Committee considered the investment in public relations could be justified only if the normal levels of service provided to taxpayers were established at a consistently high standard. The Committee was concerned by evidence suggesting a haphazard approach to the management of taxpayer enquiries.²⁶

23. Evidence, vol. 4, p. S778.

24. Evidence, vol. 4, p. S775.

25. Evidence, vol. 9, p. S1545.

26. Evidence, vol. 3, pp. S384-6.

10.43 Supervision and monitoring of the technical quality of advice provided should, in the Committee's view, be formalised and linked to training. Examples of advice being provided by different branches which was contradictory concerned the Committee.²⁷ While opinions on technical issues may vary, the ATO has a duty to the taxpayer community to ensure a single consistent opinion is provided regardless of the office from which an opinion is sought. The Committee has concluded that the ATO needs to introduce a mechanism for resolving disputes between offices on questions of interpretation, thus providing the entire ATO with a definitive guide to the law.

10.44 The Committee recommends that:

the Australian Taxation Office introduce a formal mechanism for the determination of cases where contradictory advice has been received by a taxpayer from two or more branch offices. Such a procedure should incorporate a formal decision making process and a method for the dissemination of the final advice to all Australian Taxation Office branch offices.

10.45 The Committee notes that computer technology will continue to contribute towards a standardisation of advice provided to taxpayers. During its inspection of the Parramatta branch office, the ATO demonstrated the use of computer programs for determining a taxpayers's capital gains tax obligation. While such programs utilise principles of mathematical choice and will therefore presumably produce the same answer in identical circumstances, it is abundantly clear that taxpayer circumstances will rarely be identical. The quality of service provided by the ATO in the area of advising will therefore continue to be determined by the quality of staff. This factor has been acknowledged in the results of a survey conducted by the Australian Society of Certified Practising Accountants.²⁸

Role of the Tax Agents and Advisers

10.46 As noted in Chapter 4, self assessment and the increased public profile of taxation generally has apparently increased the number of taxpayers who currently utilise tax agents and advisers in the preparation of their returns.²⁹

27. Evidence, vol. 3, pp. S385, S474.

28. Evidence, vol. 8, p. S1394.

29. Evidence, vol. 2, p. 577.

While there are numerous possible reasons for this shift, including the convenience of utilising the Electronic Lodgement Service, the influence and importance of agents and advisers to the efficient operation of the system have never been greater.

10.47 The role of agents within the system is currently the subject of a joint review by the ATO and tax professionals. The terms of reference for this review were provided to the Committee in evidence.³⁰ Standards of behaviour by professionals in the taxation industry will be critical to the on-going commitment of taxpayers. As such, the Committee considered agents and advisers represented a defined group capable of significantly influencing behaviour. Advice and assistance to this group cannot therefore be underestimated and should be provided at a level commensurate with its significance.

10.48 The Committee noted the priority the ATO had attached to supervising tax agent lodged returns. In particular, the Committee noted the development of the capacity to audit agents through examination of the level of deductions claimed by them relative to statistical standards. Tax agents and advisers who lodge returns are consequently supervised implicitly by the ATO.

10.49 In submissions to the Committee, agents and advisers pressed for greater assistance from the ATO, particularly in respect of access to information and the ATO's databases.³¹ Such access would facilitate administrative efficiency and reduce the cost to agents of business. Access to computer databases could be made available on a fee basis for the line time utilised. As a general rule the Committee considered the ATO should not charge for information. However in the case of access to computer systems, the marginal cost of capacity utilised in on-line access should be chargeable.

10.50 Resources allocated to servicing the tax agents network included the staff of tax agent resource centres. Within these centres, staff service a given list of tax agents and provide a focus for enquiries and a first contact point. Agents were enthusiastic about the concept but suggested resources were too thinly allocated and delays in making contact and receiving assistance were too long. In recognition of these claims the Committee considers the ATO should review periodically the resources devoted to tax agent assistance. The Committee noted that the terms of reference of the National Review of Standards for the Tax Profession included a review of the service needs of professionals and the services provided to professionals by the ATO.³² While the ATO indicated an intention to bring under

30. Evidence, vol. 15, p. S3020.

31. Evidence, vol. 3, p. S483; vol. 6, p. S890; vol. 8, p. S1396; vol. 2, p. 564.

32. Evidence, vol. 15, p. S3020.

a single management umbrella all aspects of tax agent service, the Committee considered there was also a need to increase the level and amount of resources allocated to tax professional assistance.

10.51 The Committee has concluded that the service provided by the ATO to small agents, and particularly those in country areas, needs to be evaluated to determine whether an equal standard of service is being provided across Australia. Expansion of the liaison role of the ATO for tax agents and professionals should, in the Committee's opinion, provide the optimum platform for the provision of a high quality, consistent and professional assistance program.

10.52 The Committee therefore recommends that:

the Australian Taxation Office review the quality and quantity of resources devoted to providing direct assistance to tax professionals.

Chapter 11

AUDITING

- . Introduction
- . The Taxpayer Audit Group
- . The Principles of Taxation Audit
- . Risk Management and Case Selection
- . Information for Case Selection
- . Types of Audit
- . Current Year Audits
- . The Role of the Auditor
- . Investigation and Information Collection
- . Analysis and Interpretation
- . Assessment
- . Audit Settlement
- . The Costs and Benefits of Auditing
- . Audit Resources
- . Length of Audits
- . Auditing of Restricted Access Status Taxpayers

11.1 The function of revenue collection has rarely endeared any public officer to the general public. This has been particularly so in the case of taxation auditors. Nevertheless, in the view of at least one auditor who appeared before the Committee all was not lost. In the auditor's own words:

I would hope that you would like me if I arrived on your doorstep ... I think you would find that I am quite a kindly auditor.¹

Introduction

11.2 The process of auditing, by definition, involves an official, systematic examination of records and documentary evidence for the purposes of determining whether a reported conclusion is in fact correct. Taxation auditing involves the examination of a taxpayer's documentary records and associated evidence for the purpose of ascertaining whether tax assessed is correct according to law.

1. Evidence, vol. 3, p. 859.

11.3 In determining the level of compliance of a taxpayer, the auditor may seek information from any source, including persons not directly associated with the taxpayer under investigation. To enable information to be collected, the *Income Tax Assessment Act 1936* provides significant powers for auditors to access premises, books, documents and other papers and to require information to be provided.²

11.4 A significant proportion of the evidence gathered during the Committee's Inquiry concerned the role, functions and performance of the auditors of the Australian Taxation Office (ATO). As the primary enforcement arm of the ATO, the public's perception of the organisation is crucially moulded by the actions of the officers employed in the Taxpayer Audit Group (TAG). Moreover, the efficiency of a self assessment system in collecting the proper amount of revenue is critically dependent on the ability of auditors to detect non-compliance with the law (which can involve under and over payments). Auditing is fundamental to self assessment.³

The Taxpayer Audit Group

11.5 In its submission to the Inquiry the ATO indicated that the objectives of the Taxpayer Audit Group were:

- . to progressively build relative and absolute measures of taxpayer behaviour by taxpayer group;
- . identify the causes of non-compliance detected, and with other Groups, identify strategies to improve compliance; and
- . where appropriate, take part in the implementation and carrying out of those strategies.⁴

11.6 Significantly, its objectives do not expressly include the raising of revenue or even the protection of the revenue from tax strategies. Nevertheless, from the weight of evidence received, the Committee concluded it was these latter two factors which taxpayers perceived formed the critical objectives of this Group.

2. *Income Tax Assessment Act 1936*, ss. 263, 264.

3. Evidence, vol. 4, p. S981.

4. Evidence, vol. 4, p. S870.

11.7 The Taxpayer Audit Group employs approximately 4000 staff. This represents around 20% of the ATO's staff resources.⁵ The Group is structured along market segmentation lines. Market segments have been identified by the ATO to provide better supervision of taxpayers and appropriate responses to problems.

11.8 Within each market segment the ATO allocates audit resources on the basis of greatest risk to the revenue.⁶ Resources are also allocated to lower level risk areas to act as a deterrent to non-compliance.⁷ Interestingly, the basis of the allocation of resources within the Group is quite specific and, as such, indicates the principal role of the Audit Group - the protection of the revenue. Such a role does not approximate to the more community focused objective of ensuring 'compliance' with the law. As the self assessment system relies upon the taxpayer to make an initial assessment, there is an inherent risk that errors may occur, whether deliberate or otherwise, in the assessment of their liability.

11.9 Auditing provides the ATO with the capacity to ascertain whether the judgements made by taxpayers were appropriate and supportable by law. Those judgements may have the effect of either reducing or increasing the revenue of the Commonwealth relative to that which should have been collected according to law.

11.10 In 1986-87 an organisational review of the ATO's audit program resulted in three major initiatives:

- audit was organised around distinct market segments, each with different resources, structures and management approaches, based on the clients in the market. Three defined streams of audit work were identified: larger companies, complex structures, businesses - cash economy and high volume checks;

- overhead and support activities in branch offices and national office were questioned with the aim of re-allocating the most senior, skilled staff to case work; and
- efforts were made to raise auditor productivity through better case selection and refocussing of each activity.⁸

5. Evidence, vol. 4, p. S934.

6. Commissioner of Taxation, *Annual Report 1991-92*, Canberra, AGPS 1992, p. 192.

7. *ibid.*

8. Evidence, vol. 4, p. S783.

11.11 The audit programs currently established by the ATO are:

- . Primary Audit;
- . Business Audit;
- . Special Audit;
- . Source Deduction Audits; and
- . Complex Audit.

11.12 Each program concentrates on taxpayers with certain generic qualities. For example the complex audit program covers the larger and more complex corporate taxpayers, industries and issues. Primary audit covers individuals who are employees, Prescribed Payments System (PPS) taxpayers, Pay-As-You-Earn (PAYE) taxpayers, pensioners and investors.⁹

11.13 In addition to the five programs identified above, the ATO's Audit Group is also responsible for the administration of the ATO's Audit Prosecution Program which concentrates on the prosecution of taxation offences which are:

- . particularly serious, blatant or involve persistent offenders;
- . representative of significant or prevalent non-compliance practices; or
- . offences that cannot be sanctioned effectively, for which no other means of ensuring compliance exists or which, if prosecuted, may carry effects wider than those in the particular case.¹⁰

11.14 The use of prosecutions for enforcement purposes is discussed in Chapter 12. While the Committee did not evaluate each audit program individually, it considered a number of issues common to all programs. Comment on the operation of the Special Audit program is also provided separately as the Committee considered the character and focus of this program was significantly different to that of general audit.

9. Commissioner of Taxation, *Annual Report 1991-92*, op. cit., p. 192.

10. *ibid.*, p. 193.

The Principles of Taxation Audit

11.15 The ATO commenced basic programs of taxpayer audit during the 1970s. In the Commissioner's Annual Report of 1975-76 it was reported that:

A new technique known as the taxpayer audit is being developed, following the lines of similar operations conducted in the United States and Canada, under which taxation officers visit the business premises of taxpayers, or call them to the Taxation Office, for on-the-spot reviews of their recent income tax returns. The audit techniques are less exhaustive than the traditional investigation, and correspondingly less certain of revealing all irregularities, but because they can be conducted in very large numbers, a much better coverage of taxpayers is obtained. Experiments have been conducted in most States and it has been found that the officers engaged on this work, although usually less experienced than the typical investigation officer, are able to produce a comparable output measured in terms of avoided tax recovered and penalties imposed.¹¹

11.16 The ATO identified the possibility that reducing assessment time and allocating resources to audit work led to an increase in revenue collections. Some \$50 million per year in extra tax and penalties, otherwise avoided, was identified as being collectable as a consequence of using audit techniques.¹² The 'new system' of audit was introduced on a general scale during 1976-77 and over 300 staff were redeployed in 1977-78 to carry out taxpayer audits.¹³

11.17 With the advent of self assessment the role of audit took on a new perspective. During the first two years of the phasing in of self assessment, 864 staff were redeployed to audit work. In comparison, 96 staff were redeployed to enquiry assistance.¹⁴ Clearly, self assessment drew into perspective the importance of an audit program. The purpose of such a program was to increase the level of voluntary compliance with the taxation laws both through the detection of non-compliance and the establishment of a visible deterrent for taxpayers who might contemplate

11. Commissioner of Taxation, *Annual Report 1975-76*, The Government Printer of Australia, Canberra, 1976, p. 6.

12. *ibid.*, p. 6.

13. Commissioner of Taxation, *57th Annual Report 1977-78*, Commonwealth Government Printer, Canberra, 1978, p. 7.

14. Commissioner of Taxation, *Annual Report 1986-87*, AGPS, Canberra, 1987, p. 3.

evasion.¹⁵ Voluntary compliance would be enhanced through the perception of detection in cases of non-compliance. Taxation auditing therefore provided both direct and indirect incentives to taxpayers, together with increased revenue returns to the Government.

11.18 In its most basic form, auditing is a contradiction of one of self assessment's primary tenets - trust. The concept of trust is ingrained through the ATO's corporate planning strategy, which states:

Trust: We trust our staff and clients to do the right thing - unless appropriate risk management shows that trust to be ill-founded.¹⁶

11.19 Through the use of statistical analysis, information collection and evaluation, as well as intelligence databases, the ATO had developed taxpayer classifications which categorise taxpayers according to their general characteristics and potential for taxation non-compliance. Risk management requires that the ATO concentrate its enforcement efforts in those areas where non-compliance is most apparent and potential revenue loss is greatest. These two criteria are not mutually exclusive. Consequently, those taxpayers who contribute the most taxation revenues may be the most compliant.

11.20 Again, the focus of taxation audit must therefore be established as being either revenue oriented or compliance driven. The Committee concluded that taxation audit, as a critical element of a self assessment system, was a revenue driven program. The Committee noted both the ATO's denial of this conclusion and taxpayer's perception of its validity.¹⁷

11.21 In principle, taxation auditing should seek to determine whether the current amount of tax payable according to law has been paid by a taxpayer. Comments made to the Committee by ATO officers focused on this statement of principle.¹⁸ Such a principle requires that auditing include circumstances in which too much tax is paid. While the Committee considered the principles of taxation

15. *ibid.*, p. 2

16. Australian Taxation Office, *Corporate Plan 1992-95*, p. 3.

17. Evidence, vol. 1, pp. 274, 279; vol. 2, pp. 345, 429, 542, 554, 589.

18. Evidence, vol. 2, pp. 344-5; Australian Taxation Office, *Mission Statement - Australian Taxation Office Corporate Plan 1991-94*, AGPS, Canberra, 1991, p. 2.

auditing should incorporate all possible circumstances of non-compliance, it recognised that case selection procedures, which focused on revenue implications, would necessarily create a bias towards the auditing of taxpayers who, for many possible reasons, had underpaid their taxation liability.

Risk Management and Case Selection

11.22 On the basis that taxpayers have an obligation to comply voluntarily with the law and self assessment provides the opportunity for taxpayers to demonstrate voluntary compliance, the ATO utilises a system of risk management to ascertain areas of potential non-compliance, particularly revenue loss. The use of risk management is a response to two factors:

- . limited resources; and
- . the need to protect revenue.

11.23 As noted elsewhere in this report, the ATO has developed a systematic approach to categorising taxpayers through the identification and classification of broad market segments. By isolating taxpayers in this way, behaviour can be observed and modelled. Responses are therefore possible which will have the greatest impact on the largest number. Risk management processes seek to limit the extent of potential revenue losses by identifying the most appropriate response to a given behaviour.

11.24 Consequently, for the large number of PAYE taxpayers, where risk of non-compliance may be great but the total revenue at risk per taxpayer is small, the ATO utilises systems to monitor both income matching and profiles of work related expenses for taxpayer groups (public servants, accountants, clerical workers, shop assistants for example). These techniques have enabled the ATO to identify compliance levels for this segment in the high 90% range.¹⁹ Intrusive auditing involving face to face desk audits or other alternatives are only necessary for taxpayers whose returns demonstrate a circumstance which might be considered unusual.

11.25 Through the use of a combination of systems and selected audits, the number of cases which produce additional revenue is high. Evidence provided by the ATO indicated that 60.7% of 1 862 cases of general desk audit, conducted during

19. Evidence, vol. 4, p. 1259.

1991-92, produced increased revenue. Of the 45 556 income matching checks, 63.8% had understated income and, of the 14 822 checks for substantiation, 56.9% of cases were found to have been incorrect and additional revenue was generated.²⁰

11.26 The number of cases selected for audit examination in this taxpayer segment must be compared to the total number of taxpayers within this group. Table 11.1 illustrates the relative size and significance of the various taxpayer segments.

Table 11.1 - Market Segmentation

Market Segment	Numbers	Percentage	Revenue Collection
Large Business	1 600	.015	\$43.8 bn (including PAYE)
Medium Business	45 000	.437	\$8.35 bn
Small Business	1 030 000	9.930	\$6.07 bn (excluding PAYE)
Individuals	9 300 000	89.625	
Total	10 376 600	100.00	

Source: Evidence p. S781

11.27 In respect of market segments other than individuals, the ATO has identified areas of risk to which audit strategies are then developed. In the large/medium business segment six areas of risk have been identified:

- . tax planning;
- . foreign controlled corporations;
- . corporate groups;
- . key individuals;

20. Evidence, vol. 3, p. 977.

- . superannuation funds; and
- . other corporations and trusts.²¹

11.28 While the large/medium business segment has always attracted audit attention due to the amount of revenue involved, the use of a targeted audit strategy was made unnecessary in 1988 when the ATO moved to target the top 100 corporations in the Large Case Audit Program (LCP). The Committee noted that the conduct of full comprehensive audits for these large corporates has been expanded to the top 600 companies. The nature of the blanket audits has also been amended and focused more strategically.²² This program is further discussed later in this chapter.

11.29 Small business has been identified by the ATO as having some of the least compliant taxpayers. With over a million taxpaying entities in this segment the ATO cannot possibly audit every taxpayer. Consequently, the ATO has developed a number of criteria for evaluating compliance amongst small business. These include:

- . industry type and nature;
- . revenue significance;
- . taxpayer type;
- . geographic location;
- . cash/non-cash business; and
- . tax agent/no tax agent.²³

11.30 Through the use of research and historical data the ATO has established industry profiles. Indeed, by using the standard industrial trade classification, the ATO has begun developing extensive profiles for 370 occupations and industry groups. The groups are ranked according to their perceived risk to the revenue, and behavioural thresholds have been established which act as a first indicator to the ATO of possible non-compliance.

21. Boucher T, *Risk Management in a Market Segmented Basis*, address given to an Australian Institute of Criminology conference, Sydney, March 1992, p. 7.
 22. Evidence, vol. 4, p. 1197.
 23. Boucher T, op. cit., p. 10

11.31 A consequence of this cyclical, iterative process of data collection, evaluation, assessment and action has been the development of a particular culture amongst auditors. The root of this culture was expressed by a Second Commissioner in the following terms:

... by the time we go out and talk to a taxpayer, we have gone through a fairly substantial process of sorting out to ensure that the taxpayers we talk to are ones where there is some reason to want to talk to them. It is not a random audit in that sense.²⁴

11.32 Processes of selection which target possible areas of non-compliance on the basis of revenue risk, thus create 'cases' for auditors in which the auditor assumes a revenue return must follow. This conclusion was expressed by one of the ATO's auditors in this way:

By the time a case gets to an auditor it has been vetted and vetted. And if the auditor does not find something then that is rare because otherwise it would say our case selection techniques are wanting ... But once an auditor gets a case, after it has been through the case selection work, almost by definition it should produce a result.²⁵

11.33 The Committee was concerned that the case selection procedures were contributing to the development of a belief amongst auditors that cases chosen by case selection staff should automatically return revenue to the Commonwealth. Such a belief confirmed in the Committee's view the revenue driven goal of taxation auditing. The ATO in response to a question from the Committee in relation to the basis of case selection stated:

In developing the overall audit strategy the aim is to provide a balanced audit program across the particular taxpayer population according to the assessed risk to the revenue.²⁶

11.34 While selection of cases for audit is conducted by parties external to the auditors, it is apparent to the Committee that insufficient explanation of why a case might be chosen for audit has been provided to the auditors. The Committee

24. Evidence, vol. 1, p. 26.

25. Evidence, vol. 2, p. 370.

26. Evidence, vol. 16, p. S3295.

considers such explanations should detail the perceived areas of non-compliance and should not simply focus on potential revenue.

