



CHARTERED ACCOUNTANTS  
AUSTRALIA • NEW ZEALAND

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Mr John Alexander OAM MP  
Committee Chair  
House of Representatives Tax and Revenue Committee  
PO Box 6021  
Parliament House  
Canberra ACT 2600

By e-mail: [taxrev.reps@aph.gov.au](mailto:taxrev.reps@aph.gov.au)

Dear Mr Alexander,

**House of Representatives Tax and Revenue Committee (House Committee) Inquiry into Tax Disputes**

Chartered Accountants Australia and New Zealand welcomes the opportunity to contribute to the House Committee's Inquiry into Tax Disputes between taxpayers and the Australian Taxation Office (ATO).

**About Chartered Accountants Australia and New Zealand**

Chartered Accountants Australia and New Zealand is made up of over 100,000 diverse, talented and financially astute professionals who utilise their skills every day to make a difference for businesses the world over.

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We focus on the education and lifelong learning of members, and engage in advocacy and thought leadership in areas that impact the economy and domestic and international capital markets.

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**Chartered Accountants Australia and New Zealand**

33 Erskine Street, Sydney NSW 2000,  
GPO Box 9985, Sydney NSW 2001, Australia  
T +61 2 9290 1344 F +61 2 9262 4841

[charteredaccountantsanz.com](http://charteredaccountantsanz.com)



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## Our Submission

The remit of the House Committee's Inquiry is extremely broad.

The Inspector General of Taxation (IGOT) is also currently conducting three reviews relevant to this Inquiry, namely:

- A review into the ATO's approach to debt collection;
- A review into tax disputes between the ATO and large business and the ATO and high wealth individuals; and
- A follow-up to a previous review of the ATO's implementation of the IGOT's recommendations in its 2009 report entitled 'Review into aspects of the Tax Office's settlement of active compliance activities'.

Our professional body is aware that a number of the larger accounting firms that have specialist tax dispute resolution teams are likely to make their own submissions to the House Committee and we look forward to their contribution to the Inquiry on issues encountered by their clients.

Accordingly, our comments are more general in nature and focus more on the prevention and settlement of disputes.

### 1. Preventing disputes arising in the first place

#### Key comment

Chartered Accountants Australia and New Zealand believes it is important for the House Committee to consider ways in which tax disputes can be prevented from arising in the first place.

#### 1.1 Existing approaches

It is important to acknowledge at the outset the range of avenues for taxpayers to avoid disputation by clarifying their tax positions with the ATO.

The House Committee will be aware that Australia's tax system is based primarily on self-assessment. This means it is important for our tax law and the ATO to help taxpayers 'get it right'.

Leaving aside the numerous and helpful ATO publications available online and taxpayer help lines, the most valuable dispute avoidance mechanism enables a taxpayer to apply for a binding private ruling from the Commissioner. Alternatively, a taxpayer whose circumstances fall within an ATO public binding ruling can rely on that ruling.

Both types of ruling (where favourable to the taxpayer's cause) provide 'safe harbour' protection in the event of a subsequent ATO review or audit and, in this sense, help avoid disputation with the ATO.

Advance pricing arrangements are also available to head-off transfer pricing disputes, although these take much more time, skill and effort to negotiate.

Although not directly related to dispute resolution, voluntary disclosures are encouraged by the tax law and by ATO practice (i.e. through penalty remission) and provide another avenue for taxpayers to reduce tax risk and the disputation that may result.

Voluntary disclosure initiatives such as the ATO's current Project DO IT also provide an attractive incentive for taxpayers to disclose tax evaded and avoid disputation.

The ATO also has 'products' which seek to flush-out potential areas where disputes may arise. In the large business taxpayer segment for example, a Risk Differentiation Framework is applied and one of the resultant tools that can be invoked is a requirement for a company to lodge a special tax return schedule identifying their reportable tax positions.

## 1.2 Can more be done to prevent disputes arising?

The ATO's Dispute Management Plan already highlights the importance of *early* action to head off disputes before they escalate.

### *Tax technical disputes*

For potential disputes on tax technical issues, we believe that the key needs are:

- greater collaboration with taxpayers and their advisers to ensure that the ATO is indeed in full possession of all the facts and arguments before forming a concluded view
- improved levels of communication by the ATO *and* professional advisers on the reasons for technical position(s)

We understand that the ATO's senior leaders are already aware that improvements are needed in these areas and Chartered Accountants Australia and New Zealand will continue to collaborate with the ATO on such matters.

### *Tax debt disputes*

The Inspector-General of Taxation has noted that over the last 10 years the ATO has reported an increase in total collectible debt. In 2012-13 the total amount of this was about \$17.7 billion and importantly, over 60% was owed by small business.

#### **Key comment**

For disputes relating to tax debts, ATO data suggests there is clearly a need to explore new ideas.

The data reflects what our members who specialise in insolvency encounter, with the ATO often the largest creditor in small company insolvencies.

