

Rulings

The history of rulings

Binding by choice

- 4.1 The rulings system has developed over time to become more formal and have greater coverage. It had its origins in the 1930s, when the Commissioner for Taxation released Income Tax Orders, which published the Commissioner's interpretation of the tax laws.¹ The Australian Taxation Office (ATO) issued other guidance as well, including public information bulletins and ATO memoranda.²
- 4.2 The first proposal for a formal system was made in the 1975 Asprey Review, which recommended creating a system of private binding rulings on a fee for service basis.
- 4.3 Although the then Government did not adopt this recommendation, the advent of freedom of information (FOI) legislation in 1982 required a more systematic approach to rulings. At that time, the ATO was using a range of internal guidance to ensure that decisions were accurate and consistent. Under FOI, taxpayers would have a claim to these documents, so it made sense to publicly release them and avoid processing many FOI requests. These published guidelines (income tax rulings and miscellaneous tax rulings) were the precursors to public rulings.

1 Discussion derived from ANAO, *The Australian Taxation Office's Administration of Taxation Rulings*, Audit Report No. 3 2001-02, 17 July 2001, pp 173-201.

2 JCPA, *An Assessment of Tax: A Report on an Inquiry into the Australian Taxation Office* (1993) Report 326, p 98.

- 4.4 In 1986, the Government introduced self assessment for individual taxpayers. Because taxpayers were subject to financial loss, through penalties and interest, if their returns led to a tax shortfall, they were given a mechanism for clarifying their position with the ATO. Section 169A of the *Income Tax Assessment Act 1936* stated that a taxpayer could bring an aspect of their tax affairs to the attention of the Commissioner at the time of lodging the return. The Commissioner would be required to 'give attention to that question.'
- 4.5 The ATO normally considered itself bound by an opinion formed in response to a section 169A request. If the Commissioner later wished to amend the assessment under section 170 of the *Income Tax Assessment Act 1936*, the taxpayer would still be liable for primary tax. Liability for penalties would depend on the taxpayer's conduct overall, as would remission of interest. The Commissioner would not permit section 169A to be used as a means of taxpayers indefinitely delaying their tax liabilities.³
- 4.6 In 1988, the ATO clarified its advisory system. It announced it would issue two types of rulings. The first was taxation rulings, which were similar to public rulings. The second was advance opinions, which were responses to taxpayer queries about proposed transactions.⁴ The latter were similar to private rulings. Both types of decisions were administratively binding on the Commissioner. They had no force of law, but the Commissioner adhered to them unless there were exceptional circumstances, such as new legislation or a new court decision.⁵

Binding by law

- 4.7 In 1990, the Federal Court handed down its decision in *David Jones Finance v Commissioner of Taxation*.⁶ There, the ATO departed from its practice of the previous 30 years of allowing taxpayers who were not registered shareholders to claim a benefit available to 'shareholders.' The ATO relied on the 1976 High Court case of *Commissioner of Taxation v Patcorp*

3 ATO, 'IT 2616, Income tax: Self-assessment – Questions concerning taxpayers liability to tax – Subsection 169A(2) requests' viewed on 14 May 2007 at <http://law.ato.gov.au/atolaw/view.htm?locid='ITR/IT2616/NAT/ATO'&PiT=99991231235958>.

4 Section 169A covered completed transactions.

5 ATO, 'IT 2500, Taxation ruling system: Policy governing issue of income tax rulings: Status of rulings: Advance opinions' viewed on 14 May 2007 at <http://law.ato.gov.au/atolaw/view.htm?locid='ITR/IT2500/NAT/ATO'&PiT=19940616000001>.

6 (1990) 12 ATR 1506.

*Investments*⁷ and won. The *David Jones Finance* case reminded taxpayers of the limits of 'administratively binding.'⁸

4.8 Following this, the then Government commenced a review of the self assessment system, which culminated in the *Taxation Laws Amendment (Self Assessment) Act 1992*. The major changes to the rulings system were that:

- rulings now became legally binding on the Commissioner
- if a taxpayer disagreed with a private ruling, they could appeal the ATO's decision to the Administrative Appeals Tribunal (AAT) and the Federal Court
- the Commissioner's power to issue rulings was expanded from income tax to cover the Medicare levy, withholding taxes, franking deficit tax and fringe benefits tax.

4.9 Previously, ATO advice was not binding on the Commissioner. For example, if a taxpayer obtained an advance opinion about a transaction and followed that advice, there was the risk that the ATO could apply a different interpretation of the law. There was no legal protection. These changes, however, gave the taxpayer legal protection if they complied with the private ruling.