11.35 The Committee recommends that:

auditors in the Australian Taxation Office be briefed on the reasons for a case being selected for audit, the briefings to stress the need to improve voluntary compliance.

11.36 The Committee noted the use of financial and statistical information in case selection. The ATO's 'Score' system generates standard industry ratios which are used for detecting cases of variance which may warrant closer audit investigation.²⁷ Criticism of the limited value of this system was also noted.²⁸ The Committee considered the Score system provided a valuable, primary case selection methodology. However as it was based on financial report analysis, the Committee was of the opinion that auditors needed to be skilled in such techniques to be able to appreciate the results the system generated. In particular, the Committee considered auditors needed to be aware of what particular report information indicated about the general corporate ethos of particular taxpayers. For example, it was felt that taxpayers who reported current tax payable as a percentage of reported profit in excess of the corporate tax rate should generally be audited only for specific reasons. Broad comprehensive audits in such cases would be regarded as exceptional. Training in the techniques of financial report analysis was considered critical.

11.37 The Committee also believes it is important that auditors be trained in accounting requirements and standards, modern financial auditing techniques and methodologies, and corporate financial record keeping systems including the use of computerised systems. The Committee is of the view that these skills are necessary in the modern day commercial business environment and notes that the ATO may need to look beyond its own staff and resources to provide this additional training.

11.38 Therefore the Committee recommends that:

all audit staff in the Australian Taxation Office undergo extensive training in financial reporting analysis;

27. Evidence, vol. 4, pp. 1103, 1131.

28. Evidence, vol. 3, p. 748.

- . all audit staff in the Australian Taxation Office be trained in accounting requirements, standard financial auditing techniques, methodologies and systems; and
- . the Australian Taxation Office ensure external input is sought in the provision of financial and accounting training for its auditors, such training to have a commercial rather than academic orientation.

11.39 The Committee was also cognisant of the use of non-financial data by the ATO. Some of the non-financial data available to the ATO includes:

- . internal and external qualitative research that identifies trends and behaviour in business that may pose a potential risk to the revenue, including information collected from on-going audits;
- . issues that have been the subject of Rulings, Determinations and legislation;
- . findings of external tribunals and commissions;
- . intelligence on the latest tax planning techniques or products;
- . anonymous information; and
- . information referred from other law enforcement agencies and foreign authorities.²⁹

11.40 The Committee considered the use of non-financial data to be particularly important in the area of special audit. While non-financial data were critical to the development of a balanced audit case selection program, the Committee concluded that the ATO must ensure that non-financial data was corroborated prior to instituting audit work solely on the basis of such information. This was particularly true for information provided anonymously.

Information for Case Selection

11.41 The Committee noted concerns regarding the amount of information currently provided in taxation returns, particularly the returns of those taxpayers operating under a full self assessment system. These concerns focused on the level

29. Evidence, vol. 16, p. S3298.

of disclosed information and the capacity of the ATO to make judgements regarding audit on the basis of the returns. The Committee noted that the ATO considered extensive information unnecessary for making audit case selection decisions as information could be drawn from sources other than the taxpayer and the returns themselves were very useful.³⁰ The Committee also considered the proposition that taxpayers be allowed, indeed encouraged, to lodge with the ATO supplementary information concerning large or unusual aspects of their returns. The Institute of Chartered Accountants suggested:

... in order for the Tax Office not to be seen to be auditing people who have a good compliance record, there simply be an opportunity for people to explain the fact that, for example, there might be a rather large deduction claim this year and just attach a piece of paper for the benefit of the auditors only.³¹

11.42 The Committee considers that such an administrative arrangement would not be overly burdensome and could be catered for by a minor amendment to return forms. Such an analysis is a key point of an external audit review. Clearly, such explanations would benefit the ATO by providing case selectors and auditors with explanations for variations which might otherwise warrant audit consideration. Taxpayers would be able to pre-empt audit enquiries and thus reduce compliance costs. The Committee has concluded that the introduction of such a system would be both beneficial and cost effective.

11.43 **The Committee recommends that:**

the Australian Taxation Office amend its tax return forms to enable taxpayers to indicate why significant variations in their affairs generally or in a particular area had occurred in an income year.

11.44 An amendment to the return forms would need to include both a simple 'yes-no' response to a question concerning significant variations and the provision for attaching explanations to the return form. In the case of returns lodged via the Electronic Lodgement Service, the written explanations could be kept with the forms whether at the agent's premises or lodged with the ATO to be accessed at the audit case selection stage.

30. Evidence, vol. 5, p. 1536.

31. Evidence, vol. 3, p. 656.

11.45 The Committee noted that 'backup' detail, in the form of annual reports and other financial reports, were often requested of taxpayers.³² When a case might be chosen from the 'Score' system, such information was critical to the ultimate decision to pursue an audit.

11.46 In the Committee's opinion, the ATO decision not to require the submission of financial reports was based on administrative efficiency and not good management practice and in reality represented a false economy. As such reports are maintained by taxpayers and are essential to the decision to audit or not, the Committee considers there was efficiency for both the ATO and taxpayers in requiring the reports be submitted with their returns. The Committee has concluded that, with the expansion of the LCP to the top 600 corporate taxpayers, the continuing focus on business record keeping and the need to provide greater certainty and less administration in the taxation system, the financial reports of corporate taxpayers should be included with returns.

11.47 **Therefore the Committee recommends that:**

corporate taxpayers attach to their annual taxation returns basic financial report information including, where appropriate, full, audited financial statements.

11.48 In making this recommendation the Committee again emphasises the need to provide all audit staff with extensive training in financial report analysis. In the absence of such training for auditors, the Committee was concerned that ignorance rather than knowledge may be the basis of judgements concerning taxpayers and the prima facie level of compliance. Also, the efficiencies from requiring the provision of financial reports would be lost through unnecessary examination of compliant taxpayers.

11.49 The Committee was further concerned by propositions put to it regarding the difficulties of accessing certain forms of information.³³ Information must be accessible and presented in a manner capable of evaluation if it is to be of value in auditing and case selection. The Committee was concerned at suggestions that certain forms of information and intelligence may not have been utilised by the ATO in audit case selection, either as a result of the information not having been readily accessible or because the cost of collection and evaluation was too great. The

32. Evidence, vol. 4, p. 1102.

33. Evidence, vol. 3, p. 734.

Committee was concerned that, having acquired a comprehensive computer resource of information, the ATO should not disregard sources of other intelligence which were not economically capable of translation on to computer databases in their current form. The best use of the information should be identified.

11.50 In addition, the Committee was concerned at the suggestion that systematic checks were not replacing manual reviews of certain forms of taxation returns, in particular trust returns.³⁴ While the Committee recognises that resources have been reallocated as a result of self assessment, it does not believe resources should have been removed from areas of revenue checking in the absence of an alternative form of review. Where new systems provide a more efficient tracking mechanism, the reallocation of human resources is appropriate. However, if information is either not gathered or not verified by a systematic review, the possibility of revenue losses is increased.

11.51 Therefore the Committee recommends that:

- . the Australian Taxation Office review its information sources to determine whether the taxation return provides the most efficient means of gathering information; and
- . the Australian Taxation Office review its methods for checking trust returns to ensure that the information disclosed in trust returns is checked against all beneficiary returns.

Conclusion

11.52 In the Committee's opinion the audit function as currently administer is primarily revenue driven. Targeting of audits through the use of risk management principles represents, in the Committee's view, an appropriate response to the economic realities of a self assessment system. Nevertheless, the Committee recognises the inherent dangers in relying too heavily on computer generated case selection and the need for the ATO to ensure those taxpayers and revenue lines not directly covered by computer strategies are manually checked for compliance.

11.53 Moreover, the Committee considers the ATO should continue to rationalise audit resources through the targeting of audit cases. Taxpayers who

34. Evidence, vol. 3, p. 736.

demonstrate commitment to the taxation system should expect recognition by the ATO in the form of only limited and non intrusive audit review. Taxation auditors need to be supported in their work through training and development of business and financial reporting skills. In the Committee's view, such training could increase the efficiency of case selection and targeting of audit reviews.

Types of Audit

11.54 As previously mentioned, the selection of a taxpayer for audit based on case selection criteria will generally be based on a risk assessment of the taxpayer's behaviour. Deficient behaviour may be caused by a number of factors and consequently the structure of the audit response needs to be developed, to take accounts of these factors.

11.55 Through the creation of computer supported checking systems, the majority of individual taxpayers are audited against known standards. The Income Matching System, while still being developed, has the capacity to produce reports on undeclared income faster than by manual checking. Nevertheless, such audit supervision can only be as reliable as the information available in the system.

11.56 In general, individual taxpayers are audited through a number of systems which check income declared and analyse the amount of deductions claimed. Information on the systems used for auditing individual returns was included in the ATO's submission.³⁵

11.57 Business taxpayers, other than those classified as falling within the large/medium taxpayer categories, represent one of the most diverse taxpayer groups imaginable. Over one million taxpaying entities fall within this segment and the development of industry groupings, as previously discussed, has allowed the ATO to recognise systematically areas of compliance difficulties. In achieving a picture of behaviour the ATO has relied on an auditing program known as 'Project Based Audit' (PBA). As described by the ATO:

The PBA approach is a research tool designed to gather data in the field to ensure that our future activities are most productive in terms of improving compliance at the broadest possible level.³⁶

35. Evidence, vol. 4, pp. S789-93.

36. Evidence, vol. 4, p. S788.

11.58 In essence the PBA establishes profiles of industry behaviour and thus enables cases which show significant deviations from the normal to be identified.³⁷ At the time of the ATO's submission to the Inquiry, 78 PBAs had been completed and another 68 were in progress. As auditing all taxpayers in this segment would not be practical, the ATO relies on the industry to circulate information in respect of the results of PBAs. The use of media releases is also significant.

11.59 Record keeping audits and reviews have been identified by the ATO as critical future strategies for this taxpayer segment.³⁸ While these audits have been promoted as encouraging small businesses to adopt better business practices, the Committee noted the potential revenue gains forecast to follow from such audits. The size of the anticipated revenue gain indicated to the Committee a fundamental problem of compliance in this segment. The Committee considered the purpose and objective for the expansion of record keeping audits needed to be clearly enunciated to business. Comments on this program are included in Chapter 8.

11.60 As mentioned earlier in this chapter, auditing of the large business segment of taxpayers was officially expanded in 1988 when the Government provided funding to the ATO for three years to conduct the LCP. At the end of the three years of funding, a review of the LCP was conducted by the consulting firm, Pappas, Carter, Evans and Koop (Pappas, Carter).

11.61 The conclusions of the Pappas, Carter Report, in so far as revenue collection was concerned, provided sufficient justification for the Government to announce in September 1992 that the audit program would be extended to the next top 500 corporate taxpayers.³⁹

11.62 Of the 25 cases finished when the Pappas, Carter Report was presented, an average of \$19 million in additional tax had been assessed. In addition,

37. Evidence, vol. 4, p. S788.

38. Australian Taxation Office, *Income Tax Compliance/Enforcement Strategy*, Canberra, September 1992, pp. 10-12.

39. Australian Taxation Office, op. cit., p. 5.

an average \$1 million in penalties and \$9 million in notional tax due to losses disallowed had been determined. The Pappas, Carter Report stated:

In total, the program has to this point made adjustments of tax and penalty of more than \$1,160m and collected more than \$480m. The incidence of pure timing adjustments has not been high.⁴⁰

11.63 By September 1992, the Taxation Office was able to report tax collections from the LCP between March 1988 and June 1992 of the following degree:

- tax assessed: \$1 429.9 million
- penalty tax levied: \$298.3 million
- notional adjustments effected: \$1 059.8 million⁴¹

11.64 These figures related to 44 cases completed out of 102 taxpayers within the LCP.⁴² It is clear from these figures that the LCP had contributed to significant revenue returns to the Commonwealth. Indeed, as noted in the Pappas, Carter Report, the LCP well exceeded revenue goals.⁴³ While the overall success of the LCP cannot be determined yet on the limited basis of revenue gains, it was clear to the Committee that the revenue outcome had been a major factor in the Government's decision to extend the program.

11.65 Nevertheless, the Committee noted suggestions that the revenue returns could not be considered as extraordinary given the changed process of scrutiny of corporate taxpayers during the 1980s.⁴⁴ The Committee recognised that the majority of the extra revenue stemmed from the resolution of strategic issues. These were issues which involved differing interpretations of the taxation law.

11.66 The LCP has highlighted in the Committee's view the importance of statutory interpretation to the future compliance of taxpayers. Large corporate taxpayers were generally compliant taxpayers. The majority of the additional

40. Pappas, Carter, Evans and Koop, *Review of the Large Case Program, Australian Taxation Office*, January 1992, p. 3.

41. Senate Estimates Committee B, *Hansard*, 20 October 1992, p. 593.

42. Senate Estimates Committee B, *Hansard*, 29 October 1992, p. 660.

43. Pappas, Carter, Evans, and Koop, *op. cit.*, p. 2.

44. Evidence, vol. 2, p. 593.

revenue identified by the ATO stemmed from what the Pappas, Carter Report called 'grey' areas of the law. To what extent the additional revenues identified by the LCP would not have been ascertained in the normal course of a taxation investigation, or even a program of limited auditing in an environment other than self assessment, is impossible to predict. The Committee did however note the opinion of the Pappas, Carter Report:

As strategic issues were the major source of revenue, it is likely the majority of this additional revenue would have gone uncollected had the ATO continued to use pre-LCP audit techniques.⁴⁵

11.67 The Committee was concerned that revenue collection had been identified as dominating other objectives within the LCP. The Pappas, Carter Report identified both the success of revenue collection and the failure of the ATO to contribute to increasing voluntary compliance by methods other than direct auditing. While the threat of audit must contribute to voluntary compliance the Pappas, Carter Report recognised that other strategies were relevant to preventing future non-compliance.⁴⁶

11.68 The Pappas, Carter Report found that 'grey' areas of the law were a major cause of non-compliance amongst major corporates. In essence, the ATO and large corporate taxpayers were reaching different tax positions as a result of differing interpretations of very difficult provisions of law. The identified intention of the taxpayers was to comply with the law. However, as self assessment provided taxpayers with the right to interpret the law, the large corporate taxpayers often adopted, quite reasonably, an interpretation which was favourable to their balance sheets rather than the Commonwealth's revenue. On the other hand, it should also be recognised that the ATO exhibited a similar bias in the other direction because of its revenue focus.

11.69 Strategically, the audits of the LCP identified the need for more effort to clarify those numerous areas of the law in dispute. While the ATO has moved to increase its Rulings program, increased consideration of issues by the judiciary has yet to occur. The Committee considered the ATO needed to move further in this area. The Committee has commented in Chapter 14 on the appropriateness of the ATO undertaking litigation, particularly through appeal cases, to clarify the law.

45. Pappas, Carter, Evans and Koop, op. cit., p. 3.

46. *ibid.*, p. 2.

11.70 The Committee concluded that the LCP had demonstrated effectively the general commitment of large corporate taxpayers to paying the correct amount of tax and the importance of the ATO concentrating audit resources, in this taxpayer segment, on the clarification of the law.⁴⁷

11.71 The Committee considered 'good corporate taxpayers' should be recognised both publicly and through the degree of audit supervision given to them. To this end, the Committee noted the development of strategy reviews in which the ATO seeks to identify with a taxpayer those areas of taxation practice which might require discussion between them.⁴⁸ Further analysis may be conducted and the appropriate taxation treatment determined. The Committee has concluded that such programs present an efficient mechanism for the determination of areas of dispute and their resolution. In the Committee's view cooperation, involving flexibility on both sides and recognition of possibly competing priorities, offers the best chance for the constructive development of genuine compliance.

11.72 The Committee has concluded that building such cooperation requires a commitment from both ATO auditors and corporate taxpayers to the establish a system of commercial morality which recognises genuine effort to comply with the law. The Committee notes that at the senior levels of the ATO there is such a recognition. However, the Committee is concerned at the apparent failure within the ATO to translate this commitment to staff at the operational level.

Current Year Audits

11.73 The Committee noted the development by the ATO of a program of 'current year' audits. The object of this program was to allow the ATO to be aware of what taxpayers were doing as early as possible.⁴⁹ Imposition of penalties was not considered to be an important aspect of this form of auditing.⁵⁰ Rather the process has been developed as an educative step in the development of compliance. To this extent, the program is not truly an audit program as much as it is a taxpayer advising project. Publicity and the publication of specific industry Rulings were noted as important stages in 'current year' audits.⁵¹

11.74 Criticism of the program was noted by the Committee. Some taxpayers considered as inappropriate the notion of auditing current practices before

47. *ibid.*, p. 4.

48. Evidence, vol. 4, p. 1196.

49. Evidence, vol. 4, p. 1278.

50. Evidence, vol. 4, p. 1279.

51. Evidence, vol. 4, p. 1280.

an assessment was made, given that the taxpayer may not have considered the tax issues and external advice may need to be taken. Also proper documentation may still be required.⁵² The use of audit resources to conduct current year audits before the taxpayer was committed to a position was raised with the Committee by one of the ATO's auditors who suggested that such a program detracted from the auditor's role of detecting evasion.⁵³

11.75 The Committee is not convinced of the efficiency of a 'current year' audit program and notes that the focus of the program is clearly to support taxpayer compliance. To this extent, the Committee considers the program offers some advantages to the taxpayer and provides an opportunity for amending the strictly revenue focus of the audit program. Also, the program could pre-empt the development of technical disputes by foreshadowing possible points of dispute. Nevertheless, the Committee recognises that under a self assessment system the initial selection of a taxation position is properly that of the taxpayer. Consequently, the 'current year' audit strategy should be viewed more appropriately as an educative program for both parties. The Committee anticipates such 'audits' would be generally by mutual consent and conducted in a manner which was as unintrusive as practical.

The Role of the Auditor

11.76 The role of the taxation auditor is far from one dimensional. Unlike other investigators, the auditor needs to both gather and interpret evidence in light of the terms of statutory provisions which establish the taxation law. The role therefore involves three principal functions:

- . information gathering and investigation;
- . analysis and synthesis of statutory interpretations and evidence; and
- . assessment.

11.77 In audit theory, the role of the financial statement auditor is principally concerned with checking that the disclosures in primary reports are supportable. However, as taxation auditing requires a far more definitive evaluation of the conclusions reached by taxpayers, analysis and application of the law and the assessment for penal sanction of a taxpayer's intentions and behaviour, the

52. Evidence, vol. 1, p. 306.

53. Evidence, vol. 2, p. 349.

Committee has concluded that the role of the taxation auditor cannot be strictly compared to that of the financial statement auditor. Rather, the more appropriate comparison is with the securities regulator.