As noted earlier, the Inspector-General of Taxation has asked for submissions on tax debt collection and we will be responding.

Chartered Accountants Australia and New Zealand has also recently met with Ms Cheryl-Lea Field (ATO Deputy Commissioner, Debt) to discuss ideas already in train to address current levels of debt and related disputes.

Our initial research indicates that the ATO's current strategy to use its data analytics capability to intervene as early as possible with taxpayers in financial difficulty is the best approach, and that improved decision-making is needed when determining whether extended time should be granted to pay tax debt.

### 1.3 Identifying areas where disputes commonly arise and considering new approaches

#### Key comment

It would be useful for the House Committee to canvass with the ATO the tax topic areas which give rise to the most disputes and explore with all stakeholders ways in which the level of disputation can be reduced, or even eliminated.

A good place to start would be in those areas impacting larger groups of taxpayers, an approach which would be in keeping with ATO plans to adopt a 'light touch' approach to individuals and small businesses with relatively straightforward tax arrangements.

For example, in our recent submission to the Board of Taxation on Tax Impediments Facing Small Business, we canvassed ideas to reduce potential disputation in a number of contentious areas confronting small business, including:

- Providing 'safe harbour' deductions (e.g. to reduce disputation over whether legal expenses are on capital or revenue account<sup>1</sup>)
- Adopting simplified methodologies for establishing acceptable transfer prices where a small business has dealings with related offshore entities
- The need for 'bright line' tests to be regularly communicated to those at risk of falling foul of the personal services income rules in the income tax law
- Addressing the uncertainty created by the current employee v contractor rules, we submitted that if a small business has verified the worker \ payer ABN online using the Australian Business Register, worked through the ATO decision making tool, and kept a record that all of this has been done, then the ATO should not impose penalties and interest on the business \ payer if the ATO concludes that the wrong decision has been made.
  - In a legislative sense, the House Committee might wish to explore whether more could be done to foster a system whereby a business \ payer can rely on the fact that a worker \ payer has an ABN without needing to check whether the ABN holder is truly an employee or contractor.

### 1.4 Reducing the current level of aged tax debt

#### Key comment

To reduce current levels of aged tax debt, one idea which the ATO might want to consider as a 'rapid response' measure is to instigate a special compromise offer as part of a stand-alone, limited life initiative<sup>2</sup>.

Apart from collecting revenue, the aim of this exercise would be to achieve an initial, hopefully sizeable reduction in the number of taxpayers who might otherwise later be the subject of insolvency action or personal bankruptcy.

<sup>1</sup> For example, we proposed that a small business which would otherwise need advice on the capital – revenue distinction from a tax adviser would be allowed a 'safe harbour' deduction for any legal expense which does not exceed a maximum annual amount (e.g. \$10,000). A deduction claimed for legal expenses exceeding this amount (e.g. \$15,000) would need to be supported by consideration of the capital – revenue distinction for the full amount claimed (i.e. \$15,000).

<sup>2</sup> A limited life project helps counter community perceptions that tax debts can always be negotiated down. The eligibility criteria also need to be carefully defined so that those who can pay their debt do not take advantage of the arrangement. The Commissioner of Taxation already delegates his powers of general administration to enable nominated ATO officers to compromise tax debts.

In the U.S. for example, an expanded 'Fresh-Start' Initiative commenced in 2012 to enable some of the most financially distressed taxpayers an opportunity to recover from the Global Financial Crisis by quickly clearing up their tax problems. The initial I.R.S. announcement included details on:

- who qualifies
- instalment agreements
- 'Offer in Compromise' arrangements enabling a taxpayer to settle the tax debt for less than the full amount owed

The initiative was further expanded in January 2014 to make 'Fresh-Start' even more attractive by adjusting the way the I.R.S. goes about its financial analysis of debtors.

## 2. Settlement of tax disputes

### 2.1 Introduction

The Australian tax policy team at Chartered Accountants Australia and New Zealand has conducted a short review of procedures for handling tax disputes in other countries. Our research indicates that the ATO – with its focus on early resolution of disputes – is one of the world's leading tax agencies when it comes to this aspect of tax administration, with several overseas agencies implementing strategies pioneered by the ATO.

The ATO has established points of view on the application of the law in most cases, and generally does not resile from publicly stated positions in tax dispute negotiations unless the taxpayer is able to put forward novel arguments which have not been previously considered. That said, there are many areas of the tax law where there is ample scope for differing technical viewpoints, such as the distinction between capital and revenue items<sup>3</sup>. On the whole however, the majority of settlements relate to untested positions on newly enacted tax law, intention, factual matters, the exercise of discretionary powers, valuation matters or apportionment.