4.10 Section 169A was amended so that taxpayers only had the option of making such a request if they were precluded from applying for a private ruling on the matter. These changes effectively discontinued the option of a section 169A request, as private rulings were available for both completed and proposed transactions. The ATO has stated that, until this time, it was receiving approximately 50,000 requests annually under section 169A.⁹

An Assessment of Tax

4.11 In 1993, the Joint Committee on Public Accounts (JCPA) released its report on tax administration, *An Assessment of Tax*. The report covered a number of themes in relation to rulings.¹⁰ The first theme was that rulings should

7 (1976) 140 CLR 247.

8 Cooper G et al, *Cooper Krever & Vann's Income Taxation: Commentary and Materials* (2005) Thomson, 5th Edition, p 885.

9 House of Representatives Standing Committee on Employment, Education and Workplace Relations, *Employee Share Ownership in Australian Enterprises*, D'Ascenzo M, transcript, 11 May 2000, p 350.

10 JCPA, *An Assessment of Tax: A Report on an Inquiry into the Australian Taxation Office* (1993) Report 326, pp 95-121.

be freely available and well known amongst the relevant stakeholders. The ATO supported these recommendations. They included:

- a requirement to publish public rulings in the Commonwealth Gazette and table them in Parliament
- access to the ATO's public rulings database
- access to the ATO's private rulings database, with identifying features on each ruling deleted.

4.12 The JCPA also wished to ensure that rulings maintained the distinction between the law and the Commissioner's interpretation of the law, the latter of which was represented in the ruling. The relevant recommendations, which the ATO supported, were to detail alternative views in public rulings and to refrain from making contentious rulings where the law needs clarification.

4.13 Another major theme in the report was that taxpayers should not automatically incur penalties for not following a private ruling or a determination (a more specific public ruling). The Committee argued that, if the taxpayer made it clear in their tax return that they had diverged from the ATO's advice, then such penalties were unnecessary. The ATO did not support these recommendations.

4.14 The JCPA noted that private rulings could be seen as free legal advice to taxpayers and argued that this could mean that the ATO would not have sufficient resources to meet demand. The Committee recommended that the Commissioner be given the discretion to charge a fee for private rulings for proposed transactions. The ATO declined this recommendation as well.¹¹

Product rulings

4.15 In 1998, the ATO introduced product rulings. These are a type of public ruling that apply only to a specific investment product. Previously, investors relied on private legal opinions sought by the investments' promoters. However, the experience of mass marketed investment schemes and employee benefit arrangements demonstrated there were risks in this approach.

4.16 Investment promoters, rather than investors, apply for product rulings. Chapter one noted that it is difficult now to market an investment without

11 ATO, 'Final Report on the Implementation of the Recommendations of Report 326 "An Assessment of Tax"', Correspondence, 20 October 1998.

a product ruling. These rulings do not advise on the commercial viability of an investment. They are limited to an investment's tax implications.

Review of business taxation

- 4.17 In 1999, the review of business taxation (the Ralph review) finalised its report, *A tax system redesigned*. The review was wide ranging and did not go to the details of the rulings system. However, it did make some significant recommendations:
- the scope of public and private rulings be expanded to allow the Commissioner to be legally bound on matters of administration, procedure, collection, conclusions of fact, and the operation of Pt IVA of the *Income Tax Assessment Act 1936* (the general anti-avoidance rule)
 - the Commissioner to be taken to have issued an adverse private ruling if the Commissioner fails to make a ruling within a specified period
 - rules for penalties be changed so that a taxpayer who declines to follow a private ruling is subject to the same penalties as a taxpayer who does not follow a public ruling
 - the ATO charge fees for rulings, in particular where there are significant amounts of revenue at stake, significant ATO resources are involved, and where the taxpayer is able to pay.¹²
- 4.18 Some of these recommendations were raised by the JCPA in 1993. The previous Government did not implement these recommendations. Its actions focussed instead on issues such as tax rates and calculations.

ANAO's performance audit

- 4.19 In 2001, the ANAO finalised a comprehensive performance audit on rulings. The ANAO found that the ATO managed public rulings much better than private rulings:

The processes for the production of **public** rulings of high technical quality operate effectively overall but the collection, analysis and use of performance information could be enhanced in some areas. The administrative processes for **private** rulings have operated poorly in many respects. Our assessment for **private** rulings confirmed the findings of administrative inefficiencies noted in reports prepared for the ATO over a number of years...