Investigation and Information Collection

11.78 Following the decision to audit a particular taxpayer and after the development of an audit plan, the auditor's first role involves the collection of information and data suitable for proving, or otherwise calculating, the taxpayer's liability. Information for this task can be derived from a diverse range of sources including those not directly related to the taxpayer. Access to a broad spectrum of information was considered necessary to allow auditors to discern the nature of many taxation arrangements.

11.79 Evidence to the Committee indicated that the ATO utilised its wide powers under the *Income Tax Assessment Act 1936* (the Act) to gather information from a diverse range of sources.⁵⁴ Concern was expressed by members of the Committee at the privacy implications arising from these access powers. While the Committee considered the ATO should not be unduly restricted in the gathering of information, it concluded that the power to collect information should be accompanied by an administrative check on the storage and dissemination of the data.

11.80 Sections 263 and 264 of the Act provide extensive powers for ATO officers to access information and require the provision of information by any person. The broad limits of these powers were commented on by witnesses.⁵⁵ Comment on the effect of legal professional privilege on the operation of these sections is contained in Chapter 13.

11.81 The Committee noted that the ATO often gathered evidence from persons other than the taxpayer. Evidence of circumstances in which such approaches had been badly handled were noted by the Committee.⁵⁶ In general, the Committee considered the ATO should consciously seek to avoid third party contact as it had the capacity to unnecessarily concern innocent individuals and publicly expose taxpayers under review, without any grounds for indicating any wrong doing.

54. Evidence, vol. 3, p. 860.

55. Evidence, vol. 3, pp. 535, 852.

56. Evidence, vol. 4, p. 1324.

11.82 Moreover, the Committee was concerned at the control and supervision afforded to information gathered by the ATO under its access powers.⁵⁷ In particular, the Committee noted the ATO was unable to provide an inventory of information supplied to it under s.264 of the Act. While the Committee noted that information gathered by the ATO was for use in individual cases, it was concerned that information should be used only in respect of the case under investigation. Where information might be useful for more than one case, the ATO should maintain a list of that information and its currency on an accessible database. In the Committee's view, such a database would enable information to be controlled, properly stored and made accessible to other officers in appropriate circumstances. Privacy concerns could be assessed and unnecessary requests for lists would be avoided. The Committee is concerned to ensure that information gathered for a particular purpose should be protected in an appropriate manner.

11.83 The Committee has concluded that the establishment of a generic lists database would assist ATO officers by identifying sources of information and would improve the protection of taxpayers' privacy by ensuring such lists were formally managed within the ATO.

11.84 The Committee therefore recommends that:

- . the Australian Taxation Office establish a database of generic lists of taxpayers gathered pursuant to Sections 263 and 264 of the *Income Tax Assessment Act 1936*,
- . the Australian Taxation Office's database of generic lists of taxpayers be security protected so that access is only possible where a case requires it; and
- . the existence of the Australian Taxation Office's database of generic lists of taxpayers be publicly disclosed in the Commissioner's Annual Report.

11.85 The Committee is concerned at the exceptional powers of access afforded to auditors by virtue of s.263 of the Act. In the Committee's view, there is no identifiable reason why the ATO should be placed in a status greater than any other enforcement body. While administrative practice may act as a check on unwarranted access to personal property, it does not provide any form of guarantee. The Committee considers it is therefore necessary to impose upon the ATO the same limitations on access as apply to other arms of government.

57. Evidence, vol. 18, p. S4117.

11.86 The Committee believes that just cause should be constituted by evidence of reasonable attempts by the ATO to gain information voluntarily from the taxpayer. Alternatively, the ATO should demonstrate there are reasonable grounds for believing the revenue of the Commonwealth is at risk if access is not obtained immediately.

11.87 The Committee recommends that:

Section 263 of the *Income Tax Assessment Act 1936* be amended to require that the Australian Taxation Office show just cause before being granted a warrant by an appropriate judicial official to access or enter the private property of a taxpayer without permission.

11.88 Information may also be collected from a taxpayer's computer system either in a hard copy format or through data transfer. The Committee noted the development of computer assisted auditing.⁵⁸ Facilities for data transfer were demonstrated to the Committee during its inspection of the Adelaide branch office. Considerable cost savings and reduced inconvenience were considered to be the primary advantages of such systems. Some problems, particularly the problem of facilities, were noted in evidence.⁵⁹ The Committee recognised that the greatest efficiencies from these developments would only be realised if ATO staff had the necessary skills to properly identify the commercial underpinnings of the data.

11.89 Taxpayer interviews commonly follow or are associated with the process of information gathering and investigation. In this regard, the significant powers of the ATO were noted, particularly the power to require a taxpayer or any other person to give evidence under oath.⁶⁰

11.90 The Committee deliberated upon the need for ATO staff to have such significant powers given the onus upon taxpayers to prove their assessments. While the Committee fully recognised the scope of the powers, it did not consider a sufficient case had been established by the evidence for reducing the powers. Nevertheless, the Committee did believe taxpayers had the right to protection from abuse of the powers. In particular, the Committee concluded all taxpayer interviews should be audio recorded and a transcript and/or copy of the tape should be provided to the taxpayer in every case. Moreover, taxpayers should have the right to representation and advice in all instances, and no taxpayer should be required to

58. Evidence, vol. 3, p. S796.

59. Evidence, vol. 2, pp. 617-8.

60. *Income Tax Assessment Act 1936*, ss.264(2).

sign a statement or interview record nor should such documents be offered to the taxpayer for signature. If it is intended that such documents be formally attested, the Committee concludes that the full range of evidence Rules should be introduced, including the right for a taxpayer to refuse to answer questions due to the potential for self incrimination.

11.91 **The Committee therefore recommends that;**

- . the Australian Taxation Office install facilities in all branch offices to allow taxpayer interviews to be electronically recorded, and all taxpayers be automatically given a copy of that interview within seven days at no cost;
- . the Australian Taxation Office purchase equipment to allow for recorded interviews to be conducted at taxpayers' premises;
- . the Australian Taxation Office cease the practice of having taxpayers sign statements or transcripts of interviews; and
- . the Australian Taxation Office discuss with a taxpayer prior to a formal audit interview the obligation of the taxpayer to answer questions according to law and, in all cases, notify the taxpayer of his/her right to representation.

11.92 Copies of any formal audit interviews should be maintained in a secure environment for a period not exceeding four years. After the four years, the tapes or other records should be destroyed unless they are needed for prosecution purposes or if any objection period has not yet expired.

Analysis and Interpretation

11.93 The second functional stage in the audit process involves the analysis and evaluation of the information gathered during the investigatory phase. In performing this task, the auditor must attempt to synthesise the information collected with an interpretation of the legislative provisions of the Act. Given the number of areas of the law identified as being uncertain and in need of

clarification,⁶¹ this function is far from simple. Indeed, to successfully perform the function to the highest standard the auditor could be seen to need both business acumen and the interpretative powers of a member of the judiciary. Only through the delicate balancing of these two skills can a fair and reasonable result be determined.

11.94 The Committee considered both the sources and quality of advice provided to the ATO auditors and the capacity of audit staff to perform the balancing act mentioned above. Principal advice on the Act's interpretation is provided by the staff of the Advising Branch of the ATO. As noted elsewhere in this report, these staff work in the Taxpayer Assistance Group and provide an advising service to both taxpayer and ATO staff. Audit officers may also seek advice from the Legislative Services Group which provides an advisers service to both taxpayer and ATO staff. Audit officers may also seek advice from the Chief Tax Counsel (CTC). The CTC's principal role is to provide technical leadership to the ATO across all its functional groups. In performing this task the CTC is assisted by Senior Tax Counsel in each State. Clearly, a large body of knowledge also exists within the audit ranks and is utilised through informal liaison.

11.95 Moreover, evidence was submitted to the Committee of the ATO having sought external advice and opinion from senior Queens Counsels on the interpretation of the Act.⁶² Clearly, whenever the application of a provision of the Act is not certain, there is a requirement that the ATO seek to determine a definitive answer. Within the theory of self assessment systems, it is unreasonable to require taxpayers to apply the law correctly if the ATO cannot easily determine a clear understanding of the law itself. Although the Committee was concerned at the proposition from auditors that there were few grey areas in the law,⁶³ the failure on the part of the ATO to clarify the law was considered to be even more significant.⁶⁴ In the Committee's view, the professionalism of the ATO required that a single source of dedicated interpretative advice should be provided within the ATO. Audit staff should have the capacity to have an issue of interpretation settled from within the ATO in such a manner as to clearly indicate the basis, authorities and reasoning behind a decision. That decision should be considered and concluded at a level within the ATO which provides both a technical and administrative authority sufficient to give audit staff, and ultimately the taxpayer, confidence in the interpretation.

61. Evidence, vol. 15, p. S2993.

62. Evidence, vol. 3, p. 723; vol. 4, p. 1076.

63. Evidence, vol. 3, p. 741; vol. 4, pp. 1057, 1086.

64. Evidence, vol. 6, p. S888; vol. 7, p. S1069; Pappas, Carter, Evans and Koop, *op. cit.*, pp. 4, 10.

11.96 The Committee considered the role of the Legislative Service Group (LSG) in providing interpretation advice to ATO staff. The LSG is a small Group within the ATO employing less than 1% of the ATO's total Average Staffing Level (ASL).⁶⁵ The LSG is required to:

- . formulate and examine proposals for new and amended legislation relating to all taxes administered by the Commissioner of Taxation, including proposals for new or revised international tax treaties;
- . examine the taxation implications of proposals to amend or introduce other legislation or to implement other non-legislative measures;
- . review the effectiveness of existing laws and coordinate proposals for improving new or existing laws;
- . instruct the Office of Parliamentary Counsel on the preparation of legislation to give effect to Government taxation decisions and draft second reading speeches and explanatory memoranda on taxation bills;
- . identify areas of uncertain interpretation and/or application of taxation law;
- . provide advice on the interpretation of taxation law to the branch offices, other areas of the Australian Taxation Office and taxpayers generally; and
- . prepare taxation Rulings, Determinations and other advice on the application and interpretation of new and amended taxation laws.

11.97 The Committee recognises the expertise that exists in the LSG in legal interpretation. Given the group's primary role in the creation of legislation, the Committee considers the foundation of an authoritative interpretations group lies within the LSG. Indeed, in the Committee's opinion, the objective of achieving consistent advice could best be achieved by the integration of all legislative factors including creation and interpretation within a single group. Linking advisings staff with officers responsible for the law's development and promotion would, in the Committee's view, establish a definitive source of legal advice for the staff of the ATO and a cohesive advisory group for taxpayers.

65. Evidence, vol. 4, p. S934.

11.98 In addition, by joining the functions of law development, interpretation and advising, the Committee considers issues of difficulty or uncertainty in the law would be more readily identified and considered.

11.99 The Committee has concluded that the ATO needs to develop a single stream of advice on legislative interpretation for both internal purposes and external consultation. To this end, the Committee is of the view that the Advisings Branch of the TAG should be aligned to the LSG to provide a single interpretations group within the ATO.

11.100 The Committee therefore recommends that;

- . the Legislative Services Group in the Australian Taxation Office be reconstituted to form a Legal and Legislative Service Group within the Office; and
- . staff of the Advisings Branch of the Taxpayer Assistance Group involved in statutory interpretation be aligned functionally with the Legal and Legislative Service Group.

11.101 In making these recommendations, the Committee considers the primary objective must be the creation of a single point of definitive legislative interpretation within the ATO such that an opinion produced by the Legal and Legislative Service Group represents the considered and definitive view of the ATO.

11.102 The Committee recognises that a single interpretations and advising group should consist primarily of professional lawyers and accountants. As such, the Committee considers the CTC should continue to be responsible for professional development within the ATO other than the development of technical skills for auditors. That role is discussed later in this chapter. The function of professional development should, however, be expanded to include the supervision of technical skills and the development of specific training modules. Resources necessary to perform this function should be specifically dedicated to the Legal and Legislative Service Group. To this end, the Committee notes the existence of the National Professional Development team and has concluded that its role should be dedicated to the development and supervision of both technical standards and the mechanisms within the ATO for the creation of a professional workforce.

11.103 A Legal and Legislative Service Group would clearly need to be decentralised in terms of its advisings arm. However the Committee is of the view that a strong National Office core would be essential to maintain consistency in

standards and provide the necessary level of authority. Furthermore, staff of the Legal and Legislative Group would be available to assist audit reviews but would not be situated within the Audit Group. The maintenance of an independent source of advice, to the extent that independence was possible, would be established most constructively by the physical separation of staff providing advice from staff utilising the advice.

11.104 In addition to statutory interpretation and advice, the Committee considered the following tasks would be relevant to a Legal and Legislative Service Group:

- . investigation, evaluation and formulation of taxation policy from an administrative perspective;
- . preparation of the necessary legislative enactments, including legislative drafting and supervision of the passage of legislation through the Parliamentary processes;
- . training of ATO staff in all legislative provisions;
- . monitoring professional standards in so far as understanding tax laws is concerned;
- . litigation and other court based activity;
- . professional training and development in law, accountancy, business and associated skills;
- . control and preparation of the Rulings programs;
- . settlement negotiation; and
- . investigation of statutory breaches.

11.105 The Committee noted that a number of these functions were currently being performed within the Appeals and Review Group. In the Committee's opinion the development of a skills based Legal and Legislative Service Group provided an opportunity to refocus the internal management of cases through the development of a professional internal review process. This process would seek to establish a quality control structure for managing issues so that decisions of the ATO, at any level, were final decisions.

11.106 In such a process, quality control prior to the making of a 'decision' would be fundamental to ensuring decisions were made at an appropriate level and secondary review was unnecessary. Ideally all secondary reviews would be conducted prior to the making of a decision.

11.107 The Committee considers the development of a 'right first time' philosophy to be critical to the future development of a professional organisation. Providing taxpayer access to the decision making process at the appropriate level is also considered fundamental. Given that interpretations of grey areas of the law lie at the root of a majority of disputes between the auditors and taxpayers, the Committee has concluded taxpayers should have the capacity to make input into an interpretations regime, outside of the Audit Group, in such a manner as to facilitate independent debate on interpretation.

11.108 On the assumption that internalised review was introduced by the ATO, the Committee considers that the role of the Appeals and Review Group needs to be re-examined. While the legal expertise in prosecutions and litigation would be transferred to the Legal and Legislative Service Group, the function of managing objections procedures would still exist, albeit more limited. As the objective of internalised review would be to produce final decisions with full explanations for taxpayers, the scope of secondary review would be marginalised to administrative practices and review of the manner in which interpretations were applied in practice. The Committee considers this latter role should also be internally reviewed to the greatest extent possible.

11.109 The Committee therefore recommends that:

- the Australian Taxation Office introduce a formal system of quality controlled internal decision making review which identifies formal mechanisms for taxpayer participation in decision making and specifies the appropriate level of review and supervision for decision making; and

- the Australian Taxation Office commit itself to providing decisions to taxpayers which are final and supportable in the first instance.

11.110 In the event that the decision making process within the ATO is amended to require that decisions on assessments and prosecutions are made after a process of internal review, the functions of the officers of the Appeals and Review

Group would be effectively reallocated to staff within the mainstream decision making process. In the Committee's view, those functions should properly be conducted in every case not merely those that go to objection. Thus, the resources of the Appeals and Review Group should be allocated to general decision making areas.

11.111 **The Committee recommends that:**

the Australian Taxation Office reallocate the resources of the Appeals and Review Group to the performance of internal review within the on-going decision making processes of the Australian Taxation Office.

11.112 Given the Committee's view that statutory interpretation and advice should be a dedicated function within the ATO, it follows that the role of audit staff should be limited to the application of that advice to given taxpayer circumstances. As the person most familiar with the details of a particular case, the auditor needs to be aware of the importance of obtaining advice to support audit recommendations. With independent advice and through the exercise of professional judgement, the auditor is then in a position to prepare an analysis of the taxpayer's liability.

Assessment

11.113 The third stage of the audit process involves the raising of an assessment. Pursuant to s.169 of the Act, the Commissioner may make an assessment of the amount of tax liable to be paid by a taxpayer. Such an assessment can be based on the taxpayer's return or any other information the Commissioner may have concerning the taxation liability.⁶⁶ Amendment to assessments previously raised by the Commissioner are permitted by virtue of s.170 of the Act. Sub-section 170(2) of the Act provides that in the absence of evidence of fraud the Commissioner may review and amend an assessment within four years of that assessment having been deemed to have been made, or within four years of the tax having become due and payable.

11.114 Evidence was provided to the Committee by ATO auditors, who argued that the four year period was too short and proving fraud or evasion was too difficult.⁶⁷ These auditors suggested taxpayers could improperly delay investigations so as to remove from investigation the fourth year of review.

66. *Income Tax Assessment Act 1936*, s.166.

67. Evidence, vol. 3, p. 744; vol. 4, p. 1053.

Notwithstanding the provisions of s.170(4) and the fact that audit reviews generally concentrate on the most recent year of income,⁶⁸ the Committee has concluded that the auditor's concerns could be ameliorated by a simple amendment to the Act to make clear that once an investigation has commenced, the years under investigation will technically be from the fourth year preceding the current year of income. Provided the taxpayer is notified of the possible years under review, the Committee considers no injustice would be suffered by providing for a fixed period of review.

11.115 The Committee notes the uncertainty which has arisen for corporate taxpayers under the self assessment system as a result of system continuing to rely upon assessment and the fact that when a corporate taxpayer makes a loss there is no assessment. This leaves open the taxpayer's affairs in so far as the ATO's capacity to review past year returns beyond four years. The Committee considers that the extension of the four year rule to these situations would not seriously jeopardise the revenue and could add both balance and certainty to the current system. Such a change should, in the Committee's view, be considered in the context of a review of the legislative basis of self assessment.

11.116 The Committee therefore recommends that:

Section 170 of the *Income Tax Assessment Act 1936* be amended to allow adjustments to the assessment of a taxpayer's tax liability that involve a year of income four years prior to the year in which the audit commences, provided the taxpayer was notified of the review of that assessment within four years of the assessment having been originally made.

11.117 The Committee was particularly concerned at the consequence of assessments being issued which were not fully supported by the ATO at the highest levels. (The negotiation of settlements is discussed in paragraphs 11.153-4). Assessment is a critical stage in the audit process because it is through the issuing of an assessment that a legal obligation is created. The importance of an adverse audit assessment is highlighted, for example, in the case of public companies where the need to provide disclosure to the Stock Exchange can materially affect the value of the company .

68. Evidence, vol. 4, p. 1052.

11.118 By virtue of s.204 of the Act, an assessed level of income tax becomes due and payable on the date specified in an assessment notice. That date cannot be less than 30 days after the notice of assessment and if, for some reason, there is no date specified in the notice of assessment, the amount is deemed to be due and payable 30 days after the service of the notice.

11.119 As soon as an assessed amount of taxation becomes due and payable, that amount constitutes a debt due to the Commonwealth.⁶⁹ The implication of this administrative and legal arrangement, particularly for corporate taxpayers, was brought to the Committee's attention by several witnesses and the need for a review mechanism emphasised.⁷⁰

11.120 As a result of self assessment, a company will initially assess its own taxation liability, and therefore create for itself a debt to the Commonwealth. This assessment is subject to evaluation and alteration by virtue of the amended assessment procedures pertaining to taxation audit and by the right of taxpayers to seek amendment of their own assessments. As mentioned earlier, s.170 of the Act, provides a discretion to the Commissioner of Taxation to amend assessments within given time frames.