Notwithstanding the ATO's improved performance on settlements<sup>4</sup>, the Commissioner of Taxation – Chris Jordan AO FCA – indicated soon after coming to office on 1 January 2013 that he wanted to further improve outcomes for all stakeholders involved in tax disputes<sup>5</sup>:

*The other area of business I believe can be improved is the speed of resolving issues taxpayers have with us and even hopefully reducing the number of disputes.*

*We've made changes to spread our tax technical expertise across the ATO. We have recently placed tax law experts with our front line compliance officers, which mean our experts are involved much earlier in your clients' matters. Our experts will in future be more visible and accessible - not 'faceless decision makers'. The right people will be involved earlier to assist with more timely advice and guidance.*

*Resolving disputes is a significant investment for the ATO and for taxpayers: it can be costly, time and resource consuming, and a potential risk to our relationships and reputation if not well handled.*

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<sup>3</sup> A coin toss has been referred to as a satisfactory test to distinguish the two: See *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634 at p.645 where Dixon J referred to the comments of Lord Greene, M.R., in *IRC v British Salmson Aero Engines Ltd* [1938] 2 KB at p.498.

<sup>4</sup> 2011-12 and 2012-13 statistics on the *Profile of settlements registered* by the ATO, are published in Part 2: Performance Reporting, Settlements, in the Commissioner's Annual Report for 2012-13.

<sup>5</sup> *Tax, the way ahead. Speech* by Chris Jordan, Commissioner of Taxation, The Tax Institute's 28th Annual Convention, Perth, 14 March 2013.

*Media interest in disputes is regular and persistent. Every week the media covers disputes, with a particular focus on perceived high profile taxpayers or significant litigation'*

*Of course, we recognise and support the taxpayer's right to have ATO decisions independently reviewed by the courts and tribunals, but disputes occupy much court time. The timely resolution of tax disputes is an important ingredient of an effective tax system and we should be able to do more of this without the need for courts.*

In the same speech, the Commissioner also highlighted what he saw as a need for a more independent review process:

*Usually in audit disputes the ATO has one position and the taxpayer another. Last year we implemented a new large business, internal review process where a taxpayer did not agree with the ATO's final audit position, prior to amended assessments and prior to objection. This followed a recommendation by the Inspector General of Taxation. I support this initiative, but I don't think it went far enough. I want to tackle any perception the review process lacks independence. To ensure a review process that is genuinely independent, and perceived as such, I want to change what we currently do and have the large business pre-assessment review undertaken by a senior technical person in our law area rather than our large business area.*

#### **Key comment**

We supported the Commissioner's objectives at the time these comments were made, and continue to do so.

Our position is that a collaborative, out-of-court process is the best way to resolve often complex tax disputes. For business taxpayers in particular, it allows them to focus on their core commercial goals.

The alternative – tax litigation – is expensive, time consuming and does not provide stakeholders with certainty of outcomes.

Unlike court-imposed solutions, settlements also enable taxpayers to agree 'going forward' tax positions with the ATO which give certainty of tax treatment for future years.

## **2.2 The need for vigilance on settlements**

We believe it is useful to consider current issues to do with this area of tax law and administration and determine whether there are concerns and \ or opportunities for improvement.

From a broader tax policy and public interest perspective, this is due to several factors:

- The substantial regulatory and enforcement powers entrusted by Parliament to the Commissioner of Taxation and (through delegation) his officers.
- The need to maintain public confidence that our tax laws are interpreted and applied fairly.
- The community benefits obtained from identifying ways to improve (already high) levels of voluntary tax compliance, as distinct from the costs and detriments associated with coercion to regulate behaviour (i.e. tax-related evidence gathering, enforcement activity, adversarial approaches and the disputation that may often result when such tactics are employed).

We note also that there is no homogenous group of stakeholders who deal with the ATO. The House Committee is likely to hear differing perspectives from taxpayers and their advisers

operating in (or servicing) different segments of the taxpayer population. For example, a small business operator might have a different perception of the ATO's power and its use in disputes than, say, a large business assisted by in-house and external expertise. The ATO's challenge is to always exercise its powers consistently to treat both taxpayer types fairly.

Experiences in other jurisdictions – such as the United Kingdom House of Commons' Public Accounts Committee (PAC) hearings in October 2011 into the handling of tax disputes by HM Revenue & Customs (HMRC) – also highlight the potential benefits of the current Inquiry<sup>6</sup>.

### 2.3. The current ATO framework for settlement of disputes

The ATO's current approach to settlement of disputes is generally encapsulated within the so-called 'good management' rule.

As noted by former Second Commissioner Bruce Quigley in a speech delivered in 2009<sup>7</sup>:

*The courts have accepted that the Commissioner has the ability to settle a dispute and compromise a debt where it is in the interests of good administration to do so. In Grofam Pty Ltd v FCT<sup>8</sup> the Full Federal Court said that the Commissioner's power to settle or compromise proceedings to which the Commissioner is a party is derived from the general administration provision of the income tax laws (section 8 of the Income Tax Assessment Act 1936).*

The settlement of disputes is one of the relatively few areas where the Commissioner has delegated his powers of *general* administration, with the ATO's *Code of Settlement Practice* and numerous supporting Practice Statements<sup>9</sup> setting out guidelines on how this delegation is to be used. The Code requires the ATO to adopt a principled basis to settlements and taxpayers are well advised to adopt a similar stance (i.e. 'global' settlement offers are not entertained: both sides need to focus on the law, arguable technical interpretations and supporting documentation).