12 Review of Business Taxation, *A tax system redesigned* (1999) Commonwealth of Australia, pp 137-45.

The quality (and reliability) of the systems that operate for public and private rulings bear directly on the systems' capacity to deliver fair treatment to taxpayers and maintain consistency over time, and across ATO regions. So too, do the legal and institutional frameworks that shape them. We conclude, overall, that the mechanisms in place for public rulings substantially provide for consistent and fair treatment for taxpayers. This positive assessment for public rulings contrasts with the situation for private rulings where, at the time of the audit, the lack of integration of systems and inadequate systems controls undermine certainty, fairness and consistency of treatment for taxpayers.¹³

- 4.20 The ANAO made 12 recommendations including improvements to performance information, monitoring by management, data security, and prioritising public rulings.
- 4.21 In 2004, the ANAO completed a follow up audit. The ANAO reported that the ATO had implemented all 12 recommendations.¹⁴

Class rulings

- 4.22 Also in 2001, the ATO introduced class rulings. These are a subset of public rulings and operate in cases where an individual entity applies for a ruling seeking advice about the operation of an arrangement for a group of persons. They reduce the need for multiple taxpayers to request private rulings where their circumstances are largely the same.¹⁵
- 4.23 Class rulings bear a number of similarities to product rulings, as they are both public rulings, requested by the members of the community involved in a particular arrangement, that reduce the need for multiple private rulings. The main difference between the two is that product rulings have an element of marketing or promotion.

A 'reasonably arguable' position

- 4.24 Section 284-90 of the *Taxation Administration Act 1953* provides that a penalty of 25% of the shortfall amount will apply if a taxpayer does not

13 ANAO, *The Australian Taxation Office's Administration of Taxation Rulings*, Audit Report No. 3 2001-02, 17 July 2001, pp 16-17.

14 ANAO, *Administration of Taxation Rulings Follow-up Audit*, Audit Report No. 7 2004-05, 9 August 2004, p 10.

15 ATO, 'What is a class ruling?' viewed on 16 May 2007 at <http://www.ato.gov.au/businesses/content.asp?doc=/content/34038.htm&page=1&H1=&pc=&mnu=4280&mfp=001&st=&cy=>.

apply a reasonably arguable treatment, and if the shortfall amount is more than the greater of \$10,000 or 1% of the taxpayer's income tax liability.

- 4.25 Section 284-15 defines a position as reasonably arguable when, having regard to the relevant authorities, it is 'about as likely to be correct as incorrect.' Without limitation, the relevant authorities are tax laws, statutory interpretation materials, court and AAT decisions, and public rulings. Some commentators have expressed concern that independent legal opinions are not relevant authorities. If the area is grey because there are no court decisions, then the concern is that a court will only examine the public ruling in determining whether a taxpayer has taken a reasonable position.¹⁶
- 4.26 The Federal Court examined this issue in *Walstern v FCT*.¹⁷ The Court considered the previous section 222C of the *Income Tax Assessment Act 1936*, which is very similar to the new section under discussion.¹⁸ There, the ATO argued that legal opinions could not constitute relevant authorities. However, Justice Hill stated:
- It is true that opinions of counsel are not referred to in the definition of 'authority'. On the other hand it may be said that the definition is inclusory so that recourse to the opinions of counsel is not necessarily ruled out by the definition. It is unnecessary in the present case to decide this question, although I am inclined to think that the opinion of eminent counsel practising in the field,... if directed at the actual facts of a case, might well fall within the definition.¹⁹
- 4.27 In other words, the list of authorities relevant to determining whether a taxpayer has taken a reasonably arguable position can include legal opinions. This is a fair approach. The ATO does not have a monopoly on legal tax advice. Taxpayers are entitled to approach private sector advisors as a means of demonstrating that they have acted reasonably. If they could not, this would be an unreasonable restriction on taxpayers' personal liberties. It would also potentially breach competition policy.

16 Scolaro D, 'Tax Rulings: Opinion or Law? The Need for an Independent 'Rule-Maker'' (2006) *Revenue Law Journal*, vol 16, pp 119-20, Corporate Tax Association and Ernst & Young, RoSA submission 27, p 17, viewed on 9 May 2007 at http://selfassessment.treasury.gov.au/content/_download/Submissions/27_cta_ey.pdf.

17 [2003] FCA 1428.

18 In section 284-15, the list of authorities operates without limitation. In section 222C, the authorities include those listed. Both sections list the same authorities.

19 *Walstern v FCT* [2003] FCA 1428, para 112.