11.121 Evidence was put before the Committee of the potential consequences for a corporate entity against whom an amended assessment was issued which established a debt exceeding the capacity of the corporate entity to fund it from the entity's total asset.⁷¹ That is, a taxation debt places the corporate entity in a situation of technical insolvency. The Committee recognised that this situation had ramifications for the company regardless of whether the company challenged the debt or not.

11.122 Corporations Law imposes a personal liability upon the directors of a company which incurs debts when the directors are aware that the company cannot meet those debts as and when they fall due.⁷² Where a taxation debt places a company in technical insolvency there is an obligation upon directors to take action to prevent further debts from being incurred. Moreover, the directors are obliged to disclose the taxation debt to a number of other groups and institutions including any creditors and, where the company is a listed entity, to the Stock Exchange.⁷³

69. *Income Tax Assessment Act 1936*, s.208.

70. Evidence, vol. 3, p. S399.

71. Evidence, vol. 18, p. S4338.

72. *Corporations Act 1991*, s.592.

73. Evidence, vol. 2, p. S400.

11.123 As long as the implications of an amended assessment and tax debt are so potentially significant, the role of taxation audit remains crucial. With the power to issue an amended assessment which places a corporation in technical insolvency, or puts it in a position where Stock Exchange notification is required, the taxation auditor wields considerable power. The Committee heard evidence of how this power is controlled through the ATO's review procedures and the statutory provisions allowing judicial challenges to ATO decisions.⁷⁴

11.124 The Committee concluded that there were no special grounds, whether legal or economic, for treating a taxation debt in any manner different from other debts, trading or otherwise. The Committee further concluded that the difficulty facing corporate taxpayers does not derive from the nature of the debt, but rather from the manner in which the debt is incurred and becomes known to the taxpayer.

11.125 The Committee's attention in this respect was drawn to the taxation system of the United States of America (USA), specifically to the operation of a Deficiency Notice System.⁷⁵ The Deficiency Notice System inserts a review mechanism between the official determination of an audit by the Internal Revenue Service (IRS) and the issuing of an assessment. Where, following the various internal IRS review procedures, the IRS and taxpayer have failed to settle a tax audit dispute, or where those procedures have not been utilised by the taxpayer, the IRS will serve a deficiency notice upon the taxpayer.

11.126 This notice sets out the details of the adjustments to tax payable and the amount determined by the IRS to be owing. The taxpayer may then, within a statutory period, seek to have a tax court redetermine the deficiency. In the majority of cases, it is only following the final determination of the full appellate process that the tax may be assessed and collected.

11.127 Procedures in this system protect against any possible losses to the revenue. These procedures place the position of the revenue above the interests of the taxpayer while at the same time allowing the taxpayer to pursue the issues involved in the amended assessment through the judicial processes.

11.128 It can therefore be seen that the Deficiency Notice System, as applied in the USA, operates as an administrative mechanism of review which establishes a procedure for protecting corporations against debts raised which place them in technical insolvency. Under the Deficiency Notice System, the corporation may challenge the debt prior to legal ramifications taking effect.

74. Evidence, vol. 3, p. 795; vol. 4, p. 1451.

75. Evidence, vol. 3, p. S399; vol. 13, p. S2426.

11.129 The Act provides a discretion to the Commissioner to allow extensions of time for taxpayers to pay tax in circumstances where a taxpayer disputes an assessment. This discretion operates in the context of the objection procedures outlined in Part IVC of the *Taxation Administration Act 1953*. However, if the objection to the assessment is decided against the taxpayer, and if the taxpayer contests the objection decision, the Commissioner may extend the time to pay the tax in dispute provided one half of the amount in dispute is paid and there is not perceived risk to the revenue. Whether technical insolvency constitutes a perceived risk will depend on the circumstances of the corporation involved.

11.130 The issue posed for the Committee was therefore whether there was a need for some mechanism, such as a deficiency notice, to allow for an independent review process prior to the issuing of assessments. The theoretical basis of the Act places the burden of proof in taxation matters generally with taxpayers. The power of the ATO to require taxpayers to justify their assessments is thus supported by the Act. The realities of commercial practice dictate that corporations will seek to develop 'tax effective' structures in their operations. Corporations, in developing these structures, must therefore consider their capacity to justify those structures to the ATO.

11.131 In the normal course of an audit, it is clear that disputes will arise between the taxpayer and the ATO in respect of the application of the Act to the 'tax effective' structures established by the taxpayer. The current mechanisms for settling these disputes prior to external review involve independent or secondary review within the ATO and negotiations between the ATO and the taxpayer.

11.132 After these reviews have occurred, the ATO retains the right, moreover obligation, to issue an assessment based upon its best interpretation of the law and its perception of the facts. For the taxpayer, it is at this stage that the implications of solvency are most crucial.

11.133 The Committee considered the arguments for and against requiring additional review procedures, external to the ATO, prior to assessments being issued. On balance, the Committee concluded that, provided changes were made to the method of determining audit based assessments, there was no advantage to be gained from imposing an additional review level in the present structure. However, the Committee further concluded that, where amended assessments would make taxpayers technically insolvent, the implications for them, its employees and Australia as a economic entity were so significant that a mechanism was needed to allow the issues creating those implications to be tested and mitigated through an external review process.

11.134 The Committee noted the development of technical review in large case audits. In particular, the Committee's attention was drawn to the development of a review mechanism for evaluation of technical decisions made by auditors in these audits.

11.135 Evidence was presented to the Committee of representations that had been made to the ATO over a period of time to establish an independent review mechanism for decisions of auditors which would operate prior to the issuing of an amended assessment.⁷⁶ For some time, the ATO resisted any formal procedure. Arguments in support of independent review concentrated on the need for a mechanism which was separate from the intensity of the audit. A perceived lack of objectivity was considered unavoidable in relation to the work of auditors.⁷⁷ Review, prior to amendment, was considered necessary as a result of the debt consequences of an assessment being issued.

11.136 Following consultation with professional bodies a review procedure was introduced in November 1992 to ensure that positions taken by auditors properly reflected the law. The Committee noted that such a procedure was, in part, a response to the Pappas, Carter Report's recommendation for a case coordinator's position.⁷⁸ The procedure was recognised as an evolving one and the guidelines for the review were being constantly refined with practical experience.⁷⁹

11.137 While the Committee acknowledges this program of review is new and still evolving, it considers the problem of assessments creating insolvency will not necessarily be met by this mechanism.

11.138 The Committee has concluded that a deficiency notice system should be established. Under this system, taxpayers who face insolvency as a result of the issuing of an assessment notice could seek, a notice of deficiency from the Commissioner prior to the notice's issuance. Such a notice would have the effect of automatically raising with the Federal Court an issue of dispute. The Court would be required to determine, in the first instance, whether there was a reasonably arguable case. If such a Determination were made, the Commissioner would not issue the assessment notice, pending the matter being settled by the Court. In the event that the Court determines that the issue is not arguable, the Commissioner would be entitled to issue the assessment with the taxpayer's full rights of objection and appeal intact.

76. Evidence, vol.2, pp. S154-62.

77. Evidence, vol. 2, pp. 406, 554.

78. Pappas Carter Evans and Koop, op. cit., p. 11.

79. Evidence, vol. 18, p. S4141.

11.139 The deficiency notice would have the effect of suspending the amended assessment and therefore technically no debt would be incurred. Consequently, issues of penalties and interest would not apply while a notice of deficiency existed. Upon the determination of the issue before the Federal Court, the Commissioner would be able to issue an assessment in accordance with the Court's decision.

11.140 The Committee considers the use of a deficiency notice would be limited and the onus would rest on the taxpayer to demonstrate potential insolvency. However, in the event such evidence was provided, the Committee anticipates the Commissioner would automatically issue the notice.

11.141 The Committee recommends that:

so much of the law be amended as would allow a system of deficiency notices to be introduced for taxpayers who would be made technically insolvent by the issue of an amended taxation assessment.

11.142 The Committee recognises that both the Act and the *Corporations Act 1991* would also need to be amended. The latter would need to allow for the case where a taxpayer continues to trade while a deficiency notice was applicable. Although such a notice would not remove the adverse publicity attached to an assessment which places the taxpayer in technical insolvency, it would at least indicate to shareholders, creditors and others that an arguable case in respect of the assessment had been identified by the Court.

11.143 Given the critical importance of the process of assessment, the Committee considered whether it was appropriate to have in a professional organisation the same person or group of people who investigate and report on a taxpayer's circumstances also making decisions on assessments. Moreover, the Committee debated whether principles of good administration required that a decision maker should be independent of an investigator.

11.144 While the Committee acknowledged the technically difficult and complicated nature of taxation auditing and regarded the professionalism of auditors generally as demonstrating a clear commitment to the taxation system, it noted the difficulty of maintaining a balanced perspective in the case of audits which spanned long periods to time. The Pappas, Carter Report identified audits which had lasted

over three years and found that the average audit lasted over two years.⁸⁰ Objectivity could, in the Committee's opinion, only be maintained in such circumstances with exceptional commitment.

11.145 Regardless of the length of audits, the Committee considered that in principle the establishment of a professional investigatory and decision making process required the separation of the investigation/evaluation stage from the decision making stage to the greatest extent possible. The Committee has concluded that the process of taxation auditing needs to be divided into two clear stages. The function performed in those two stages needs to be seen to be performed by officers from separate professional streams.

11.146 The Committee anticipates that the separation of the audit investigation and evaluation functions from the decision making stage would allow the creation of a 'classical' audit function within the ATO. Such a stream would be supervised by a professional leader, highly qualified in the skills of auditing and audit approaches. A senior position equivalent to the Chief Tax Counsel would be responsible for the development of audit skills in the ATO. Officers working in the technical audit stream would be required to gather evidence on taxpayer cases and prepare quality reports detailing all the relevant facts, legal precedents, Rulings, interpretations and advice provided by the Legal and Legislative Service Group and other relevant material, pertaining to the case. The written audit report would be reviewable by superiors within the audit group. The final audit report produced by this Group would then be presented to an independent decision maker outside the Audit Group.

11.147 The responsibility for determining the final assessment and issuing the notice of assessment or recommending a deficiency notice would rest with a management group established by the ATO. The Committee considers this group would include technical experts in taxation law, business practices, evidence and accountancy. In the Committee's opinion, this group would have the responsibility for assessing all audit reports and determining the ATO's position in respect of the actual assessment notices to be issued. Settlement negotiations would be performed by this Group on the basis of the evidence contained in the audit report. The Group would also be responsible for assessing the weight of evidence and the appropriate direction in which to advance cases, that is, whether through settlement, litigation or prosecution. The Committee anticipates that this Group would balance commercial practicalities and the importance of clarifying the law, with the need to maintain the legal revenue of the Commonwealth.

80. Pappas, Carter, Evans and Koop, op. cit., p. A8.

11.148 To ensure auditors' morale was maintained the decision management group should be required to brief case auditors on the final decisions reached in cases. Moreover, comment on the quality of audit reports should be fed back to those responsible for the Audit Group for the purposes of further developing quality audits.

11.149 The Committee concludes that a formal separation of functions, in the manner detailed above, would provide the ATO with the opportunity to develop a professional organisation and establish transparency in the handling of taxpayers' cases.

11.150 The Committee recommends that:

- . the Australian Taxation Office separate the functional roles of the Taxpayer Audit Group by establishing a unit independent of the Taxpayer Audit Group with responsibility for making decisions regarding amended assessments;
- . the role of auditors within the Australian Taxation Office's Taxpayer Audit Group be clarified and limited to the investigation and preparation of reports on taxpayers;
- . the Taxpayer Audit Group in the Australian Taxation Office be headed by a senior professional auditor responsible for the technical development of audit skills within the Office and the maintenance of quality standards within the Taxpayer Audit Group; and
- . in the preparation of taxation audit reports, officers of the Taxpayer Audit Group in the Australian Taxation Office obtain all legal and interpretation advice from officers in the Office's Legal and Legislative Service Group.

11.151 The Committee recognises the significant re-organisation which its recommendations would entail for the TAG and the ATO generally. Nevertheless, the Committee considers the process of developing a quality audit program capable of achieving broad support within the community requires a delineation between the investigation, evaluation and judgement stages of the administrative process.

11.152 A direct consequence of the Committee's above recommendations would be the need to remove from audit staff the power to impose culpability penalties upon taxpayers. This subject is more fully discussed in Chapter 12. The Committee notes that officers at the decision making stage are more appropriately situated to assess arguments concerning a taxpayer's state of mind which is required in assessing levels of culpability.

Audit Settlement

11.153 The suggestion was made to the Committee by representatives of corporate taxpayers that instances had occurred where taxation auditors had, in effect, lodged ambit claims with taxpayers prior to negotiation and ultimate settlement. It was stated:

We have experiences where companies are put in a situation of having the tax auditor say to them 'Here is about the level we might look at to settle this and, if you do not accept that, here is what you will cop'. The alternative will be an assessment: we refer to it as an ambit claim, but that is only a cliché. In many cases we believe there are only tentative positions being adopted. We have had cases where, on further challenge, they have backed off, because they have not done their work. We see that as being a very undesirable feature within certain audits, and there are certainly a number of companies who have had that experience. ... They have paid and settled up, just to get the whole process over and done with.⁸¹

11.154 While the Committee considered the process of negotiation and settlement was commercially defensible, it was concerned at the implications of such a system within a self assessment environment. As the onus has been placed upon the taxpayer to 'get the law right', it seems incongruous to the Committee that the ATO should penalise a taxpayer in the event that the ATO was not absolutely clear about the application of a provision. If the organisation responsible for administering the law is not clear about the implication of the law itself, in the Committee's view, it is appropriate to have the matter settled by the Court. The Committee concludes that the ATO needs to establish a program for litigating major points of dispute and grey areas of the law. This program should be established by the group responsible for making decisions on audit cases and should be without expense to the taxpayer whose case has been selected as a 'test' case.

81. Evidence, vol. 2, p. 599.

- the group made responsible for determining audit cases in the Australian Taxation Office establish a priority program for litigating cases where the application of provisions of the *Income Tax Assessment Act 1936* is unclear; and**
- such a litigation program be conducted at no cost and with no penalty to the test case taxpayer.**

11.156 The commercial reality of audit settlement reflects the cost of litigation and the uncertainty of outcomes based on the weight of evidence. The Committee is concerned to ensure that the obligation to pay tax should not be seen as a negotiable debt. However, the Committee recognises the efficiency of allowing negotiation and settlement between a taxpayer and the ATO, where the law may be clear but the weight of evidence uncertain. In the Committee's view where the law is unclear, the obligation lies with the ATO to seek judicial clarification or give the benefit of the doubt to the taxpayer. This is the nature of self assessment.

11.157 Clearly, audit settlements involving large corporate taxpayers present the potential for the exercise of improper influence. While no evidence of coercion, corruption or bribery was presented to the Committee, the potential for such action was illustrated in a submission to the Inquiry.⁸²

11.158 In the Committee's view, all negotiated audit settlements should be audio recorded and the tapes kept under strict security within the ATO. A copy of the tape should be provided to the taxpayer. Audit negotiations should never be conducted by a single officer but rather should involve no less than three representatives of the ATO. The Committee considers there is merit in requiring that one of the three officers be the investigating auditor. In this way the conduct of the taxpayer can be compared and evaluated with the support provided to the ATO during an audit.

82. Evidence, vol. 1, p. S102.

all audit settlement negotiations be conducted in the presence of no less than three officers of the Australian Taxation Office, with one of the negotiating officers being the auditor responsible for the taxpayer's case; and

all audit settlement negotiations be audio recorded and a copy of the tape provided to the taxpayer within seven days of the discussion.

The Costs and Benefits of Auditing

11.160 Evidence presented to the Committee by the ATO indicated the direct revenue benefit derived by the Commonwealth from auditing. These benefits are indicated in Table 11.2. Also in that Table is a breakdown of the total cost of ATO resources devoted to auditing in recent years. The Table demonstrates the size of the marginal benefit derived from auditing during the same period.

Table 11.2 - Costs and Benefits of Audit 1989-90 to 1991-92

Cost Item	1989-90 (\$m)	1990-91 (\$m)	1991-92 (\$m)	Total (\$m)
Salaries	124.2	136.1	141.8	402.1
Administrative Expenses	11.1	28.7	17.9	57.7
Total Cost	135.3	164.8	159.7	459.8
Estimated Audit Collection Excluding Large Case Audit	605.9	698.5	844.8	2149.2
Audit Collections Including Large Case Audit				3579.1
% Benefit	450	420	530	770

Source: Evidence, vol. 16, pp. S3303-4.

11.161 Section 69 of the Act allows taxpayers to claim the cost incurred as a result of a taxation audit as a deduction against assessable income. The Committee noted the direct costs incurred by taxpayers as the result of an audit and the claims

by taxpayers' representatives as to the significance of these costs.⁸³ More significant however were the indirect costs incurred by taxpayers during an audit. The Committee noted that the costs of providing facilities, disruption to income earning, effects of market knowledge about the audit activity and even personal anguish were all issues during a taxation audit.

11.162 While the Committee did not believe the ATO could directly factor these issues into a cost-benefit equation, the Committee considered it reasonable that the ATO should impute a cost to the facilities and downtime faced by the taxpayer during an audit. Such costs should be evaluated as part of a cost-benefit analysis in audit case selection and should be evaluated in all cases during an audit to determine the reasonableness of the imputed cost. In the Committee's view the taxation system needs to be considered as a total community environment and thus the cost to taxpayers of audit is a relevant consideration in selecting audit cases.

Audit Resources

11.163 The Pappas, Carter Report made a number of significant points concerning the resources dedicated to the LCP. In particular, the size and location of Complex Audit staff resources were noted.⁸⁴ In the Committee's view the Pappas, Carter Report highlighted the importance of a strategic allocation of resources based on the following factors:

- . the need to provide sufficient expertise to conduct audits efficiently;
- . the importance of matching audit skills to taxpayer demographics; and
- . the importance of providing sufficient skills and support for auditors to enable cases to be appropriately managed.

11.164 While the Pappas, Carter Report examined the auditing of the large corporate segment of taxpayers, the Committee considered the comments made in the Report could be applied to all audit functions across all taxpayer segments.

11.165 With the continued development of computer assistance for auditors, the allocation of skilled resources will continue to require that staff are placed in

83. Evidence, vol. 1, p. 310; vol. 2, pp. 574, 582, 617.

84. Pappas, Carter, Evans and Koop, op. cit., p. 12.

positions where they are able to return a maximum commitment to the ATO's corporate goals. The Committee noted suggestions by the ATO that the need to establish priorities determined by reference to relative risk to the revenue was a major factor in determining the total amount of resources devoted to auditing a given tax.⁸⁵ While the Committee acknowledged the use of revenue proportions as one method for determining audit priority, it considered the public perception for tax non-compliance was also relevant.

11.166 As part of its Inquiry the Committee received and considered a large amount of evidence with respect to the administration of the withholding tax provisions of the Act.⁸⁶ In particular, following continued discussion as to the significance of potential evasion in this area, the ATO commissioned and presented to the Committee a Report by the Bureau of Industry Economics, which analysed the scope of the problem with withholding tax administration.⁸⁷ Without commenting upon the technical merit of the Bureau's work, the Committee noted the conclusion that the actual figure for Interest Withholding Tax (IWT) associated with schemes is almost certainly in the range of \$7.8 million to \$26.4 million per annum. The Bureau also concluded that evidence suggested there had been a fall off in the use of IWT provisions since 1986-87, the year the data on which the Bureau made its assessment was based.