Our members' experience is that ATO officers undertake full due diligence before commencing settlement discussions and will have a 'range' in mind on the amount they are prepared to negotiate. Litigation risk is a factor which the ATO will take into account

In keeping with broader principles governing the independence of public officials, ATO officers engaged in settlement negotiations must abide by conflict of interest rules<sup>10</sup> as well as a raft of other legislation and guidance on how they must go about their work, including:

- Financial Management and Accountability Act 1997 (especially s. 44 of that Act) and Regulations about appropriate spending of Commonwealth monies

<sup>6</sup> The PAC review made a number of critical findings and recommendations relating to HMRC's handling of large tax disputes and resulted in a further investigation by the UK's National Audit Office (NAO) into HMRC's handling of five large tax settlements, with the assistance of Sir Andrew Park, a former High Court tax judge. Although the NAO concluded that all five settlements were reasonable in the circumstances, concerns were expressed about the processes by which the settlements were reached and poor internal communication about the justification for the settlements. These events ultimately led to the establishment of the Office of Tax Assurance Commissioner within HMRC (the activities of the Tax Assurance Commissioner are discussed later in our submission).

<sup>7</sup> *The Commissioner's powers of general administration: how far can he go?* Speech by Bruce Quigley, Second Commissioner (Law). Taxation Institute 24th National Convention, Sydney, 12 March 2009.

<sup>8</sup> (1997) 36 ATR 493 at 503.

<sup>9</sup> For example: PS LA 2003/3 - Precedential ATO view; PS LA 2004/13 - The Transfer Pricing Review Panel (TPRP); PSLA 2007/6 - Guidelines for settlement of widely-based tax disputes; PS LA 2009/9 - Conduct of Tax Office litigation; PS LA 2012/1 - Management of high risk technical issues and engagement of tax technical officers in Law and Practice.

<sup>10</sup> For example: Corporate Management Practice Statement PS CM 2004/02 - *Conflicts of interest*; Corporate Management Procedures and Instructions CMP1 2004/02/03 - *Gifts, hospitality and other benefits*; the Australian Public Service Values and Code of Conduct [s. 10 and s. 13 *Public Service Act 1999*].

- Legal Services Directions dealing with the Commonwealth's obligations as a 'model litigant' and with handling of monetary claims
- Civil Dispute Resolution Act 2011 which encourages the resolution of civil disputes prior to filing applications in the courts
- Prosecution policy of the Commonwealth and policy statements on Fraud Control and the Prosecution Process
- Freedom of Information legislation and information disclosure guidance such as PS CM 2013/02 (Information pro-disclosure)

We also understand that there is an Integrity Unit and (as required under the *Public Service Act 1999*) 'whistleblower' procedures within the ATO should an ATO employee (or external party) feel that there has been misconduct or that proper procedures are not being followed.

These legislative requirements, guidelines and procedures, as well as the Taxpayers Charter, also assist taxpayers in their dealings with the ATO on settling disputes although it has to be said that few tax practitioners would be familiar with all of the relevant material in this particular field of tax law and administration.

#### **Key comment**

A sound legislative and administrative framework currently governs the way in which the ATO, taxpayers and their advisers currently deal with tax disputes.

## **2.4 Secrecy and confidentiality of ATO settlements – Knowledge sharing and quality of decision making – Public commentary – Community safeguards**

### *Secrecy and confidentiality of ATO settlements*

The resolution of tax disputes by way of settlements is governed by strict confidentiality rules founded in both the tax law<sup>11</sup> and normal commercial principles.

Confidential tax settlements by their nature do very little to advance the general knowledge of taxpayers, their advisers and the general public on how the tax law is being interpreted and administered: the 'tax intelligence' gleaned from such settlements is normally confined to the relevant group of officers within the ATO, the taxpayer which is a party to the settlement and the practitioners within the professional firms involved.

Unlike litigated outcomes, there is no published judgment to read and no appeal to a higher court to be monitored.

Parliamentarians will typically be unaware of tax settlements and are not in a position to form views as to the adequacy of current tax laws which give rise to settlements. We note however that the ATO moves quickly to provide Ministerial advice via Treasury where it considers remedial legislative action is required<sup>12</sup>.

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<sup>11</sup> The best known secrecy provision in the tax law is s. 16 of the Income Tax Assessment Act 1936. Secrecy provisions cannot be displaced unless authorised by law or by the taxpayer. Refer to Corporate Management Practice Statement PS CM 2004/07 for guidance on the *Secrecy and privacy obligations of Tax Office employees*.