- 4.28 If a court were to subsequently rule that such opinions are not relevant authorities, then the Committee's view is that this matter should be corrected through legislation. The Committee also expects there would need to be exceptional circumstances for the ATO to challenge Justice Hill's comments.

Review of self assessment

- 4.29 The next major investigation of the rulings system was Treasury's Review of Aspects of Income Tax Self Assessment (RoSA), completed in 2004. RoSA made 54 recommendations, 25 of which applied to rulings and other ATO advice. The previous Government accepted all of RoSA's legislative recommendations and the ATO agreed to implement all of the administrative recommendations.²⁰
- 4.30 RoSA addressed many of the issues that had been outstanding in relation to rulings. One important recommendation was to clarify the extent to which taxpayers can rely on ATO advice. For example, taxpayers are protected from interest, and not just penalties, where they follow:
- long standing ATO administrative practice
 - oral advice from formal inquiry centres
 - all written advice, unless it is labelled non-binding.²¹
- 4.31 Other key recommendations included:
- expanding the category of public and private rulings to cover administration, procedure, collection, and ultimate conclusions of fact
 - where the ATO changes long standing practice to the detriment of taxpayers, the change should be prospective and, where necessary, from a future date to allow taxpayers to adjust their affairs
 - where taxpayers rely on draft public rulings, they should be exempt from penalties and interest where the final ruling is to their detriment
 - in private rulings, the ATO should state whether it has considered Part IVA (the avoidance provisions) and, if there has been full disclosure, the ATO be prevented from reopening an assessment

20 Hon P Costello MP, Treasurer, 'Outcome of the review of aspects of income tax self assessment', press release, 16 December 2004, viewed on 15 May 2007 at <http://www.treasurer.gov.au/tsr/content/pressreleases/2004/106.asp>.

21 Treasury, *Report on aspects of income tax self assessment* (2004) Commonwealth of Australia, p 10.

- for private ruling applications older than 60 days, taxpayers be able to request that the ruling be finalised within 30 days. If no ruling is given, the ATO is taken to have made a negative response, triggering appeal rights
 - abolishing the penalty for a tax shortfall resulting from a failure to follow a private ruling.²²
- 4.32 RoSA considered whether the ATO should be able to charge for private rulings, but decided against making such a recommendation. This conclusion was based on:
- the general opposition to such an arrangement
 - taxpayers have a right to understand how the tax laws apply to them
 - concerns about whether paying for a ruling increases the taxpayer's chance of success.²³
- 4.33 *The Tax Laws Amendment (Improvements to Self Assessment) Act (No 2) 2005* implemented the RoSA legislative recommendations in relation to rulings. The legislation completely re-wrote the provisions in relation to rulings.

Inspector-General of Taxation's review

- 4.34 RoSA noted the perception in the tax community that the ATO's private rulings were biased in favour of the revenue. The data was not necessarily consistent with this perception. In 2002-03, the ATO 54% were wholly favourable to the applicant, 16% were partially favourable and 29% were unfavourable.²⁴ However, due to the strength of the perception, RoSA recommended that the Inspector-General conduct a review of possible bias in private rulings.²⁵
- 4.35 The Inspector-General's report in February 2008 confirmed that there were significant perceptions of ATO bias in the tax community. Most stakeholders did not consider this bias to be undue. Rather, they thought it was the sort of approach to be expected of a revenue agency. The few examples given of undue bias occurred when the ATO was applying a legal interpretation that it thought best represented the policy intent of a law.

22 Id, pp 11-26.

23 Id, p 23.

24 Figures do not add up to 100 due to rounding.

25 Treasury, *Report on aspects of income tax self assessment* (2004) Commonwealth of Australia, pp 17-18.

- 4.36 Similar to the ANAO performance audit, the review examined the ATO's processes, rather than examining the legal correctness of particular rulings. The Inspector-General found no evidence of bias. Rather, what the review found was that the ATO neither communicated effectively nor was sufficiently transparent in its dealings with taxpayers. Where the ATO did something unusual without explanation, such as delaying a ruling while it confidentially conferred with Treasury, taxpayers concluded that this was evidence of bias.²⁶
- 4.37 The Inspector-General made a number of recommendations designed to improve ATO transparency and communication in relation to private rulings. The ATO accepted all recommendations, either wholly or in part. In the response to the recommendations, the ATO agreed to:
- advise taxpayers when it is consulting with Treasury
 - keeping taxpayers up to date of the progress of their applications
 - including the ATO's understanding of the policy intent of legislation in the private ruling where this is relevant to the ATO's decision
 - issuing private rulings regardless of whether the technical issue is or may be the subject of a future public ruling.²⁷