11.167 The Committee noted that the issue of the abuse of IWT was extensively considered by the House of Representatives Standing Committee on Finance and Public Administration in 1991. In its Report, *Follow the Yellow Brick Road*, the Standing Committee concluded that:

Despite the confidence of the ATO about the adequacy of existing anti-avoidance measures, the continued use of techniques or arrangements which take advantage of the withholding tax provisions, as acknowledged by the ATO, suggests to the Committee that there is a perception among some in the community that arrangements can be established which are beyond the scope of Part IVA and section 100A of the ITAA.⁸⁸

85. Evidence, vol. 4, p. 1373.

86. Evidence, vol. 11, p. S1948(a)-2261; vol. 15, pp. S3035-117; vol. 20, pp. S4606-5039.

87. Bureau of Industry Economics, *Analysis of Withholding Tax Collections prepared for the Australian Taxation Office*, Canberra, November 1992.

88. House of Representatives Standing Committee on Finance and Public Administration, *Follow the Yellow Brick Road*, AGPS, Canberra, March 1991, p. 21.

11.168 The Standing Committee went on to recommend a move towards the taxing of trusts and corporations in a uniform manner. As at October 1993, no Government response had been made to this recommendation.

11.169 While the terms of reference for this Inquiry did not include specific investigation of the provisions of the Act, the Committee considered the administration of the withholding tax provisions demonstrated a failure within the ATO to actively pursue an identified field of taxation evasion based upon the ATO's assessment of relative revenue loss. Although not proportionally significant, the Committee considers that the ATO should have acted publicly to stop possible evasion practices when they were first identified. The longstanding public debate over the significance of the revenue loss has merely served to highlight the ATO's inadequate response to the problem. The Committee has concluded that, as a matter of urgency, the ATO should take steps to reduce the possible abuses of the IWT provisions. In particular, the ATO should examine administrative and policy responses to the difficulties evidenced in administering cases where trusts distribute income to beneficiaries resident in countries with which Australia does not have a taxation treaty.

11.170 The Committee recommends that:

- . the Australian Taxation Office review its administrative arrangements for the supervision, monitoring and auditing of non-resident beneficiary trusts and determine as a matter of priority administrative and/or policy mechanisms to better control abuses of interest withholding tax; and
- . as a matter of priority the Australian Taxation Office seek to obtain double taxation treaties with those countries which are significant destinations for distributions from Australian trusts.

11.171 In making this recommendation the Committee is particularly concerned at the degree of audit supervision given to trusts. It considers that, in addition to greater technical scrutiny of trusts, better matching arrangements between income declared in trust returns and that disclosed by individual domestic beneficiaries is necessary.

11.172 With regard to technical audit skills, the Committee recognised the importance of developing and maintaining a skills base within the Audit Group. The Committee considers this skills base would be nurtured most appropriately by the establishment of a technical Audit Group apart from the decision making aspect of

tax administration. The Committee notes the belief amongst some taxpayer representatives that auditors are currently not sufficiently skilled to manage their tasks. In the words of one witness:

There is a very real need for more adequate recognition in the Tax Office that auditors are not by and large properly equipped to do the job that they seek to do.⁸⁹

11.173 Through the specialisation of the classical audit function, the Committee considers the ATO genuinely could expect the level of audit investigation and evaluation skills to be improved. Moreover, through the requirement to provide complete quality audit reports to an independent decision maker, the scope of the need for improved skills would be revealed, both for individual auditors and the professional group.

11.174 As the development of skills will be a constant process, the Committee considers an immediate evaluation of audit skills is necessary. The creation of such a workforce plan across Australia and the development of appropriate training courses within branches, will in the Committee's view provide the basis for the further enhancement of audit skills and the progressive improvement of the Audit Group.

11.175 **The Committee recommends that:**

the Australian Taxation Office conduct a survey of skills within its Taxpayer Audit Group for the purposes of establishing a register of currently available skills and to enable the development of appropriate training responses.

Length of Audits

11.176 As previously noted, large case audits have been conducted over a period as long as three years. The Committee recognised that such comprehensive audits would generally involve extensive investigation and consideration. In the Committee's view, however, any audit which extended over 12 months was not

89. Evidence, vol. 2, p. 411.

sufficiently targeted and was probably not appropriate on a cost-benefit analysis. This view stemmed from the need to ensure audit resources were continually allocated to priorities, and recognised the fact that priorities would shift over time.

11.177 The Committee noted that the Pappas, Carter Report had identified the development of a diverse range of audit products.⁹⁰ Continued development of audit strategies and plans offered, in the Committee's view, the best mechanism for more efficient targeting of audits. In addition, the continued refinement of the audit database should allow information on taxpayer compliance to be readily compiled and updated. This enables audit responses to be tailored more accurately to a taxpayer's behaviour. The Committee noted that statistics were maintained by the ATO on the time taken to complete audits. The Committee also noted that time to completion of audit would include time to settlement or judicial referral rather than merely time to issue of assessments. These data were used to monitor the efficiency of audits as well as providing a guide to future audits.⁹¹ The Committee accepts that the development of more specific audit programs in the future should reduce any time delays that may have been experienced in the past. Moreover, the experience gained from the development of new audit teams should allow a path for the transfer of skills and knowledge to new auditors in the future. The Committee notes a number of administrative changes the ATO has introduced to monitor and improve the efficiency of audits.⁹²

Finalisation of Audit

11.178 In the Committee's view there is a need for the ATO to develop a formal mechanism for advising taxpayers that an audit has been finalised. Where the auditors' report evidences no cause for the ATO to amend the taxpayer's assessment, the taxpayer should be given a clear statement to that effect and the issue upon which the audit was conducted should be concisely and definitively enunciated in the written advice to the taxpayer.

11.179 The Committee is concerned that taxpayers should not be left uncertain as to whether an audit has been completed, investigations are continuing or a decision is yet to be reached. In particular the Committee is concerned at those circumstances where a taxpayer has settled an audit but the case is referred to the Director of Public Prosecutions for advice on the merit of prosecution. The Committee has made recommendations on this matter in Chapter 12.

90. Pappas, Carter, Evans and Koop, op. cit., p. 9.

91. Evidence, vol. 16, p. S3305.

92. Evidence, vol. 4, pp. 1022-3.

Special Audit

11.180 Within the ATO a small group of officers are responsible for the taxation affairs of taxpayers involved in illegal activity. During 1991-92, 165 auditors across Australia conducted audits in respect of 678 entities and were able to make adjustments in 487 cases. Total revenue adjustments of \$103 million were made and penalties of \$70 million were imposed.⁹³ Officers in this section of the ATO work closely with a range of Commonwealth and State law enforcement agencies. Any law enforcement activity involves inherent risks to officers performing the enforcement duty and this is the case for officers of the ATO who are engaged in Special Audit. The Committee commends all officers employed in this area. Due to the nature of the work of Special Audit, the Committee did not devote a substantial proportion of its resources to examining this strategic area. However, it noted that additional resources were allocated to Special Audit in the Income Tax Compliance/Enforcement Strategy in September 1992 and the revenue return from that investment was estimated to be of the order of \$10 million to \$20 million.

Auditing of Restricted Access Status Taxpayers

11.181 Following a request from the Committee, the ATO provided the following Table showing the number of audits of members of Parliament up to 31 October 1992:

**Table 11.3 - Audits of Members of Parliament (State and Federal)
for the Three Year Period up to 31 October 1992.**

	Liberal	Labor	National	Other	Total
Audits Undertaken	48	55	29	8	140
Not Completed	9	17	12	-	38
Completed	39	38	17	8	102
Tax Adjustments Made	27	19	8	3	57
Not Necessary To Adjust	12	19	9	5	45
Prosecutions	3	-	-	-	3

Source: Evidence, vol. 15, p. S2963.

93. Evidence, vol. 4, p. 1315.

11.182 Based on an approximate number of 845 members of Parliament in Australia during the period in question, the audited number of 140 represents 16.5% of the auditee population. It is not possible to determine what the annual rate of audit for this taxpayer group might be due to the absence of a per year breakdown. Nevertheless, Table 11.3 illustrates a higher than average rate of auditing of members of Parliament.

11.183 Members of Parliament are classed by the ATO as Restricted Access Status Taxpayers (RASTs). As such, the handling of their taxation affairs is accorded particular security arrangements. This is in recognition of the public position of members of Parliament. Judges and ATO staff are also RASTs. Over the same period of the audit of members of Parliament, the ATO revealed there were 656 audits of the tax affairs of ATO staff. This represented an average rate of 3.5% based on an average ATO staffing level of 18,500.

11.184 The Committee's concern for the treatment of members of Parliament as a taxpayer group was summarised during public hearings by the former Chairman of the Committee, in the following manner:

... if we get to the stage - and this applies to the Customs Service or anywhere else; it does not matter whether it is Liberal, Labor or Callithumpian - where people are being singled out because they are public office holders, then public office holders will eventually be terribly fearful of taking on any or every bureaucracy to reform anything in this country. It will come to the point where we will all put our backs to the wall and slug it out, as I said to you [Commissioner] once before, on a unity ticket.⁹⁴

11.185 In response, the ATO noted that there were many possible reasons for the selection of members of Parliament for audit, including:

- . the level of non-salary income;
- . a high level of work related expense claims and the payment of electoral allowances;
- . reports of Royal Commissions; and
- . the need to follow up 'dob-ins'.⁹⁵

94. Evidence, vol. 4, p. 1296.

95. Evidence, vol. 15, p. S2964.

11.186 The Committee considers the higher than average auditing of members of Parliament does not of itself represent an inappropriate practice for the ATO, provided case selection is conducted in a professional and unbiased fashion.

11.187 The Committee notes that in all instances case selection is performed by officers independent of audit and as such the potential for abuse is restricted. Nevertheless, the Committee considers the identification of a particular group of taxpayers as warranting treatment not accorded to the general taxpayer population imposes upon the ATO the duty to publicly demonstrate the fairness of the system by reporting general statistics in a manner which did not allow for the identification of any members of the RAST group.

11.188 The Committee therefore recommends that:

- . the Commissioner of Taxation publish each year in the Annual Report the broad statistical details of the number of Restricted Access Status Taxpayers subject to audit, without identifying any taxpayer group.

11.189 Identification of the 'type' of taxpayer in the RAST category is neither necessary nor acceptable. However, to heighten public confidence in the equitable treatment of all groups in society, the Committee considers the total number of RAST taxpayers audited each year should be publicly disclosed.

Chapter 12

ENFORCEMENT AND PENALTIES

- . Causes of Non-Compliance
- . Detection of Non-Compliance
- . Interest
- . Late Payment Penalty
- . Culpability Penalties
- . Prosecutions
- . Double Jeopardy

12.1 Any system which requires the voluntary commitment of individuals to make it work will necessarily be open to abuse by those unwilling to observe the normal standards of behaviour. In such cases it is necessary for action to be taken by the majority to enforce the agreed behavioural standards. In respect of the taxation system, the Australian Taxation Office (ATO) summed up this situation by stating:

Regardless of how good our service or systems may be or how understandable the laws are, there will be times and circumstances where other activities are required to ensure that revenue properly payable is paid by those who fail to meet their responsibilities.¹

Causes of Non-Compliance

12.2 The ATO has identified a number of reasons for non-compliance with taxation laws:

- . ignorance;
- . mistake;
- . a genuine difference of opinion;

1. Evidence, vol. 4, p. S722.

deliberate evasion; and

collection systems which make it difficult to comply.²

12.3 Actions by the ATO itself, including the overruling of private Rulings by a general Ruling,³ can affect the capacity of taxpayers to comply with the law. In the vast majority of cases, taxpayers seek to comply with Australia's taxation laws. There are many factors which make compliance difficult but by far the most important remains the complexity, uncertainty and, inherent technicality of Australia's primary taxation legislation. The High Court's decision in *Hepples' Case* adequately demonstrated this point.⁴ As noted in Chapter 5, taxpayer compliance can best be advanced by urgent attention being given to the cause of a redraft of the *Income Tax Assessment Act 1936*.

Detection of Non-Compliance

12.4 The ATO has moved in recent years to develop a number of systematic techniques for the detection of non-compliance.⁵ Within the self assessment system, both as it applies to those taxpayers who fully self assess and all other taxpayers, the assessment process no longer provides the principal opportunity for detection of errors in returns or attempts to evade a taxation obligation. In the place of technical assessment, the ATO relies upon information systematically obtained from market research, analysis of internal data, audit activity and information otherwise obtained from external sources on a cost effective basis, to determine the extent and causes of non-compliance.⁶

12.5 In each case of non-compliance, the response taken by the ATO is determined by which cause(s) are identified as contributing to the failure to pay the proper amount of tax. This response recognises that a taxpayer's intentions are important to the overall commitment of the community to the taxation system and particularly significant to ensuring future compliance. The ATO has identified, in broad terms, a number of enforcement responses to recognised areas of non-compliance. These include:

education of taxpayers;

2. Evidence, vol. 4, p. 1549.

3. Evidence, vol. 4, pp. S723, S784.

4. *Hepples v FCT* 91 ATC 4808.

5. See Chapter 8 for discussion of the Income Tax Compliance/Enforcement Strategy.

6. Evidence, vol. 4, p. S722.

- . improvements to the law;
- . the development of systematic collection systems;
- . administrative penalties; and/or
- . prosecution.⁷

12.6 Enforcement action against non-compliance is thus a cyclical process.⁸ Following detection, an appropriate strategy is identified for improving the level of compliance. This determination can be made on an individual case basis or for groups of taxpayers, for example particular industries. The implications of utilising a particular strategy are then evaluated and the strategy implemented. The level of compliance is again measured. Further compliance improvement action may follow.

12.7 Generally speaking, depending on the cause of non-compliance, the response of the ATO will move gradually from education and assistance to penalty and prosecution. Evidence from taxpayer representatives suggested the ATO's mix of enforcement strategies, while correct in theory, was inappropriately balanced and skewed too heavily in favour of penalty and prosecution.⁹ Such a claim, if correct, would represent a fundamental imbalance in the taxation system in that it would represent an inequity in the treatment of taxpayers. Equity in this respect means that taxpayers in like situations are treated in a similar fashion. It is the nature of the non-compliance and not the character of the taxpayer which should be significant.

12.8 A major benefit to taxpayers of targeting is that taxpayers who do comply with the law are less likely to be the subject of an ATO investigation. However, a disadvantage is the resulting uncertainty. Under the law, the ATO may adjust a taxpayer's assessment up to four years after the year of income for which the taxpayer has lodged a return.

12.9 Utilisation of computer technology and information interrogation systems to compare claims included in returns with objective data from a second source has enabled the focus of enforcement activity to be shifted from the general to the specific. Timing of intervention in the areas of non-compliance is critical, as is the time taken to respond to taxpayer behaviour. Criticism of the ATO's response to emerging legislative interpretation difficulties was highlighted by taxpayer

7. Evidence, vol. 4, p. S722.

8. Evidence, vol. 1, p. 13.

9. Evidence, vol. 4, p. S883; vol. 7, p. S1056.

representatives.¹⁰ The Committee acknowledged that legislative interpretation and clarification were critical elements in the enforcement strategy, and that the ATO had moved to allocate additional resources to the preparation of Rulings. The Committee considered there was a two-way responsibility on taxpayers and the ATO. Taxpayers need to seek ATO assistance in interpretation at the earliest possible opportunity while the ATO must respond to such requests promptly and adequately.

12.10 Education, advising of legislative changes and direct assistance are all strategies which can be seen to have a positive effect on both the taxpayer and the ATO. Nevertheless, when they are not followed, the law provides for a number of penal sanctions. These sanctions are used in the enforcement strategy, both as a penalty for past actions and as a deterrent to future behaviour.

12.11 Though not exclusive, there are three major pieces of Commonwealth legislation, other than the *Income Tax Assessment Act 1936*, which establish punishable offences for breaches of the taxation law:

- . *Taxation Administration Act 1953;*
- . *Crimes (Taxation Offences) Act 1980; and*
- . *Commonwealth Crimes Act 1914.*

12.12 Administrative penalties and prosecution action are not mutually exclusive. The number of breaches of the taxation system, for whatever reason, are so numerous that it would be administratively impossible to prosecute every taxpayer. The use of administrative penalties is seen as an alternative to prosecution.¹¹

12.13 In 1992 the Parliament passed the *Taxation Laws Amendment (Self Assessment) Act 1992* which, amongst other things, established a new penalty regime for taxpayers who breach the provisions of the *Income Tax Assessment Act 1936* (the Act). The penalty regime took effect for the 1992-93 year of income although, as a result of a decision by the Commissioner to exercise his powers of remission, the regime was effectively operating for the 1991-92 taxation year.

10. Evidence, vol. 4, p. S636, p. S703.

11. Evidence, vol. 4, p. S795.

12.14 Three forms of administrative penalty exist:

- . interest on late tax payments including late payments and underpayments of tax (tax shortfall);
- . late payment penalties; and
- . culpability penalties.

Interest

12.15 An interest penalty, determined by reference to the weighted average yield for 13 week Treasury Note tenders, plus 4%, is payable on the tax shortfall and on any amount of unpaid tax. A tax shortfall is the difference between the amount paid by the taxpayer on assessment and the amount determined by the ATO to have been the correct amount of tax payable. The interest component is payable by the taxpayer regardless of whether a culpability penalty is applicable under Part VII of the Act.¹²

12.16 Interest is charged on the basis that it acts to compensate the revenue of the Commonwealth for being denied the use of the funds for the period since the due date for payment.¹³ The Commissioner may remit the interest penalty but the conditions under which he will do so are very limited. Interest paid on late or unpaid tax was made tax deductible by the *Taxation Laws Amendment (Self Assessment) Act 1992*. This introduced a symmetry into the tax treatment of interest paid to and interest paid by, the ATO.

12.17 The Committee concluded that an interest charge on money owed to the Commonwealth was a reasonable imposition. The Committee recognised that the additional amount of 4% was added to the commercial rate to act as a deterrent to taxpayers who may seek to use the ATO to gain a financial benefit. On the basis of evidence available to it, the Committee could not form a judgement as to the effectiveness of this deterrent.

12. *Income Tax Assessment Act 1936*, s. 170AA.

13. *Taxation Laws Amendment (Self Assessment) Act 1992*, Explanatory Memorandum, p. 106.

Late Payment Penalty

12.18 Section 207 of the Act imposes a late payment penalty of 8% of the amount of tax unpaid, calculated from the time the tax became due and payable. The 8% late payment penalty is not tax deductible and is imposed primarily as a deterrent to persons who may seek to understate their tax liability or who consider the payment of tax obligations to be a low priority debt. While the imposition of the 8% penalty may seem contrary to the more liberal tenor of the self assessment system, the Commissioner does have the power to remit late payment penalties where he is satisfied special circumstances contributed to the delay in payment of the tax.¹⁴

12.19 As in the case of the imposition of interest, the Committee considered the application of a late payment penalty was appropriate, particularly as a deterrent to late payers. Given the administrative cost to the ATO in pursuing late or unpaid tax debts, the Committee has concluded the 8% charge was fair and reasonable.

Transition Arrangements

12.20 In a press release in May 1992, the Treasurer announced that taxpayers would be given the benefit of the new self assessment changes by amendments to the law which would have the effect of reducing the existing late payment penalty rate under s. 207 of the Act from 20% to 16% in relation to amounts outstanding from 1 October 1992. This rate was established to be in line with the combined interest and late payment penalty charges. Changes were also effected to the legislation establishing interest on underpayments of tax and the rate of interest paid to taxpayers for overpayments of tax.