<sup>12</sup> A recent example is the communication to government of concerns about tax planning involving the use of s. 25-90 of the Income Tax Assessment Act 1997 to increase levels of deductible debt claimed against the Australian revenue base.



### Key comment

Due to secrecy and confidentiality requirements, much public trust is placed in the:

- quality of ATO decision-making processes leading to tax dispute settlements
- skill and judgment of senior ATO officers involved in settlement negotiations.

### *Knowledge sharing and quality of ATO decision-making*

In the context of tax dispute settlements, the central player in a knowledge sharing and quality sense is the ATO.

Put simply, it is vital to confidence in our tax system that, to the maximum extent possible, the ATO applies well-considered and appropriate processes which accord similar treatment to different taxpayers in similar circumstances when dealing with tax disputes (both in terms of the matters in dispute and also the imposition of interest and penalties<sup>13</sup>).

Although our members indicate that further improvement is necessary in the area of staff skills (see below), our understanding is that the ATO has a strong internal focus on quality decision-making<sup>14</sup> and its internal procedures largely achieve the desired goal of uniform, equitable treatment of taxpayers.

### Key comment

A focus on knowledge sharing and improved communication within the ATO is, in our view, key to further improving the ATO's performance in dispute resolution.

The ATO's *Code of Settlement Practice* already sets out circumstances where it is or is not appropriate to settle a dispute. Within these guidelines however, situations will inevitably arise where the 'tax intelligence' gained from the negotiations, or the terms of a particular settlement, will be of relevance to another taxpayer in a similar set of circumstances.

The Code of Settlement<sup>15</sup> indicates that the ATO uses the Siebel case management system to record 'details of every settlement, including the justification or underlying reasoning for the settlement'.

We are not familiar with the attributes of the Siebel system, nor the current status of other initiatives which have been mentioned in recent times to improve quality, such as the Transforming Tax Technical Decision Making Project (TTDM)<sup>16</sup>.

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<sup>13</sup> The composition of a settlement can be very important. For example, some technical adjustments, although adverse to the taxpayer in a current year, may create compensatory deduction opportunities or timing benefits in a later year. Also, interest paid to the ATO is deductible to the taxpayer whereas penalties are non-deductible.

<sup>14</sup> There are many ATO procedures designed to enhance quality within the organization. In the context of this submission, particular reference should be made to [PS LA 2009/6](#) - *Quality improvement and assurance: application of and conformance with the Integrated Quality Framework*.

<sup>15</sup> Refer paragraph 68 of the Code.

<sup>16</sup> Both the Siebel system and TTDM were mentioned in the *Review into the Australian Taxation Office's administration of class rulings*, Inspector-General of Taxation Report to the Assistant Treasurer, September 2011.

### **Key comment**

It is important that:

- ATO knowledge management systems adequately record the 'tax intelligence' resulting from dispute settlements so that it can be shared internally
- These systems are actually used by ATO staff (both in terms of contributing and accessing knowledge) and communication is constantly improved, particularly now that there is a greater focus within the ATO on alternative dispute resolution

### *Public commentary on tax dispute settlements*

Mention has already been made of the secrecy and confidentiality surrounding the settlement of tax disputes.

However, this does not prevent occasional public commentary on the topic in the media and from groups within civil society concerned about tax issues.

These public comments are typically based on the limited insights available from:

- Adjustments which may be made in a company's published accounts
- Disclosures required under specific rules such as 'FIN 48' enacted by the U.S. in 2007<sup>17</sup>
- Listed company disclosures to the ASX that a settlement has been reached with the ATO, although such announcements generally provide very little detail<sup>18</sup>

Whatever the source, the disclosure of a sizeable amount of tax payable to (or refundable by) the ATO can attract commentary which, to some, reflects adversely on the taxpayer and \ or the performance of the ATO.

Given that company officials rarely comment publicly on such matters, professional advisers are governed by client confidentiality requirements, and the ATO is legally obliged to stay silent, such comments often give an incomplete picture to the public of the true nature of the dispute and the actual outcome agreed between the two parties.

### **Key comment**

Notwithstanding the damage that un-informed comments can cause, we feel that it is vitally important to the proper functioning of the tax system that tax settlements continue to be governed by legislative and commercial secrecy safeguards.

Our main reasons for this view are as follows:

- The fact that settlements are confidential encourages the parties to settle rather than litigate
- Confidentiality means that all parties are more open in their discussions with the result that settlements can be achieved more quickly and without recourse to litigation

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<sup>17</sup> Broadly, FIN 48, *Accounting for Uncertainty in Income Taxes* requires a company evaluate its tax positions by determine whether it is more likely than not that the tax position will be sustained upon examination (based on the technical merits) and measure the amount of tax benefit that is to be recognized in the financial statements.

<sup>18</sup> Such announcements can be accessed from the [ASX website](#).