Committee comment

- 4.38 Australia's arrangements in relation to rulings are similar to those in other countries. For example, the OECD's comparison of tax systems amongst its member countries shows that the tax administrations in all but one of the 30 OECD countries issue public rulings and of these, the rulings are binding in 23 countries. The tax administrations in 28 OECD countries issue private rulings and of these, the rulings are binding in 24 countries.²⁸ As RoSA noted, 'The Australian system is unexceptional on most points of comparison.'²⁹
- 4.39 Simply, it appears that taxpayers have a basic need to obtain advice from their tax authorities and it is only fair that the tax authorities stand by this advice. Rulings are one way of meeting this need. Given the risks that

26 Inspector-General of Taxation, *Review of the potential revenue bias in private binding rulings involving large complex matters* (2008) Commonwealth of Australia, pp 3-4.

27 Id, pp124-126.

28 OECD, *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series* (2006), October 2006, p 87, viewed on 31 January 2007 at <http://www.oecd.org/dataoecd/43/7/37610131.pdf>.

29 Treasury, *Report on aspects of income tax self assessment* (2004) Commonwealth of Australia, p 3.

taxpayers potentially face under self assessment, a formal system of rulings is fundamental to the tax system. As the Inspector-General of Taxation stated, 'The ability to obtain a private ruling is a key feature of the self assessment system.'³⁰

The quality of rulings

Public rulings

4.40 In 2006-07, the ATO finalised 369 public rulings. This comprised 132 class rulings, 119 product rulings and 118 public rulings and tax determinations (84 final and 34 draft).³¹

4.41 The evidence to the Committee during the inquiry about public rulings was largely positive. For example, the Institute of Chartered Accountants in Australia (ICAA) advised the Committee that the public rulings panels, which include external experts, have improved the standard of public rulings:

...the establishment of a Public Rulings Panel and an International Public Rulings Panel, which include external tax experts, to supplement a public consultation process, in which professional bodies participate, has gone some way to ensure the quality of public rulings and, more particularly, public confidence in these rulings.³²

4.42 CPA Australia agreed that public rulings have a reasonable standard of technical accuracy:

...while the Commissioner can withdraw a ruling or change it should his interpretation of the law change, this is not a frequent event, and in general where it has occurred the changes have not been in dispute.

The tax, accounting and legal professional bodies, amongst others, are also involved in the ongoing review of draft rulings and determinations. It is not the norm for there to be significant

30 Inspector-General of Taxation, sub 48, p 5.

31 ATO, Annual Report 2006-07, p 96.

32 ICAA, sub 37, p 8.

disagreement with the Commissioner's/ATO's interpretation of the law.³³

- 4.43 Further, the system used for prioritising public rulings has industry support³⁴.

Private rulings

- 4.44 Year by year, the ATO has been issuing fewer private rulings. In 2006-07, the ATO issued 12,398 private rulings, down from 13,888 in 2005-06 and 14,387 in 2004-05. The *Annual Report 2006-07* showed that just under half of these (5,055) related to individuals. The next largest category was for GST (2,411).³⁵ This appears to be a low level of usage, given the complexity of the tax system and that there are 12 million taxpayers.³⁶
- 4.45 Consistent with the Inspector-General's findings in the review of private rulings, the Committee received evidence of perceptions of bias from organisations such as CPA Australia.³⁷ The ICAA also took this view and argued that the statistics in relation to private rulings did not tell the whole story. Firstly, only 2% of private rulings involved a precedent. These were the key rulings because the ATO had to come to a considered decision, whereas with the other 98% it only had to follow previous decisions.³⁸
- 4.46 Further, applying for a private ruling tended to bring the applicant to the ATO's attention. If the ATO issued an unfavourable private ruling, then the taxpayer would almost certainly be subject to litigation if they did not comply with the ruling. On the other hand, if the taxpayer was confident in their legal advice and could take the risk of losing any possible litigation, then it made more sense to apply the preferred tax treatment and not advise the ATO.³⁹ One implication from this is that any sample of private rulings will be biased because many taxpayers will only make a private ruling application where they expect a favourable outcome.

33 CPA Australia, sub 36.1, p 1.

34 ICAA, sub 37, p 5.

35 ATO, *Annual Report 2004-05*, p 65, ATO, *Annual Report 2005-06*, pp 111, 118, ATO, *Annual Report 2006-07*, pp 96, 112.