Culpability Penalties

12.21 Ten additional pages of legislation were needed to introduce the new penalty regime to Part VII of the Act. The major features of the non-interest penalty provisions are summarised below:

 failure to exercise reasonable care in the conduct of tax affairs results in a penalty of 25% of the tax shortfall or franking tax shortfall;

14. *Income Tax Assessment Act 1936*, s. 207(1A).

- . in addition, if the shortfall is greater than the higher of \$10 000 or 1% of the 'return tax', a further 25% penalty will apply unless the taxpayer has a reasonably arguable position;
- . 25% penalty for failing to follow a private Ruling issued under the system of private Rulings;
- . 50% penalty for recklessness in the preparation of a tax return and 75% for deliberate evasion;
- . 50% penalty for the use of a scheme whose sole or dominant purpose is to avoid tax unless the taxpayer can show they had a reasonably arguable position;
- . any action to hinder the Commissioner will attract a 20% increase in any penalty applied;
- . any voluntary disclosure of information during an audit will result in a 20% reduction in the penalties applied, whereas an earlier voluntary disclosure will result in a reduction of 80% in the additional tax payable; and
- . all penalties are still subject to remission by the Commissioner and may be the subject of the objection and appeal processes.

12.22 In practice, provided 'reasonable care' has been exercised in the preparation of an assessment, the average taxpayer should face no culpability penalty under the new regime as the extent of their tax shortfalls are likely to be less than 1% of their return tax.

12.23 For larger taxpayers, and in the case of larger tax assessments, the new regime introduces some uncertainty for the near future. This uncertainty will result from the need to have judicially defined the concepts of 'reasonable care' and 'reasonably arguable position.' From first principles, it seems appropriate to assume the reasonable care test will impose a greater duty of care upon taxpayers who do or should utilise professional advice in the preparation of their assessments. However, given the ready availability of tax agents and professionals, the extent of the duty of care is not entirely clear.

12.24 In the explanatory memorandum issued with the legislation, reasonable care was discussed in the following terms:

The reasonable care test requires a taxpayer to exercise the care that a reasonable ordinary person would be likely to have exercised in the circumstances of the taxpayer to fulfil the taxpayer's tax obligations ... Whether a taxpayer has behaved reasonably will depend on all the facts of each case.¹⁵

12.25 This explanation of itself raises some difficulties which will need to be resolved in time by the judiciary. For example, the paragraph speaks of a 'reasonable ordinary person' as the defining individual for assessing behaviour. It would seem open to argue that the ordinary person will have very little understanding of the technicalities of corporate taxation, and therefore a reasonable person may not be expected to take certain precautions that a corporate taxpayer might. A reasonable taxpayer may have established a different test. The Committee sincerely anticipates that commonsense will prevail in the interpretation of the provision and the true intention of establishing an ethical, tortious test will allow the law to be applied with practical reason.

12.26 Of more concern to the Committee was the continuation in the legislation of the right of the Executive to impose culpability penalties in the taxation environment. These concerns are magnified by the operation of the self assessment system. Any taxpayer who has exercised reasonable care in the conduct of their taxation affairs should not in a self assessment environment, be penalised. As put to the Committee:

The whole thrust of self assessment is predicated on the basis that a taxpayer is not penalised merely because he got it wrong.¹⁶

The question of penalties for innocent error was considered to be critically important in a self assessment system.¹⁷

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15. *Taxation Laws Amendment (Self Assessment) Act 1992*, Explanatory Memorandum, p. 80.
16. Evidence, vol. 2, p. S166.
17. Evidence, vol. 3, p. S398, p. S466; vol. 4, p. S989-991.

12.27 In the view of the Committee, self assessment has placed a greater burden of responsibility upon taxpayers to understand and apply the law. Where previously taxpayers had merely to provide the ATO in their returns a disclosure, which was true and full, it is now the taxpayer's responsibility to calculate the tax payable based upon the taxpayer's understanding of the law. Underlying the self assessment system is the theory that taxpayers know tax law at least equally as well as the ATO and will calculate the same liability as would the ATO if it were allowed to do so. Knowledge is critical therefore to an efficient self assessment system.

12.28 The Committee was concerned that officers of the ATO intrinsically involved in the audit process, who are required to investigate and evaluate judgements of taxpayers in a self assessment system, are also required to make judgements concerning the intention of taxpayer. That is, the auditor is required to assess the state of mind of the taxpayer, whether as a corporate entity or as an individual. This difficulty is compounded by the fact that the actions in question may have been undertaken many years previously. In the case of the corporate taxpayer, the decision makers may well have changed in the meantime and, while the value of the underpaid tax should clearly be recouped, the use of culpability penalties in such circumstances appeared to the Committee to be inappropriate.

12.29 While the ATO recognises the commercial value of imposing penalties as contrasted to instituting prosecution proceedings, there is a risk, in the Committee's opinion, that penalties may be utilised as an avenue of avoiding the need to justify conclusions reached as to intent. The Committee was gravely concerned at the suggestion that penalties may be used as bargaining tools in negotiation over settlements. Such a procedure is facilitated by the Commissioner's discretion to remit interest, late payment penalties and culpability penalties.

12.30 Based on the need to maintain taxpayer compliance, administrative penalties need to be set in such a manner as to effectively deter wilful behaviour but not penalise inadvertent error. Culpability, as the word implies, has a technical legal meaning and the Committee considers ATO auditors should not have the power to impose culpability penalties. While the Committee has concluded it would be preferable if culpability penalties were abolished, it recognises this was not a position that administrators would necessarily agree on. In the absence of a move to abolish culpability penalties the Committee concludes that it is essential that an officer with legal qualifications from outside the Audit Group of the ATO consider and determine culpability penalties.

12.31 The Committee therefore recommends that:

- the *Income Tax Assessment Act 1936* be amended to remove the capacity of officers of the Australian Taxation Office to impose administrative culpability penalties; but
- if culpability penalties are retained in the law, they be determined in all instances by a legally qualified officer of the Australian Taxation Office who is independent of the Taxpayer Audit Group.

Prosecutions

12.32 Part III of the *Taxation Administration Act 1953* establishes penalties for various offences related to the administration of the taxation system. The penalties range from a monetary fine to imprisonment for up to two years. The Administration Act, as its name suggests, is utilised by the ATO in respect of offences which are of a generally administrative character such as failing to furnish a return, failing to answer questions, incorrectly keeping records and making false or misleading statements.

12.33 For more serious offences, the ATO has generally sought to utilise the provisions of the *Crimes Act 1914* or the *Crimes (Taxation Offences) Act 1980*. The use of these statutes, though not uncommon, is generally reserved for cases involving alleged deliberate evasion or other conduct which can be portrayed as being of a serious criminal character and/or likely to seriously affect taxpayer commitment to the taxation system such as cases of corruption.

12.34 The process for conducting a prosecution of an alleged offender will generally begin with the detection through the audit process of an illegal action by a taxpayer. Since 1985 the ATO has utilised administrative guidelines for the determination of which cases should be referred to the Audit Prosecution Unit for assessment of the value of prosecution.

12.35 The Committee examined those guidelines, and considered their operation. In particular the Committee noted the following statement:

The prosecution option forms an integral part of our overall enforcement strategy and, in a self assessment environment, is a major tool in our endeavours to encourage voluntary compliance. In contrast to the administrative penalties provided by the legislation, the overt nature of prosecution action may provide an invaluable and widespread deterrent effect by exposing the offender, the offence and the consequent penalty to full public scrutiny.¹⁸

12.36 Auditors are required to notify the Audit Prosecution Unit whenever a case falling within a given offence and category is observed. The ATO's prosecution case selection strategy seeks to concentrate on offences which fall within the following categories:

- . those that are particularly serious, blatant or involve persistent offenders;
- . those which are representative of significant/prevalent non-compliance practices; and
- . those for which there are no other effective means of ensuring compliance or no other sanction.

12.37 The effect of a case prosecution on taxpayer behaviour is a critical consideration. The Committee is concerned that the guidelines do not seem to differentiate between prosecution activity and successful prosecution activity. While any prosecution may have a deterrent effect, the Committee considers it imperative that the emphasis of prosecution case selection should be on cases in which there was a better than reasonable chance of success. The Committee notes the screening procedures of the Audit Prosecution Unit include consideration of the strength of the defence case.

12.38 Nevertheless, the Committee is concerned that any decision to refer a case to the Director of Public Prosecutions (DPP) should be strictly on the merit of the evidence in the case and questions of publicity should not be allowed to weigh

18. Godfrey A W W, Chief of Audit Group, *Prosecution Case Referral Guidelines for all Audit Officers*, Australian Taxation Office covernote 10 November 1985.

at all in this assessment. For compliance enforcement to be valuable it must itself maintain an integrity in the administration of justice. The Committee is of the view that the guidelines used by officers in determining cases for prosecution should not make reference to the potential for publicity.

12.39 **The Committee recommends that:**

the Australian Taxation Office review its guidelines and instructions in respect of prosecutions to ensure all references to the issue of potential or actual publicity are removed.

12.40 Where a decision is taken to refer a case to the Audit Prosecution Unit for screening and possible reference to the DPP, the ATO is required by the referral guidelines to inform the taxpayer of the decision to refer the case at the time of settlement. In addition, the ATO audit officer is required to inform the taxpayer of the process for the payment of penalties under the *Taxation Administration Act 1953*.¹⁹ As is made clear in the guidelines, audit officers cannot give an undertaking not to prosecute as part of audit settlements. While the Committee strongly supports this position, it considers the ATO should clearly indicate to taxpayers prior to settlement the possibility of the case being referred to the DPP.

12.41 Following a two stage screening process by the Audit Prosecution Unit, cases may be referred to the DPP for possible prosecution action. Ultimately, the decision to prosecute an offence against a Commonwealth law rests with the DPP. However, the DPP has agreed that officers of the ATO may conduct summary prosecutions for offences against the *Taxation Administration Act 1953* and other taxation laws provided an agreed list of cases, set out in the Liaison Guidelines for Investigation and Prosecution, are referred to the DPP. In addition, officers of the ATO may prosecute cases which fall into that list with the permission of the DPP.

12.42 The relationship between the ATO and the DPP is thus formally constrained by the Liaison Guidelines. The Committee evaluated these guidelines and considers them generally satisfactory. In particular, the Committee notes the requirement for regular liaison between the DPP and the ATO and the involvement of the Australian Federal Police when necessary.

19. *Taxation Administration Act 1953*, s. 82E.

Double Jeopardy

12.43 Double jeopardy refers to the circumstance in which a person may be penalised for the same offence more than once. In the area of taxation law, the double jeopardy occurrence is considered to occur if a person who is required to pay an amount of penalty tax, does so, but is then prosecuted for the same offence. By virtue of s. 82E(2) of the *Taxation Administration Act 1953*, in such cases the penalties paid by the taxpayer are required to be refunded. However if the prosecution is withdrawn the taxpayer once again becomes liable to pay the penalty tax.

12.44 As stated earlier, the Committee is concerned at the use of culpability penalties as substitutes for prosecution action. A determination to prosecute, which requires the return to the taxpayer of penalties, should involve a clear judgement as to the merit of the prosecution. In such an instance, for the taxpayer to be put to the expense of engaging legal counsel, having the ATO and DPP later withdraw the case and still be required to pay culpability penalties is, in the Committee's view, unreasonable.

12.45 As acknowledged by the ATO the prosecution decision involves both commercial and legal judgements. In the Committee's opinion, where a penalty is refunded to a taxpayer as a result of the commencement of a prosecution, no culpability penalties, to the extent that they apply, should be capable of recovery by the ATO.

12.46 The Committee recommends that:

sub-section 83E(2) of the *Taxation Administration Act 1953* be amended to remove the right of the Commissioner of Taxation to re-impose a culpability penalty in the circumstances where a prosecution is withdrawn.

12.47 In Chapter 14, the power of the ATO as a litigant is discussed and recommendations made in respect of the need to balance the ATO's financial powers with the need to obtain greater clarity and certainty in the law.

PART 3 - TAXPAYERS AND THE ATO

CHAPTER 13 Taxpayers' Charter

CHAPTER 14 Avenues of Review

Chapter 13

TAXPAYERS' CHARTER

- . The United Kingdom Citizen's Charter
- . The United States Taxpayers' Advocate
- . Taxpayers' Charter
- . Taxation Ombudsman
- . Taxpayer Privilege

13.1 The *Income Tax Assessment Act 1936* (the Act) establishes amongst its numerous provisions obligations and duties in respect of tax. When taken together with the *Taxation Administration Act 1953* and the Income Tax Regulations, this body of law imposes an extensive framework of legal responsibilities on taxpayers. The Australian Taxation Office (ATO) administers this body of law and in so doing utilises given provisions to enforce the obligations of the law upon the taxpayer. The question arises, 'Where is the corresponding statement of taxpayer rights?'

13.2 In reality no formal statement of the rights of taxpayers currently exists. Although protection is afforded by the principles of equity and justice established by the common law, the review and objection rights provided by relevant acts and a number of administrative mechanisms for supervising the actions of the ATO, taxpayers have no single written statement of rights. This is despite the fact that the ATO investigatory powers are far more extensive and less well supervised than any criminal law enforcement agency.¹

13.3 No better example of the powers of the ATO and the inferior standing of taxpayers is provided than by the requirement under the Act that taxpayers should satisfy the burden of proving their cases. Reversal of the 'onus of proof' for tax administration highlights the status tax collection and revenue gathering holds in Australian society.

13.4 While the ATO has established standards of performance for dealing with taxpayers, there is no obligation in law for the ATO to achieve these standards, particularly in individual cases. Consequently such standards are of limited academic interest to taxpayers. Moreover, as mentioned in Part 2 of this Report, the Committee noted that the ATO itself was using performance standards, particularly

1. *Income Tax Assessment Act*, ss. 263-4.

in the areas of record keeping and debt management, which it would not have tolerated as normal practice by either business or individual taxpayers. The sizeable investment taxpayers have made in the ATO warranted, in the Committee's opinion, the ATO providing service guarantees to taxpayers and the introduction of a formal mechanism for providing redress where those standards were not met.

13.5 The Committee noted that there were a number of formal channels for taxpayers who suffer loss as a result of actions of officers of the ATO.² However, such avenues were limited and not well publicised.

13.6 In addition to these formal channels, the Committee also sought to explore other avenues for redressing the balance of authority between the ATO and the taxpayer. Primary consideration was given to the formalisation of a statement of principles which would embody the minimum standards of interaction that taxpayers should anticipate when dealing with the ATO. These 'rights' are really no more than the currently unstated expectations of ordinary taxpayers and common law rights of citizens in their dealings with the State.

13.7 During the Inquiry, the Committee's attention was drawn to mechanisms in the taxation systems of the United Kingdom and the United States of America which provided guarantees and protection to taxpayers. One of the principal avenues of protection available to citizens of those countries lies in a statement of their rights vis-a-vis the revenue authorities of their countries. A brief summary of each follows.

The United Kingdom Citizen's Charter

13.8 In July 1991, Britain's Prime Minister John Major announced the introduction of the White Paper on the Citizen's Charter. The Charter was intended to 'raise quality, increase choice, secure better value, and extend accountability' in the provision of public services.³ In relation to revenue departments, the Citizen's Charter stated that taxpayers should be treated fairly and efficiently and that:

The Inland Revenue and Customs and Excise work closely in partnership with taxpayers to ensure that they fully understand their rights and obligations under tax law and, in particular, what to do if they feel unfairly treated.⁴

2. Evidence, vol. 16, p. S3243.

3. *The Citizen's Charter: Raising the Standard*, HMSO, London, 1991, p. 4.

4. *ibid.*, p. 24.

13.9 Following the release of the Citizen's Charter, the 'Taxpayer's Charter' was revised in August 1991, setting out the standard of service taxpayers were entitled to expect from the Revenue Departments and the measures that were to be taken when they were dissatisfied. Included among these measures were instructions on how to complain and request reconsideration of tax affairs, and the processes of appealing to an independent tribunal and referring complaints to an Ombudsman. A copy of the Charter is at Appendix 12.

13.10 In respect of the need for concrete channels of redress for dissatisfied taxpayers and citizens in general, Prime Minister Major commented when introducing the Charter into the House of Commons:

... in the area of redress, where problems occur people are entitled to an explanation, and to know what to do. Avenues for complaint should be well publicised and simple, and when that does not suffice, there should be clear routes to compensation or redress.⁵

The United States' Taxpayers' Advocate

13.11 During its Inquiry, the Committee also noted proposals in the United States for the creation of a Taxpayers' Advocate within the Internal Revenue Service (IRS) as part of a Taxpayer Bill of Rights.⁶ This position would have subsumed the role of the Taxpayer Ombudsman and established within the IRS an independent review mechanism. The Committee further noted the proposal for the Secretary of the Treasury to prepare a statement describing in simple and non-technical terms the rights of taxpayers and the obligations of the IRS during an audit. This statement would explain the taxpayer's rights of review and appeal, including any administrative or judicial appeals, as well as the internal procedures of the IRS for processing and enforcement. It was proposed that the statement would be distributed to all taxpayers contacted with respect to the determination or collection of any tax.

13.12 Further proposed US changes included taxpayers being given specific rights in relation to:

recording of interviews;

5. United Kingdom, *House of Commons Hansard*, 22 July 1991, p. 763.

6. Evidence, vol. 19, p. S4339.

- . procedures in relation to interviews;
- . penalty abatement for erroneous advice;
- . the content of deficiency notices;
- . levy and lien provisions;
- . recoverable costs; and
- . damages from unauthorised actions of the IRS.

13.13 The Committee noted that the proposed Bill, which has been included in currently pending legislation, involved a significant watering down of proposals originally submitted. These proposals included provisions allowing taxpayers to take actions against individual IRS employees where a court determined that proceedings against the taxpayer had resulted from any capricious, arbitrary or malicious act of that employee.

13.14 The Committee was impressed with the intention, evident in both the UK and US proposals, of informing taxpayers of their rights and clearly establishing their administrative entitlements. Furthermore, the Committee was persuaded of the desirability of establishing an independent body to review the administrative functions of the taxation authorities from a practical perspective and to work for the resolution of taxpayer relationship problems prior to any court action.

Taxpayers' Charter

13.15 Evidence to the Committee in relation to the desirability of a statement of taxpayer rights concentrated on the need to provide protection to taxpayers against the bureaucracy and formally set out the relationship between the two.⁷ This point of view was put to the Committee by the representative of the Taxpayers' Association of Australia in the following manner:

It is very difficult if you are in a Mini Minor, meeting a huge express train at a level crossing and dead heat, you lose. It makes an awful mess and it does financially too.⁸

7. Evidence, vol. 5, pp. S699, S701; vol. 1, pp. 190-3, 229; vol. 2, p. 478; vol. 3, p. 813.

8. Evidence, vol. 1, p. 190.

13.16 Taxpayers, like every citizen, should be entitled to be fully informed of their rights and obligations according to law. In the Committee's opinion the ATO, as the body established to administer the taxation laws, was obliged to clearly, concisely, accurately and consistently advise taxpayers of their duties and rights. Such publicity should neither be restrained nor restricted to circumstances in which taxpayers were required to confront the ATO. Information concerning a taxpayer's rights and the standards of conduct expected of the ATO readily available for all taxpayers and specifically cast for taxpayers who are required to interact with the ATO. Taxpayer agents and representatives should similarly be entitled to a given level of service.