- Discussions which occur during settlement negotiations take place on a confidential, 'without prejudice' basis, and the parties naturally expect the confidentiality aspect to flow through to the settlement deed
- Disclosure is unlikely to adequately convey the full detail of the arguments which prompted the settlement, nor the complex tax law on which those arguments were based (i.e. disclosure could still give rise to un-informed comment).

### *The need for safeguards*

Although secrecy provisions and the confidential nature of settlements make it difficult to delve into the detail of actual settlement decisions and the processes leading to those decisions, it is nonetheless important that adequate safeguards are in place to maintain community confidence in our tax system.

Our starting point here is to note that the ATO is perhaps the most scrutinised public sector agency in Australia<sup>19</sup>.

Organisations such as the Inspector-General of Taxation have reviewed tax dispute settlement aspects of ATO operations, primarily from the perspective whether the procedures set out in the Code of Settlement have been adhered to. Reports from the Australian National Audit Office have also touched on this topic.

Although such reports always contain helpful recommendations, the general impression given is that ATO governance generally, and in dealing with tax disputes in particular, is very robust.

### **Key comment**

Overall, our position is that the current framework for the external review of ATO administration of tax disputes adequately protects the community's interest.

We acknowledge however that other jurisdictions have adopted a different stance in relation to tax-related dispute settlements, and determined that greater levels of assurance are required about how their tax agency undertakes its work.

The approach in these jurisdictions – particularly the United Kingdom – may provide models for consideration in Australia.

For the benefit of the House Committee, our research into U.K. and USA models is shown at Appendix A.

## **2.5 Alternative dispute resolution**

All government agencies are encouraged by the Attorney-General's Department to embrace Alternative Dispute Resolution (ADR) strategies, with guidance from the National Alternative Dispute Resolution Advisory Council.

The ATO has also developed its own Dispute Management Plan which states that it 'will continue to review our use of ADR to identify opportunities to improve our understanding of when it should be used and what types of ADR are most effective in different types of disputes'. ADR intervention often starts with a neutral evaluation, a process which seeks to identify and limit the issues of fact and law

<sup>19</sup> Regular reviews of ATO operations are conducted by: Australian National Audit Office; Inspector-General of Taxation (as a result of the most recent Federal Budget, it is envisaged that the duties performed by the Commonwealth Ombudsman will be transferred to the Inspector-General of Taxation); Office of the Australian Information Commissioner

that are in dispute and, by that means, assist to resolve the dispute. The process is typically undertaken on a without prejudice basis.

Prompted in part by the Inspector-General of Taxation's May 2012 Review into the ATO's Use of Early and Alternative Dispute Resolution, the ATO has embarked upon a change process in the way that it handles disputes. Using a consultative process in which we participated, the ATO:

- updated its 2007 guidelines on ADR<sup>20</sup> and revamped its published Disputes Policy
- published a Plain English Guide to Alternative Dispute Resolution
- engaged the Australian Centre for Justice Innovation (Monash University) to design, implement and administer a mechanism for independently evaluating ATO use of ADR
- trained a select group of ATO officers as facilitators in dispute resolution
- improved the collation of data and feedback on settlement cases, and
- encouraged ATO officers to engage in more open communication with taxpayers as to the nature of the matters in dispute and the arguments being relied upon by the ATO.

Our members report that there is now a more pro-active approach from the ATO in exploring ADR with taxpayers, and we believe this is a good thing.

The House Committee may wish to review the key recommendations in the Inspector-General's report and consider whether those agreed with by the ATO have been fully implemented.

#### *Skill levels relating to settlement of disputes*

##### **Key comment**

Members of our professional body report that outcomes when attempting to resolve ATO disputes using ADR can vary due to differing levels of preparedness, advocacy and knowledge skills, and experience amongst ATO staff involved in negotiations.

We also acknowledge the variable skills and experience that tax practitioners may also bring to the table.

Negotiating tax disputes requires talents which go beyond sound tax technical tax knowledge.

House Committee members will be well aware that successful negotiation outcomes also require a range of personal skills developed through formal and (more importantly) experiential learning.

Recommendation 3.7 of the Inspector-General of Taxation's *Review into the ATO's Use of Early and Alternative Dispute Resolution* dealt with training issues and the ATO will no doubt be in a position to report to the House Committee on the follow-up which has occurred in response to this recommendation.

##### **Key comment**

From our viewpoint, we see an opportunity here for collaborative learning with ATO officials on negotiation skills and dispute resolution.

The ATO has engaged in collaborative learning arrangements with external organisations in the past, but the renewed focus on ADR suggests to us that this is an area where professional organisations such as ours and the ATO could do more, for the benefit of all stakeholders.

<sup>20</sup> PSLA 2013/3 - Alternative Dispute Resolution (ADR) in ATO disputes (previously Law Administration Practice Statement 2007/23).