36 ATO, sub 50, p 35.

37 CPA Australia, sub 36, p 7.

38 ICAA, sub 37, pp 63-65.

39 Ibid.

- 4.47 However, despite these strong perceptions of bias, the ICAA acknowledged that it did not have evidence from its members of actual bias in private rulings.⁴⁰

Conclusion

- 4.48 In his submission, the Tax Ombudsman stated that he has 'not discerned any issues of systemic concern' in relation to rulings.⁴¹ This is consistent with the evidence during the inquiry and reviews by the ANAO and the Inspector-General. Therefore, the Committee decided to focus on the managerial aspects of rulings, in particular delays in issuing private rulings.

Timeliness of private rulings

The extent of delays

- 4.49 In some respects, private rulings represent a return to the pre-self assessment period. Under administrative assessment, taxpayers gave the ATO the circumstances of their case in the tax return. The ATO spent resources assessing it and gave the taxpayer their view in the notice of assessment. With private rulings, taxpayers give the ATO their circumstances in an application form and the ATO gives its view in the private ruling.
- 4.50 Both administrative assessment and private rulings present resource problems for the ATO. In each case, the taxpayer is obtaining something from the ATO without payment. In the case of administrative assessment, the ATO's response was to apply a token level of resources to each taxpayer, resulting in 1-minute assessments for individuals. For private rulings, one approach the ATO uses is for tax agents to do as much preliminary work as possible and then provide that information to the ATO. CPA Australia stated:

My understanding is that the tax office might have a habit of asking for that type of information and encouraging taxpayers to submit that in an effort to ensure that they meet their targets, and it helps facilitate arriving at the answer and getting the private binding ruling back to the taxpayer in a timely manner. As you

40 Ibid.

41 Commonwealth Ombudsman, sub 38, p 10.

know, the private binding ruling system is meant to work in a 28-day turnaround...⁴²

- 4.51 Tax agents can sometimes expend significant resources on a private ruling application to no ultimate benefit to their client, but at a cost to themselves. Ruddicks Chartered Accountants advised the Committee as follows:

The ATO said that they could only rule on the matter if we were able to say how much the dividend was going to be. We said, 'This company has not been formed yet; we don't know what the dividend is going to be. That will depend on the profits made by the company and various other things ... In the end, the ATO refused to rule, because we were not able to give information in advance as to what the dividends might be for the next 20 years...

We spent about \$8,000 worth of time on that. We billed our client \$400 for that time, because we obviously did not expect it to be so difficult; we did not explain to the client that we were going to be stymied at every point ... this particular case was not a complex situation ...⁴³

- 4.52 Another resource management strategy that the ATO uses for private rulings is delay. Lack of timeliness was the most common and serious comment raised during the inquiry in relation to private rulings. The list of participants who raised this issue included the Ombudsman, the ICAA, CPA Australia, the Taxation Institute of Australia and the National Institute of Accountants.⁴⁴ Treasury also reported it in RoSA.⁴⁵
- 4.53 Because of the delays, less people are using private rulings. Taxpayers Australia stated:

The evidence suggests that the number of people that seek a private binding ruling is not very high and that, if we operate under a very complex system, why is it that there are not a lot more private binding rulings? I agree with some of the earlier comments in the sense that time and costs work against the taxpayer. In essence, taxpayers do not have the luxury of time and a lot of transactions need to be dealt with on a real-time basis, especially with GST issues. You cannot wait 28 days for a private

42 Drum P, transcript, 28 July 2006, p 36.

43 Leighton C, transcript, 24 August 2006, p 23.

44 Commonwealth Ombudsman, sub 38, p 10, ICAA, sub 37, p 8, CPA Australia, sub 36, p 7, Taxation Institute of Australia, sub 40.1, p 4, National Institute of Accountants, sub 31, p 4.

45 Treasury, *Report on aspects of income tax self assessment* (2004) Commonwealth of Australia, p 18.

binding ruling on something like GST where you need to know today to assess your tax implications. Because of the time, the cost and what is required from the ATO, you might put in a request for a private binding ruling and then they will come back and ask for more information and delay the process. That all costs time and money. At the end of the day, it works against the taxpayer. In principle, it is good that you have got access to that system but, from a practical point of view, not a lot of taxpayers access that avenue.⁴⁶

- 4.54 These delays harm businesses because they sometimes lose opportunities. The Taxation Institute of Australia noted that there is often a restricted window in which to sign off on a project which can be missed through the delay in obtaining a private ruling:

...the time taken is too long given that many business or investment decisions which may be best served by obtaining a PBR have a shortish lead time (eg it is uncommercial for a taxpayer acquiring an asset or a business to have to wait two months for a ruling on the proposed arrangement).⁴⁷