13.17 No prima facie evidence of systematic maladministration at any level of the ATO was presented to the Committee. Indeed, a number of witnesses praised the direction taken by the Commissioner and gave credit to the ATO for its actions in many circumstances.⁹ Clearly however, as in any large organisation, individual officers have the capacity to exercise powers conferred on the organisation as a whole in an excessive, oppressive or arbitrary manner. Abuse of power, or even the threat thereof, requires the development of checks and balances in the administration.

13.18 The Committee concluded that there was a case for a charter of the rights of taxpayers which detailed the basic entitlements taxpayers had in dealing with the ATO. Such a charter would include statements in respect of taxpayers's rights to:

- . legal and commercial advice;
- . due process;
- . timely, accurate and confidential advice;
- . independent review;
- . access to administrative and judicial review;
- . information;
- . privacy;

9. Evidence, vol. 3, p. S397; vol. 5, pp. S698, S724, S848; vol. 7, p. S1055; vol. 1, pp. 170, 200, 279; vol. 2, pp. 352, 420, 586, 600; vol. 3, pp. 673, 750.

the presumption of innocence; and

individual consideration and treatment.

13.19 The Charter would therefore set out the current common law rights of taxpayers, as well as the standards of service determined for the ATO as being possible, given their current resources. These standards may need to be reviewed by the ATO and taxpayer representatives in the light of the development of the Charter. For example, the Committee considered that taxpayers should have a guaranteed right to an electronic recording of any interview conducted with the ATO in the course of a taxation audit. At present, tape recordings are regularly made, but only where the taxpayer requests will a copy of the tape be provided.¹⁰ In the case of prosecution interviews a copy of the tape is always offered to the taxpayer. The Committee considered this practice inadequate and believed it should be formalised as a protection for both the taxpayer and ATO staff.

13.20 Furthermore, the Committee believed the Charter should document the entitlements to assistance and support within the ATO of persons from non-English speaking backgrounds, or those persons with any form of disability. The Charter should also, as a guiding principle, seek to ensure that taxpayers had the same rights and were treated in an equal manner no matter where in Australia they resided.

13.21 The Committee considered the Charter should detail in particular the taxpayer's right to the current review arrangements established under law. Brochures detailing these procedures should also be made available to taxpayers wherever the Charter was displayed.

13.22 The Committee considered whether a Taxpayers' Charter should confer legally enforceable rights on taxpayers other than those currently existing at common law. In support of additional enforceable rights, a witness argued:

Where the taxpayer is presumed to have, under self-assessment, a deep knowledge of the law, there must be at least some protection given to the fact that the average taxpayer will not have that knowledge and should not be arbitrarily put upon by the revenue authorities for that failure.¹¹

10. Evidence, vol. 16, p. S3317.

11. Evidence, vol. 1, p. 314.

13.23 The Committee considered the 1992 draft US model, which sought to increase significantly the legal rights of taxpayers. That draft had the potential to increase dramatically the amount of litigation between taxpayers and the IRS by making officers personally responsible for their actions. Providing such a right to taxpayers, in the Committee's view, had the potential to stymie all administrative action and was unlikely to be widely supported.

13.24 The Committee considered it necessary that financial redress be provided in cases where a taxpayer suffered a loss due to ATO negligence. The obligation to provide satisfactory performance was seen by the Committee to rest primarily with the 'corporate' entity rather than the individual. Consequently, a taxpayer's right to redress would lie against the ATO and not the individual officer. Mechanisms for internal accountability should provide sufficient incentive for individuals to act reasonably.

13.25 The Committee noted the proposed Bill of Rights prepared by the Taxation Institute of Australia (TIA).¹² This Bill formed, in the Committee's opinion, a useful foundation for the development of a list of standards or 'rights'. In particular, the TIA Bill establishes 11 'rights' and provides a description of the nature of each 'right'. While not accepting that all the 'rights' contained in the TIA's draft should be incorporated in the Charter, the Committee believed consideration should be given to including reference in the Charter to both standards of behaviour and conduct expected of the ATO and the redress available to taxpayers where those standards were not satisfied.

13.26 As a model for the Charter, the Committee felt that the UK Citizen's Charter was superior to the US system. The use of direct language and the formal presentation of standards of service and expectations were considered to be preferable to the creation of enforceable rights.

13.27 The Committee concludes that the concept of a Taxpayers' Charter should be explored through consultation with relevant taxpayer representatives, the ATO, community leaders and the Commonwealth Ombudsman.

12. Taxation Institute of Australia, 'Taxpayers' Bill of Rights' - a draft prepared for public comment, Sydney, April 1993.

13.28 The Committee recommends that:

the Government consider establishing a Taxpayers' Charter based on a review of the various models available.

13.29 Once promulgated, the Charter should be widely circulated. Specific distribution should be to all taxpayers undergoing audit, all ATO staff and the general taxpayer population via the TaxPack. In addition, ATO staff should be given specific training on the consequences and implications of the Charter and, where necessary, the ATO should review current procedures to ensure the rights established in the Charter are capable of being delivered.

Taxation Ombudsman

13.30 The Committee considered that the recommendation for a Charter of Rights would be of little practical effect unless the current administrative procedures for reviewing taxpayers' complaints were reformed. The capacity for taxpayers to have administrative issues, not necessarily involving a decision of the Commissioner, reviewed and explained was of paramount importance. Moreover, where taxpayers consider the ATO has acted illegally or unconscionably, an avenue of redress was necessary.

13.31 At present the taxpayer can approach the Commonwealth Ombudsman for an external review of the problem or obtain an internal review through one of the ATO's Problem Resolution Units (PRU). These units, which have been established in every ATO branch office, consist of a small number of officers who are expected to act on behalf of taxpayers within the ATO.¹³ The principal function of the PRUs is to seek to resolve within 10 working days those problems of an administrative character where taxpayers have no formal avenue of review or redress.

13.32 Evidence from taxpayers and their representatives urged the creation of a dedicated Taxation Ombudsman for the purpose of providing a remedy to administrative impropriety or inefficiency which impacts upon taxpayers.¹⁴

13. Evidence, vol. 16, pp. S3259-60.

14. Evidence, vol. 5, p. S728; vol. 7, pp. S1060, S1064, S1091; vol. 15, p. S2939.

13.33 In a submission to the Committee the current Commonwealth Ombudsman set out the general characteristics of an Ombudsman's office:

- . actual and perceived independence from the subject of scrutiny and complaint;
- . impartiality conducting independent investigations rather than acting as an advocate on behalf of any party;
- . having the power to make recommendations regarding remedial action but not to make determinations which are binding on any party; and
- . being appointed by statute, and usually reporting to the Parliament.¹⁵

13.34 The Committee considered a number of options for the development of a Taxation Ombudsman including:

- . the creation of an independent Taxation Ombudsman's office outside the current Commonwealth Ombudsman's Office;
- . the extension and expansion of the current reference for the Commonwealth Ombudsman's Office in respect of taxation matters; and
- . improved administrative access by the Commonwealth Ombudsman's Office to the ATO.

13.35 The Committee concluded that the most effective approach to securing an adequate review of complaints was to expand the existing review mechanisms of the PRU and link them with a Taxation Ombudsman. Such an approach would present an ideal opportunity to link internal administrative review and external independence.

13.36 Resources allocated to the PRUs to manage both current workloads and work arising from review of complaints to an ombudsman would need to be increased. However, the Committee considered that the resources required for cost-effective operations would be small and could be managed within current allocations.

15. Evidence, vol. 21, pp. S5267-9.

Staff working in a PRU would need to be sufficiently senior to conduct investigations of complaints with authority and should be placed in the PRU for a specific period of time, but not less than 18 months. This would allow the relevant officers time to establish an understanding of the process without harming their normal ATO careers. Officers working in PRUs should not suffer any career detriment as a result of placement in those positions and should, following the completion of a placement, be reintegrated to at least their previous levels and roles.

13.37 The Committee envisages that staff of the PRUs would be selected by the Taxation Ombudsman upon a recommendation of the Commissioner of Taxation but would at all times remain officers of the ATO.

13.38 For consistency of process, the Committee considered that all complaints currently lodged with the PRUs should in future be lodged with the Taxation Ombudsman. The Ombudsman would be required to investigate all complaints using the PRU staff, and prepare a report on the reasons for the complaint and the manner of resolution of the problem or why the problem cannot be resolved. The Ombudsman would continue to make recommendations for remedial action, particularly where a systemic problem was identified. The Ombudsman's report should be provided to both the taxpayer and the ATO while continuing to report generically to the Parliament.

13.39 In this way the Committee believed taxpayers who considered they had been treated unfairly by the ATO, whose rights at law had been violated, or whose rights under the Charter had been abused, would be able to approach the Taxation Ombudsman. The Ombudsman would then conduct the review process from a position of authority, knowledge and independence with the assistance of internal ATO staff. As a result, the administration of the ATO would be improved by the PRU's on-going review of work practices and reports on administration difficulties identified by the Ombudsman.

13.40 The Committee acknowledged the proposition that any Taxation Ombudsman should be established outside the current Commonwealth Ombudsman's Office. Arguments in support of this suggestion focused on the lack of technical capacity and resources within the current Office. Contrary arguments were included in the evidence of the Commonwealth Ombudsman. They were the cost effectiveness of a single Ombudsman's Office, the potential for public confusion and the need to maintain independence.¹⁶ In considering these arguments, the Committee acknowledged the recommendation of the Senate Standing Committee on Finance

16. Evidence, vol. 22, p. S5270.

and Public Administration, in review of the Office of the Commonwealth Ombudsman which proposed that specialist ombudsman institutions be under the control of the Commonwealth Ombudsman.¹⁷

13.41 The Committee concludes that a Taxation Ombudsman's Office should be properly resourced within the Office of the Commonwealth Ombudsman. The Committee believes it is imperative that the public should be able to clearly identify and communicate with the Taxation Ombudsman's Office. To this end the Committee considers that the location of the Taxation Ombudsman's offices should be clearly advertised at all ATO branch offices and the address and contact numbers included in all ATO publications.

13.42 Therefore, the Committee recommends that:

- . a statutory position of Commonwealth Taxation Ombudsman be created within the current Commonwealth Ombudsman's Office;
- . resources be provided to the Commonwealth Taxation Ombudsman to allow the Ombudsman to adequately investigate all complaints;
- . the role of the Problem Resolution Units in the Australian Taxation Office be amended such that the staff of those Units work directly to a Commonwealth Taxation Ombudsman;
- . reports by the Commonwealth Taxation Ombudsman on taxpayer complaints be provided both to the taxpayer and the Commissioner of Taxation; and
- . a report on the activities of the Commonwealth Taxation Ombudsman be incorporated in the Annual Report to Parliament of the Commonwealth Ombudsman.

17. Senate Standing Committee on Finance and Public Administration, *Report on Review of the Office of the Commonwealth Ombudsman*, AGPS, Canberra, 1991.

Taxpayer Privilege

13.43 An important right established by common law which applies in the area of taxation is the right to confidentiality between a lawyer and a taxpayer in respect of certain forms of communication which passes between them.

13.44 Legal professional privilege (the privilege) was initially a rule of evidence and is now established as a substantive rule within the common law which, generally stated, requires that:

In civil and criminal cases, confidential communications passing between a client and his/her legal adviser need not be given in evidence or otherwise disclosed by the client and, without the client's consent, may not be given in evidence or otherwise disclosed by the legal adviser if made either -

- (1) to enable the client to obtain, or the adviser to give, legal advice; or
- (2) with reference to litigation that is actually taking place or which was in the reasonable contemplation, or apprehension, of the client.¹⁸

13.45 Justification for the privilege was clearly stated in a majority decision of the High Court in 1976:

... it promotes the public interest because it assists and enhances the administration of justice by facilitating the representation of clients by legal advisers, the law being a complex and complicated discipline. This it does by keeping secret their communications, thereby inducing the client to retain the solicitor and seek his advice, and encouraging the client to make a full and frank disclosure of the relevant circumstances to the solicitor.¹⁹

13.46 The existence of the privilege has always been recognised as mitigating the operation of a competing public interest, that of ensuring all trial

18. Byrne D, Heydon JD, *Cross on Evidence*, 3rd edn., Butterworths, 1986, p. 635.

19. *Grant v Downs* (1976), 135 CLR 674 at 685.

litigation should be conducted on the footing that all relevant documentary evidence is available.²⁰ As such, it has also been recognised that the privilege can be overridden where it is considered to be inconsistent with, or subservient to, a more dominant public interest. A more dominant public interest may be determined by the courts in the course of a case or trial²¹ and may be evidenced by Parliament specifically excluding the operation of the privilege through legislation.²²

13.47 In the course of the Inquiry, the Committee took evidence from taxpayer representatives, particularly tax agents, who urged the Committee to recommend that the privilege through statute be extended to communications concerning taxation between a taxpayer and professional advisers who may not be lawyers.²³ Guidelines on access to accountant's papers, negotiated between the ATO and the professional accounting bodies, have established an administrative privilege for these papers during an audit. This protection is based on the recognition by the Commissioner of the right of taxpayers to consult professional advisers on a confidential basis to facilitate full and frank discussion. However, such a protection has no legal authority and may be withdrawn at any time.

13.48 The Committee acknowledged that recommending a change to the current arrangements would have implications for the commercial operations of professional firms and the general administration of the ATO. It would extend a common law, evidentiary concept into statute. On this basis, the Committee considered the implications of such a change should be carefully evaluated in the context of a full review of the operation of the privilege in respect of the taxation system in particular, and its implications for public administration in general.

13.49 The Committee reviewed the October 1993 report by the Trade Practices Commission (TPC) on the legal profession and noted the recommendation which stated:

The Commission is not convinced that legal professional privilege is of significance to competition in the area of taxation advice or litigation, and does

20. *ibid.*

21. *R v Cox and Railton* (1884) 14 QBD 153 and *R v Bell; Ex parte Lees* (1984) 55 ALR 545 at 555-6 per Woodward and Neaves JJ.

22. *Corporate Affairs Commission of New South Wales v Yuill and Others* (1991) 172 CLR 319.

23. Evidence, vol. 3, p. S479; vol. 5, p. S729; vol. 7, pp. S1066, S1139; vol. 2, p. 529; vol. 3, p. 752.

not think that a change to the operation of the privilege is justified on competition grounds alone.²⁴

13.50 In its report the TPC concluded that there were good reasons for not changing the current form or application of legal professional privilege in the absence of a very good case being argued for such a change.

13.51 The Committee noted that the TPC based its conclusion in respect of market advantage, in part, on a survey by the Corporate Tax Association of Australia.²⁵ While this survey indicated that the market in which legal professional privilege was said to be problematic was small, the Committee considered that the potential taxation revenue from this market segment was probably significant.

13.52 Moreover, the Committee noted that the TPC investigation had not evaluated the operational issues for the ATO stemming from the operation of legal professional privilege. The Committee therefore concluded that the principle of the privilege needed to be fully evaluated from a public policy perspective.

13.53 The Committee recommends that:

the Attorney-General refer the question of the operation and impact of the doctrine of legal professional privilege, as it applies to the administration of the taxation system, to the Australian Law Reform Commission for evaluation, review and report; and

the Australian Law Reform Commission in evaluating the operation of the doctrine of legal professional privilege give consideration to the impact of the doctrine on the treatment of advice on taxation matters passing between taxpayers, lawyers and other professional advisers, vis a vis, the Australian Taxation Office.

24. Trade Practices Commission, *Study of the Professions, Legal, Draft Report*, AGPS, Canberra, October 1993, p. 475.

25. *ibid.*, p. 468.

13.54 On an administrative level, the Committee received evidence of the impact that the privilege has upon ATO auditors.²⁶ The capacity for claims of privilege to stall audit investigations was noted. The Committee considered that, while a privilege existed, taxpayers had the right to make claims for the protection of documents. The scope of that right however was limited by the doctrine. Nevertheless, the Committee noted that lawyers in making claims of privilege on behalf of their clients had a duty to the clients to claim all documents potentially covered by the doctrine.

13.55 As a consequence of this obligation, many documents upon which privilege does not apply may be unnecessarily claimed and temporarily removed from the purview of auditors. Negotiation and discussion can rectify many of these difficulties. The Committee believes however that a sanction should apply to prevent abuses of the claim of privilege, but notes that a theoretical problem existed in that lawyers only act as agents for taxpayers. Consequently, the Committee concludes that the question of the administrative arrangements for managing claims of privilege should be considered by the Australian Law Reform Commission, along with the question of sanctions for persons who make unreasonable claims.

13.56 Therefore the Committee recommends that:

the Australian Law Reform Commission, as part of a reference into legal professional privilege, investigate and make recommendations on the administrative mechanisms for handling claims for privilege and the need to provide a sanction for persons who make unreasonable claims.

26. Evidence, vol. 15, p. S3157; vol. 3, pp. 739, 775-787, 832-833; vol. 4, pp. 1038, 1041, 1071.

Chapter 14

AVENUES OF REVIEW

- . Avenues of Review
- . Right of Review - Objections
- . Internal Review - Appeals and Review Group
- . External Review
- . Reporting by the Administrative Appeals Tribunal
- . Cases Before the Federal Court
- . The Australian Taxation Office as a Litigant

Avenues of Review

14.1 The Committee noted that taxpayers had a number of avenues for seeking formal review of the ATO's decisions. These included:

- . applications for order of review, declaratory orders and prerogative writs under the *Administrative Decisions (Judicial Review) Act 1977*;
- . application for information regarding decisions under the *Freedom of Information Act 1982*;
- . investigation and review of case circumstances by the ATO's Problem Resolution Unit; and
- . application to the Ombudsman for investigation of the taxpayer's case.

14.2 The Committee also noted the capacity for taxpayers to seek relief under provisions of the *Income Tax Assessment Act 1936* and other taxation enactments, where the payment of the full amount of the taxation liability would cause hardship. Further discussion of the operation of the Relief Board is contained in Chapter 9.

Right of Review - Objections

14.3 The primary right of a taxpayer dissatisfied with a decision of the Australian Taxation Office (ATO), whether an administrative decision, a legal interpretation or a combination of both, is to seek a review of that decision and ultimately to have the issue settled by either administrative review or judicial determination.

14.4 The process of review commences within the ATO itself. In 1991, the *Taxation Law Amendment Act (No.3) 1991* amended several Acts and established an objections, review and appeals procedure pursuant to Part IVC of the *Taxation Administration Act 1953*. Taxpayer's rights of objection stem from the statutory provisions of taxation Acts which generally provide that, where taxpayers are dissatisfied with an assessment, determination, notice or decision, they may object in the manner set out in Part IVC of the *Taxation Administration Act 1953*.

14.5 Taxation objections must be made in writing and lodged with the Commissioner within a given period (currently 60 days). They must state in full and in detail the grounds upon which the objection is based. The right of objection may be limited in certain cases, and the period for lodgement of an objection may be extended at the discretion of the Commissioner.¹

14.6 Once an objection has been lodged with the Commissioner, provided it was lodged within the 60 day period or the Commissioner has agreed to extend the period of lodgement, the Commissioner is compelled to make a decision on the objection.² If the taxpayer is dissatisfied with the Commissioner's decision, the taxpayer may either apply to the Administrative Appeals Tribunal (AAT) for review of the decision or appeal to the Federal Court of Australia (the Federal Court) against the decision, depending upon the nature of the objection decision.³

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1. *Taxation Administration Act 1953*, s. 14ZV.
 2. *Taxation Administration Act 1953*, s. 14ZY.
 3. *Taxation Administration Act 1953*, s. 14ZZ.