### *An annual report on ADR*

The ATO has implemented Recommendation 5.4 in the Inspector-General's *Review into the ATO's Use of Early and Alternative Dispute Resolution* to implement an independent system to collate and assess feedback from all parties, their representatives and ADR practitioners as to the effectiveness of the process, including the conduct of the ATO's representatives when engaging in ADR and any suggestions for improvement.

The first report will be for the period 2013-14 and the ATO [website](#) indicates it be published online 'later in 2014'.

The Commissioner of Taxation's latest public update on ADR provided the following insights<sup>21</sup>:

*We are having very good results with alternative dispute resolution and settlements – with earlier, direct and open contact with taxpayers and use of in-house facilitators for less complex disputes. We continue to use third parties such as former Federal Court and High Court judges for early neutral evaluation or mediation in complex disputes and we are keen to expand all of these approaches.*

#### **Key comment**

The ATO 2013-14 annual report (or at least preliminary findings) on ADR will hopefully be made available to the House Committee as part of this Inquiry.

## **2.6 Independent review**

Apart from the enhanced focus on ADR, an important recent ATO initiative – instigated by the Commissioner of Taxation – has been the introduction of an Independent Review process under the stewardship of First Assistant Commissioner Deborah Hastings (Review and Dispute Resolution) in the large company segment, both for income tax and (from 1 July 2014) GST matters.

The Independent Review casts a 'fresh set of eyes' over the matter in dispute, and is somewhat similar to the process used within accounting firms for the review of important items of tax advice before it enters the public domain. The review team sits outside the ATO compliance team that made the initial decision.

We understand that a slightly modified Independent Review process will be implemented by the ATO's Deputy Commissioner Michael Cranston for the Private Groups and High Wealth Individuals segment of the taxpayer population. We support the extension of Independent Review procedures to this group: the tax in dispute may not be as large as that for the large company segment, but equality of ATO treatment is an important principle and an outcome which our members who advise this sector have actively sought.

Here again, the Commissioner of Taxation's most recent public update was positive<sup>22</sup>:

*We are pleased with the results from our independent review function for income tax audits of large businesses...*

*Fourteen cases of independent review have been completed (as at the end of April [2014]), with seven and a half of those found consistent with the ATO's original position and six and*

<sup>21</sup> Keynote address to the Institute of Chartered Accountants Australia Practice Forum, [Speech](#) by Chris Jordan, Commissioner of Taxation, Sydney, 12 June 2014.

<sup>22</sup> Keynote address to the Institute of Chartered Accountants Australia Practice Forum, op cit.

*a half in the taxpayer's favour. You may also be interested to know that we are now in settlement negotiations for six of the cases found in favour of the ATO.*

To be an *independent* review, it is essential that the ATO officers handling the taxpayer's compliance and objection matters are able to obtain the support (e.g. from the Tax Counsel Network) they need to do their work, but do not then subsequently re-engage with the same supporting group of individuals during the review stage. Staff allocations within the ATO need to be carefully managed to ensure that a well-skilled, truly independent group of ATO officers are available to conduct the review.

#### **Key comment**

The beneficial results flowing from the initial implementation of the Independent Review process should be drilled down to other segments of the taxpayer population as quickly as possible to avoid any perception that the process favours large companies or well-off taxpayers.


Chartered Accountants Australia and New Zealand sees a role for retired tax practitioners in the conduct of Independent Reviews, subject to strict compliance with rules around conflict of interest.

## **2.7 Valuation disputes**

Valuations underpin the application of a number of important provisions in the tax law – especially dealings between related parties or taxpayers not dealing at arm's length. Disputes over valuations commonly arise.

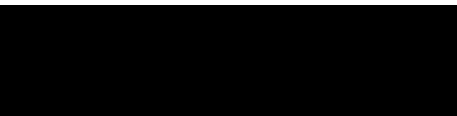
Our December 2013 [submission](#) to the Inspector-General of Taxation's review into the ATO's administration of valuation matters identified a number of factors contributing to the number of valuation disputes, and offered a number of suggestions to reduce the level of disputation.

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If you would like to discuss any aspect of our submission please contact me on 

Chartered Accountants Australia and New Zealand would be happy to discuss our submission with members of the House Committee should the Committee wish to hold hearings on this Inquiry.

Yours sincerely



Michael Croker  
Tax Australia Leader  
Chartered Accountants Australia and New Zealand

## Appendix A

### Public oversight of tax agency settlements with taxpayers in other jurisdictions

In a review of overseas jurisdictions, we noted the following approaches to enhance the transparency of tax settlements.

#### The United Kingdom response to concerns about the settlement of disputes with large corporate taxpayers

Reference has already been made in our submission to the United Kingdom House of Commons' Public Accounts Committee (PAC) hearings in October 2011 into the handling of tax disputes involving large companies by HM Revenue & Customs (HMRC) and the subsequent review by the U.K. National Audit Office.