- 4.55 The ICAA made a similar argument:

We also note that the Burges Report, which focused on the largest companies in the Large Business Segment, indicated that all the companies interviewed reported great difficulty in obtaining timely PBRs, to the extent in many cases of rendering the private binding ruling concept virtually useless to them.⁴⁸

- 4.56 Both the Taxation Institute of Australia and the ICAA stated that the ATO was taking remedial action, including a fast tracking system for priority private rulings.⁴⁹

- 4.57 Under Practice Statement Law Administration 2005/10, the ATO applies case management principles to priority requests for private rulings. These include pre-lodgement meetings with the applicant and developing a case plan. Further, the ATO applies its various areas of expertise simultaneously to a priority request, rather than each section handling it in turn. Priority requests need to meet a number of criteria, including

46 Greco A, transcript, 25 August 2006, p 17.

47 Taxation Institute of Australia, sub 40.1, pp 4-5.

48 ICAA, sub 37, p 9.

49 ICAA, sub 37, p 9, Taxation Institute of Australia, sub 40.1, p 5.

being time sensitive, prospective, of major commercial significance, and being a board level transaction.⁵⁰

- 4.58 Following RoSA, there are new delay provisions in the tax laws. Where an application for a private ruling is older than 60 days (subject to some extensions), the taxpayer can request the ATO to determine their application within 30 days. If the ATO does not respond, the taxpayer can object as if they had received a negative response. The taxpayer's objection must include a draft private ruling.⁵¹ The ICAA was uncertain whether this new arrangement would help taxpayers:

Given that the purpose of obtaining a PBR is to obtain certainty relatively quickly, we consider that triggering formal objection and review procedures will do little to address the lack of timeliness of PBRs.⁵²

- 4.59 Overall, the ICAA suggested that it was too early to determine if these measures would be effective.⁵³
- 4.60 Given these concerns about delays, the Committee decided to examine what objective measures existed in relation to the ATO's performance.

Performance reporting of timeliness

- 4.61 Overall, the ATO's service standard for responding to private ruling requests is 28 days. However, there are qualifications to this:
- the ATO must receive all necessary information
 - if the ATO needs more information, it has 14 days in which to contact the taxpayer and request the information
 - if the request is 'particularly complex' and will take more than 28 days, the ATO will contact the taxpayer within 14 days to negotiate an extended deadline.⁵⁴
- 4.62 In 2006-07, the ATO's target for meeting the 28 day standard was 83% and it exceeded this target with a performance level of 93.3%.⁵⁵ This data

50 ATO, 'Priority Private Binding Rulings', PS LA 2005/10, viewed on 22 May 2007 at <http://law.ato.gov.au/atolaw/view.htm?Docid=PSR/PS200510/NAT/ATO/00001>.

51 Section 359-50 of the *Taxation Administration Act 1953*.

52 ICAA, sub 37, p 9.

53 ICAA, sub 37, p 9.

54 ATO, 'Our service standards' viewed on 22 May 2007 at <http://www.ato.gov.au/corporate/content.asp?doc=/content/25940.htm>.

55 ATO, *Annual Report 2006-07*, p 40.

suggests that the ATO is performing well. However, the situation is more complex.

4.63 Firstly, the ATO commonly requests additional information from taxpayers. The National Institute of Accountants stated in evidence:

The ATO states that the majority are handled within 28 days, but we have quite a lot of feedback from members that suggests that is not necessarily correct. The ATO may respond within 28 days and seek further information, then the clock starts again on the 28-day test.⁵⁶

4.64 The ATO also negotiates an extension of the deadline. The ICAA noted that the ANAO, in its 2001 performance audit on rulings, had questioned the value of the ATO's performance standard:

...as noted in the...ANAO report, the 'negotiated extended timeframe' is a limited target or standard by which performance can be assessed. Stakeholders consulted at the time of the ANAO review felt that they had little choice but to agree to the ATO's proposed extension of time for satisfying the PBR request. We would be surprised if taxpayers feel any differently today.⁵⁷

4.65 From the point of view of the ATO, the current 28 day performance measure is fair. If a taxpayer does not sufficiently explain an application, then the ATO should be able to extend the deadline by asking for more information. If a taxpayer has a complex issue that has significant revenue implications and agrees to an extension, then the ATO can also argue it is performing appropriately.