Internal Review - Appeals and Review Group

14.7 Clearly the process of objection review is not conducted personally by the Commissioner of Taxation. An internal Appeals and Review Group exists within the ATO for this purpose. It works with other groups within the ATO to:

- . minimise the level of unnecessary disputes with taxpayers and other clients;
- . resolve disputes where they occur; and
- . litigate effectively with respect to issues that will appropriately develop and clarify the law.⁴

14.8 Internal reviews of the kind practised by the Appeals and Review Group seek to operate from a perspective which is independent from the original decision maker. The process of review only occurs after a decision has been made and following an objection from the taxpayer. Consequently, the role of the Appeals and Review Group does not extend to the supervision of the process of decision making, although the Group does seek to investigate the causes of dispute and instigate proper remedial action.⁵

14.9 It is difficult to characterise the function of the Appeals and Review Group as one of 'independent review'. This is because, to the extent that this Group is established within the ATO, it is subject to the same culture, corporate goal and values of all other ATO Groups. That culture includes a commitment to the protection of the revenue of the Commonwealth.

14.10 To the extent that a decision has been made within the ATO which advances the collection of revenue and which may be considered likely to be as equally valid as a decision which would reduce revenue collection, the Appeals and Review Group can be seen to be culturally bound to determine the matter in favour of the ATO. However, it is not possible to determine whether subjective judgements of this nature have ever been made. The unresolved nature of the issue means that 'internal review' is fundamentally flawed as a process of 'independent' review.

4. Evidence, vol. 4, p. S870.

5. Evidence, vol. 3, p. 871.

14.11 The Committee considered whether internal review as currently practised by the ATO was efficient and effective and noted the need for an independent internal review procedure, that is, one outside the normal channels of the assessment process. This raises fundamental questions about both the quality of primary decisions and any internal decision making review procedures.

14.12 The Committee considered that taxpayers should be able to understand not only how but also why a particular decision or position has been adopted by officers of the ATO. At the same time, ATO personnel should be capable of rationalising, explaining and supporting every decision they make. It was unacceptable in the Committee's view that any taxpayers' rights, including the right to personal property, should be violated or compromised without taxpayers having reasons for that decision explained to them. Justification on the grounds of administrative complexity was not acceptable. Responsibility for the provision of reasons should lie entirely with the ATO.

14.13 Although the Committee could not draw a firm conclusion on the relative efficiency of internal review compared to a systematic review procedure internalised in a decision making process, it did conclude that a consequence of relying on internal review was the potential for a conflict between taxpayers and the ATO. In the Committee's view it was preferable that decisions of the ATO were both professionally determined and communicated to taxpayers. In essence this would require the ATO to provide reasons for final on all occasions and be willing to accept, evaluate and critically respond to taxpayer submissions on all aspects of administration and interpretation. From the taxpayer's perspective, decisions of the ATO which were reasoned and supported by the organisation should be considered as final decisions. Armed with the ATO's reasons, the taxpayer should then be able to select external review and/or appeal.

External Review

14.14 Primarily because of the limitations of internal review, further rights to review are provided in the *Taxation Administration Act 1953*. Those reviews are currently conducted by either the AAT or the Federal Court.

14.15 Taxpayers must determine initially whether they desire to pursue their right to a review of the objection decision through the AAT or take the matter directly to the Federal Court. In making this decision taxpayers need to consider and evaluate a number of factors including:

- . whether of the dispute is legal or administrative;
- . the cost and formality of proceedings;
- . the potential delay in having the matters resolved;
- . privacy; and
- . the ability to appeal.

14.16 Associated with either decision is a cost. A \$300 filing fee is imposed in both jurisdictions and a further \$500 hearing fee is payable if the matter is listed for determination. Should the taxpayer be successful in the AAT, both fees are recoverable although no interest will be paid for the time the money is held.

14.17 A decision of the AAT does not create a legally binding precedent. Evidence to the Committee illustrated occasions where the ATO had determined not to follow an AAT decision or to strictly limit the decision to the narrow facts of the case in question.⁶ The Committee recognised that the AAT did not determine questions of law.

14.18 Table 14.1 illustrates the workload of the AAT over recent years in the taxation jurisdiction.

6. Evidence, vol. 18, p. S4337.

**Table 14.1: Taxation Workload of the Administrative Appeals Tribunal
1986-87 to 1992-93**

	Lodgement/ referrals	Finalised	Outstanding	Conferences	Hearings
1986-87	24 224	10 358	60 851	2 886	818
1987-88	9 184	15 680	54 355	12 179	1 429
1988-89	1 148	32 891	22 612	37 864	791
1989-90	726	18 690	4 648	14 520	654
1990-91	521	2 891	2 278	1 226	161
1991-92	523	1 064	1 737	488	139
1992-93	856	2 002	556	1 059	129

Source: Evidence, vol. 21, p. S5043; vol. 22, p. S5347.

14.19 A number of factors have contributed to the significant decline in the AAT's workload in this jurisdiction. Most importantly, in the middle of the decade, streamlined pre-hearing procedures were developed in an effort to settle matters before a formal hearing or determine an agreed area of dispute. The significant use of conferences was particularly evident during 1992-93. Through pre-hearing procedures both parties are made aware of the positions adopted by their opponents prior to a hearing. Settlements can often be reached prior to hearing, thus reducing the number of cases which require hearing proceedings.

14.20 The current level of lodgements with the AAT represents approximately 10% of its workload.⁷ Since 1 March 1992, taxpayers have been able to lodge applications for review of a decision of the Commissioner, directly with the AAT. Previously these applications were made to the Commissioner.

14.21 In evidence to the Committee it was argued by a representative of the Australian Taxpayers' Association that the cost of Tribunal procedures does not allow taxpayers to challenge actions of the Commissioner which, on the basis of the size of the tax in dispute, could be classified as 'minor'. This is because the action involves small sums of money or sums which, when taken together with legal and filing fees, represent a risk to the individual greater than the potential benefit of success. Thus a taxpayer may be forced to accept the ATO's position or settle an

7. Evidence, vol. 21, p. S5043.

assessment rather than seeking review.⁸ The development of a small claims jurisdiction was raised with the Committee, arguments for which included:

- . the need for questions of principle involving small sums of money to be determined;
- . development of a procedure to settle small claims outside of a formal legal framework; and
- . the integration of all taxation issues, both administrative and legal, within a single operational framework.⁹

14.22 The Committee sought advice from the ATO on the possible value of a small claims tribunal to the general operation of the taxation system. The model considered by the Committee would involve an election by the taxpayer to seek a review or lodge an objection against a decision of the Commissioner with a Small Taxation Claims Tribunal (the Small Claims Tribunal). Only matters under a certain monetary limit would be considered and the taxpayer would pay a once only non-refundable fee, of modest proportions, to the Small Claims Tribunal.

14.23 Under this proposed system, once the Small Claims Tribunal proceedings had been initiated both the ATO and taxpayer would agree to accept the verdict of the Small Claims Tribunal as final, but the ATO would not be bound by the decision in respect of any other case. Furthermore, if the ATO considered the matter was of such significance to warrant determination with legal precedence, it could elect to have the matter heard before the Federal Court provided all the taxpayer's costs, including the full cost of legal representation, were met by the ATO.

14.24 A Small Claims Tribunal would consist of a single individual considered expert in taxation law who would hear the evidence either in conference or formal hearing and issue a decision in each case. A registry would be established within the AAT in each State for administrative convenience. Formal rules of evidence would not apply and, in general, legal representation would be permitted though not required. The Committee envisages accountants and tax agents also appearing before the Small Claims Tribunal.

8. Evidence, vol. 3, pp. S398, S478; vol. 5, p. S701; vol. 14, p. S2785.

9. Evidence, vol. 1, p. S59; vol. 3, p. S517.

14.25 In responding to the Committee's request for advice, the ATO noted that it was not possible to devise a scheme which would be cost neutral. The ATO estimated that the proposal considered by the Committee would require an annual outlay of between \$1 million and 1.5 million.¹⁰

14.26 The ATO proposed a Small Claims Tribunal for cases where the tax on the item or items in dispute was less than \$2 000.¹¹ However, the Committee considers this threshold was too low as it would exclude many middle income earners and small businesses. Instead the Committee concludes a \$5 000 threshold is appropriate.

14.27 Appointment from outside the ATO of Tribunal members was considered essential as were the proposals to have matters heard by a single member and for a small fee to apply to cover administrative costs. The Committee concludes this fee should be non-refundable.

14.28 While the procedures outlined in the ATO's proposal were generally considered satisfactory by the Committee, it believes the AAT, and not the ATO, should administer the Small Claims Tribunal. Furthermore the Committee is of the view that the decisions of the Small Claims Tribunal should be non-appealable and notes that legislative changes would be necessary to give effect to the proposal.

14.29 To ensure major taxation issues of general importance are determined by a competent authority, the Committee concludes the ATO needs to be able to remove matters from the small claims jurisdiction to the Federal Court. However, as previously stressed, such a decision would have to impose no additional cost on the relevant taxpayer.

10. Evidence, vol. 22, p. S5330.

11. Evidence, vol. 22, p. S5329.

- . the current taxation law of Australia be amended to allow the establishment of a Small Taxation Claims Tribunal within the registry of the Administrative Appeals Tribunal;
- . the relevant taxation laws of Australia be amended as to allow the establishment of a procedure to permit taxpayers to lodge objections against, or seek review of, decisions of the Australian Taxation Office before a Small Taxation Claims Tribunal;
- . where the amount of tax in dispute with the Australian Taxation Office is less than \$5 000, taxpayers be able to elect to have their objections or reviews of decisions heard by the Small Taxation Claims Tribunal;
- . a \$50 non-refundable fee be required to be lodged by taxpayers seeking review of decisions of the Australian Taxation Office in the Small Taxation Claims Tribunal;
- . any decision of a Small Taxation Claims Tribunal be final and non-appealable; and
- . where a taxpayer intends to take a matter before the Small Taxation Claims Tribunal, the Australian Taxation Office have the option to refer the matter to the Federal Court of Australia provided all the taxpayer's costs, including legal representation, are met by the Australian Taxation Office.

14.31 Aside from a Small Claims Tribunal within the AAT, the Committee considered the merit in establishing a similar facility, with a higher threshold and appeal rights, within the registry of the Federal Court. The Committee acknowledged the duality of such a facility and concluded that an evaluation of the efficiency of a Small Taxation Claims Tribunal should be conducted prior to any extension to the Federal Court.

Reporting by the Administrative Appeals Tribunal

14.32 AAT reports are currently reprinted by the two main legal publishing houses, Butterworths and CCH, under two different classifications, even though the cases reported are the same. Cases are reported in such a manner as to not disclose the relevant taxpayer. In the Committee's view this strict secrecy is unnecessary and the use of two report classifications is confusing. The suppression of taxpayer names can be explained by:

- . the ATO's insistence that proceedings of the AAT concerning taxation issues should be heard in the strictest confidence; and
- . the obligation to preserve the privacy of a taxpayer's affairs under review, in accordance with those rights which existed at the time the AAT was awarded the jurisdiction previously held by the Taxation Boards of Review.

14.33 Having considered the merits of the issues related to this matter and the arguments for and against changes to the current arrangements,¹² the Committee considered there was merit in allowing taxpayers to preserve their confidentiality if they so desired. However the generality of cases should be determined in the public domain. While arguments relating to privacy were considered important, the Committee noted that administrative matters can, in certain very limited circumstances, be considered by the Federal Court and publicly reported.

14.34 As the confidentiality protection is provided for the taxpayer, the Committee concludes the relevant Act should be amended to embrace the options for taxpayers.

12. Senate, *Hansard*, 24 March 1992, p. 995.

Sections 14ZZE and 14ZZJ of the *Taxation Administration Act 1953* be amended so as to establish the presumption that hearings before the Administrative Appeals Tribunal in taxation matters are held in public unless the taxpayer elects to hold the hearing in private; and

the Government encourage the reporting of taxation cases from the Administrative Appeals Tribunal under a single reporting series.

Cases Before the Federal Court

14.36 Taxation related workloads in the Federal Court have fallen in a manner commensurate with the workload of the AAT. In 1987 when jurisdiction over taxation appeals was conferred on the Federal Court, a total of 2 768 taxation appeal cases were filed in the Court. Of this number, 1 946 were matters transferred by the State Supreme Courts. In 1988, a total of 1 247 appeal cases were filed in the Court. Table 14.2 and 14.3 list the number of taxation appeal cases commenced in the Federal Court since 1987.

Table 14.2: - Workload of Federal Court in Taxation Related Matters 1987-88 to 1992-93 Cases Filed or Transferred from State Supreme Courts

	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93
No. of cases	3 591	268	114	192	120	162

Source: Evidence, vol. 21, p. S5040; Federal Court of Australia
1991-92 Annual Report, AGPS, Canberra, 1992.

Table 14.3: Workload of Federal Court in Taxation Related Matters 1987-88 to 1992-93

	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93
No. of cases	3455	259	105	180	63	31

Source: Federal Court of Australia, *Draft 1992-93 Annual Report*, AGPS, Canberra, 1992.

14.37 A clear reduction in the taxation workloads of the Federal Court is evident from the above tables. A number of factors may explain this decline:

- . the development of a system of case management within the Federal Court for handling appeal cases;
- . the requirement to treat each year of income as a separate appeal such that, although there may have been only one issue in question several years were affected - each year represented a new appeal with appeals now only considering one year and settlement following that one year determination of the issue;
- . the decline in cases involving schemes which originally formed a large proportion of the transferred workload - test cases served to reduce the number of such cases outstanding;
- . fewer disputes being put before the Court - this would reflect, in part, the greater role of settlement being utilised by the ATO and the operation of full scale audits of the major corporate entities;
- . the development of the self assessment system such that appeals now follow audit rather than assessment; and
- . taxpayers being deterred from appealing because of cost considerations.

14.38 Regardless of the reasons behind the decline, the absolute level of the decline indicates a serious revision of the role of litigation in respect of taxation matters. Evidence of the success of the ATO in matters before the Courts was provided to the Committee to demonstrate the importance of litigation to clarification of the law.¹³ Auditors of the ATO expressed concern at the apparent reluctance of the ATO to prosecute or challenge taxation strategies through the courts.¹⁴

14.39 The Committee considered the merit of restricting appeals from the Federal Court to the High Court in respect of taxation matters. The Committee noted the significant reduction in the Federal Court's workload in the taxation

13. Evidence, vol. 3, pp. S401, S596; vol. 6, p. S887.

14. Evidence, vol. 7. pp. S1030, S1073.

jurisdiction. Arguments in favour of removing the right to seek leave to appeal to the High Court include:

- . the reduced cost of litigation and the freeing up of the resources of the High Court;
- . specialisation of judicial skill in respect of taxation matters in the Federal Court; and
- . the capacity to develop a revenue specialisation in an Australian judicial jurisdiction.

14.40 Arguments against such a move principally revolve around the importance of allowing access to the highest Court in the land in respect of an issue of economic importance to the stability of the Australian economy. In the Committee's view, no conclusive case has been established to alter current arrangements.

The Australian Taxation Office as a Litigant

14.41 The ATO, like other Commonwealth agencies, has access to significant funding for the conduct of litigation. Criticism of the 'bottomless pit' of financial legal resources of Commonwealth agencies is not restricted to the ATO. Any litigant facing the Commonwealth Government must reconcile themselves with the absolute financial resource the Commonwealth possesses. While legal expenses allocation from the annual Budget may be exhausted, access to additional funding via the Advance to the Minister for Finance is generally available. It would be exceptional if litigation were to be suspended on account of a refusal for additional funding.

14.42 The limitless nature of Commonwealth legal resources means that Commonwealth agencies can, in effect, conduct cost-benefit analyses of litigation, free from the constraint of a limited financial resource. Unlike individual taxpayers, the ATO is never forced to refrain from litigation as a result of a lack of money. To the extent that the personal financial element does not play a role in decisions concerning litigation, the ATO is able to consider litigation issues in a sterile fiscal environment.

14.43 The potential for success, rather than financial constraint, is the dominant factor influencing the ATO's decisions on litigation. The Commissioner of Taxation expressed the nature of the cost-benefit calculation in the following manner:

I guess I see three categories [of cases]. There is the case where the tax at issue in that particular case is such that you have to take it, and there is a qualification on that which I will come back to. There is the case where the amount of revenue in the particular case might not be that much but it is representative, because of other similar cases, of a large amount of revenue at stake. I guess a third category could be that there is a technical issue that is desirous, needful, of resolution...In all of that, we endeavour to make a proper assessment of chances of success. In that, we work through counsel, before the courts anyway, and at the AAT partly through counsel and our own people. So there is AG's [the Attorney-General's Department] and external counsel giving us advice on our chances of success. It is part of that broad risk thing, if you like.¹⁵

14.44 While concentration on the likelihood of success is appropriate for any litigant, this would normally be balanced against the cost of litigation. In the case of the ATO the absence of financial considerations means that cases are judged purely on the merits of success for the ATO.

14.45 Given the financial strength of the ATO as a litigant, the Committee considered whether particular rules were necessary for the determination of a decision to litigate issues. Where a large amount of revenue is at stake, whether in an individual taxpayer's case or for the totality of taxpayers, the Committee agreed that the charter of the ATO dictated that issues should be litigated as test cases.

14.46 However, in the case of a small representative taxpayer, the Committee considered it appropriate that the ATO should fund both the Commonwealth and the taxpayer's case where the circumstances were such that the taxpayer had been successful in any prior competent judicial forum. It was considered inappropriate that the ATO should be able to utilise its financial strength to effectively wear down a taxpayer where the maximum benefit to the taxpayer was far less than the potential revenue benefit to the Commonwealth.

15. Evidence, vol. 5, p. 1456.

14.47 Evidence of the potential for the ATO to effectively isolate a taxpayer from the judicial process in respect of taxation was given in a submission to the Committee.¹⁶ This case demonstrated to the Committee the worst features of the taxation system as it currently applies. Not only was the taxpayer forced to take the case on appeal in the first instance, but the Commissioner's decision to challenge to the Full Federal Court put the taxpayer to additional costs. In addition, the failure of the ATO to seek a fair and reasonable settlement with the taxpayer in the first instance was calculated and bureaucratic. Moreover, the failure of the ATO to properly assess the taxpayer after the Full Federal Court decision was tactless, unprofessional and demonstrated a gross misjudgment.¹⁷

14.48 At present the ATO utilises guidelines to determine those cases which it will fund, on appeal, as test cases. The overriding criterion in these circumstances is that the case must involve a matter of perceived significance.¹⁸ In the Committee's opinion all cases taken on appeal by the ATO from a decision of a competent judicial forum should require that the ATO fully fund the taxpayer's case. Fully funded in this situation means all costs, not merely party-party costs.

14.49 The Committee recommends that:

in all cases where the Australian Taxation Office is unsuccessful at any stage of litigation and a decision is made to appeal the relevant decision, the Office fully fund the taxpayer's expenses in defending the case.

14.50 Although the Committee has made a number of recommendations in this chapter relating to the creation of a new, low cost review tribunal and suggested that the method of internal ATO review should be evaluated, it was cognisant of the many pressures ATO staff face in the form of public scrutiny. The Committee, however, does not resile from its belief that public scrutiny and review are essential to the efficient, effective and equitable performance of public service.

L J Scott, MP
Chairman
5 November 1993

16. Evidence, vol. 7, p. S1082.

17. Evidence, vol. 15, pp. S2951-6.

18. Evidence, vol. 9, p. S1456.