The package of changes that resulted at HMRC is summarized in *How We Resolve Tax Disputes*, the Tax Assurance Commissioner's Annual Report 2012-13, HMRC, 2 July 2013.

Broadly, the changes were as follows:

- A new position – Tax Assurance Commissioner – was established to assess whether a proposed settlement secures the right tax outcomes efficiently and fairly to taxpayers (note that the Tax Assurance Commissioner does not engage directly with specific taxpayers on their liabilities, but does oversee the decision-making process)
- The HMRC decision-making model was changed for large and sensitive cases, using the Tax Disputes Resolution Board (established in September 2012) and ensuring decisions on whether to settle or not are made by three Commissioners
- A review was undertaken of HMRC processes in settling disputes using samples of completed cases
- The role of HMRC's Audit and Risk Committee was enhanced
- A new code of governance was published on settling tax disputes to improve transparency about HMRC processes

#### Key comment

There are no doubt learnings for the ATO from the recent experiences in the United Kingdom.

However, the strong concerns expressed by the PAC which ultimately led to the changes within HMRC have not been raised in an Australian context.

We also note that recent changes within senior ranks of the ATO and the Commissioner of Taxation's plans to 'reinvent' the organisation point to beneficial changes in many areas of ATO operations, including dispute resolution.

Chartered Accountants Australia and New Zealand believes that the new leadership team at the ATO should be given time to implement its new strategies. We are already engaged with the ATO on some projects related to the new approach, and look forward to further engagement on the co-development of new ways to improve tax administration.

## **The United States of America – Joint Committee of Taxation role in reviewing large tax refunds or credits**

The U.S. Congress' Joint Committee of Taxation is a bipartisan committee established under the Internal Revenue Code of 1986<sup>23</sup> and is closely involved with every aspect of the tax legislative and revenue estimation process. It is supported in its work by specialist staff comprising economists, lawyers and accountants.

One of the Committee's roles is to review tax refunds by the I.R.S. in excess of USD 2 million<sup>24</sup> 'to determine whether the provisions of the tax law operate as intended or cause unintended administrative, interpretive, or statutory problems'.

The Committee also undertakes a post review program, under which the I.R.S. submits reports on its 'closed' large cases.

### *Refund review mechanism*<sup>25</sup>

The process for reviewing refunds is set out below:

- The I.R.S. prepares a written report for the Joint Committee staff on each refund case<sup>26</sup>. The report contains:
  - a brief history of the taxpayer's situation
  - an explanation of the reasons for the refund
  - supporting documents prepared by the I.R.S.
- The Joint Committee staff review the I.R.S. reports, focusing on the technical aspects of the case and the I.R.S.'s resolution of the issues presented. This review enables the staff to become familiar with specific issues in individual industries and unearth problems in the administration of the law
- If the problem identified is legislative in nature, the Joint Committee staff may recommend an amendment to the Code
- When the problem identified relates to I.R.S. pronouncements (e.g. rulings), the Joint Committee staff may request that the I.R.S. clarify or reconsider its published position
- When the problem identified is lack of uniform application of the law, the Joint Committee staff may request that the I.R.S. publish guidance on the issue

The refund review also helps identify issues that, as a technical matter, were not handled correctly by the I.R.S. In these instances, the Joint Committee staff recommends adjustment to the amount of the refund when the tax effect in the case is significant.

Adjustment is also recommended when, as a result of the correction, loss or credit carry forwards will be reduced significantly even though there is no effect on the proposed refund. When the impact in a given case is small, no adjustment is recommended, but the staff still provide comments to the I.R.S. to prevent repetition of the error.

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<sup>23</sup> Sections 8001-8005 and 8021-8023 and predecessor sections in the Internal Revenue Code of 1954.

<sup>24</sup> There is a proposal to increase the review threshold to USD 5 Million for entities classified as C Corporations under US tax law: refer *Technical Explanation of the Senate Committee on Finance Chairman's Staff Discussion Draft of Provisions to reform Tax Administration*, prepared by the Staff of the Joint Committee on Taxation, 20 November 2013.

<sup>25</sup> This material is adapted from page 13 of the document *About the Joint Committee on Taxation*, available as a download from the 'About Us' section of the Joint Committee's website.

<sup>26</sup> Internal Revenue Manual 4.36.2 provides I.R.S. guidance on Identification of Joint Committee Cases.



Although the statute does not require that the I.R.S. comply with Joint Committee staff requests for adjustments, both the Joint Committee Staff and the I.R.S. view the review process as a way of improving tax administration.

Thus, the I.R.S. will not pay any part of a refund while the Joint Committee staff has a continuing objection, and has on occasion requested that the staff monitor a particular issue to ensure that I.R.S. agents are handling the item appropriately.

**Key comment**

Although well intentioned, the U.S. Joint Committee approach appears to us to be:

- overly bureaucratic
- labour intensive
- costly
- time consuming, and
- (potentially) raises the perception that tax administration is impacted by political considerations.