4.66 However, the 28 day measure is much less relevant to taxpayers. The commercial world has its own rate of progress and does not wait for the ATO. In other words, the current service standard only tells the ATO's side of the story. The Committee is concerned at this arrangement because private rulings are there to assist taxpayers. The Committee is of the view that a performance measure of total elapsed time, in addition to the 28 day standard, is necessary to present the whole picture.

4.67 In its 2001 performance audit on rulings, the ANAO noted that taxpayer uncertainty increased where the ATO took longer to consider an application in total elapsed time. The ANAO recommended that the ATO review its service standards for both internal and external reporting,

56 Ord G, transcript, 25 August 2006, p 5.

57 ICAA, sub 37, p 9.

including the measurement of total elapsed time as an internal management tool.⁵⁸

- 4.68 In its 2004 follow-up audit, the ANAO reported that the ATO was using total elapsed time as an internal reporting measure. The target for 2003-04 was that 100 per cent of cases should be completed within 90 days of receipt. The ANAO noted that the ATO had made significant progress:

Between February 2003 and January 2004, the total number of cases on hand was reduced by 55 per cent and the number of over 90 days cases was reduced by 60 per cent.⁵⁹

- 4.69 Recently, the Inspector-General of Taxation completed a review of the ATO's private rulings. From this review, it appears that the ATO continues to improve its elapsed time performance. For large business private ruling applications, the average elapsed time has decreased from 92 days in 2005-06 to 74 days in 2006-07. Similarly, the proportion that met the 90 day benchmark increased from 65% to 70% over the same period.⁶⁰

Committee comment

- 4.70 The Committee recognises that the ATO is taking action to improve its performance in relation to delays in private rulings, such as prioritising commercially important applications. However, the Committee is also concerned that the ATO's high performance against the 28 day service standard bears little resemblance to taxpayers' reality. Given this discrepancy, the Committee believes the ATO should also publish performance information on total elapsed time for private rulings. It need not be presented as a service standard, but should be compared against the service standard to more fully explain to the community the ATO's operations.
- 4.71 In the recent review of private rulings, the Inspector-General recommended that the ATO publish elapsed time statistics. The ATO declined this recommendation, arguing that 'some delays can be caused by the taxpayer'. It also noted that, with priority private rulings, much of

58 ANAO, *The Australian Taxation Office's Administration of Taxation Rulings*, Audit Report No. 3 2001-02, 17 July 2001, pp 150, 154.

59 ANAO, *Administration of Taxation Rulings Follow-up Audit*, Audit Report No. 7 2004-05, 9 August 2004, p 41.

60 Inspector-General of Taxation *Review of the potential bias in private binding rulings involving large complex matters* (2008) Commonwealth of Australia, p 5.

the work is done before the taxpayer lodges the application. Therefore, an elapsed time statistic would be 'an irrelevant measure'.⁶¹

- 4.72 In response, the Committee notes that the ANAO and the Department of Finance and Administration jointly published a better practice guide on annual performance reporting in 2004. That document noted that agencies can be achieving shared outcomes in partnership with other agencies or 'players external to government'. The guide's preferred approach is for agencies to report performance overall and then identify their areas of influence within those operations. In other words, the presumption is to present information provided that, after explanation, it helps the reader.⁶²
- 4.73 If an agency such as the ATO is not prepared to report performance information where it has shared responsibility for an activity, the result would be that no-one would take responsibility for joint projects. Therefore, it is preferable that agencies involved in joint projects report on the performance of these projects and explain how they and other participants contributed to the final result.
- 4.74 The Committee understands that an elapsed time statistic, on its own, would not be fair on the ATO. However, with suitable explanation and adjustment for special cases such as priority applications, this extra information will assist readers of the ATO's annual report and present a more balanced view of the ATO's work.

Recommendation 9

- 4.75 **The ATO, in its annual report, compare its performance in relation to the 28 day service standard for private ruling requests with information on total elapsed time for these applications.**

The RoSA reforms of performance reporting of timeliness

- 4.76 During RoSA, Treasury noted widespread concerns about delays in private rulings. Treasury made a number of recommendations, including 2.14, which stated:

The Tax Office should enhance its published performance reporting on PBRs to distinguish response times to individuals

61 Inspector-General of Taxation, *Review of the potential bias in private binding rulings involving large complex matters* (2008) Commonwealth of Australia, pp 51-52, 126.

62 ANAO and Department of Finance and Administration, *Better Practice Guide: Better Practice in Annual Performance Reporting* (2004) Commonwealth of Australia, p 10.

and very small business from those for larger businesses, and separately report agent and non-agent case statistics.⁶³

- 4.77 The Committee supports this recommendation. For example, data from 1998 to 2000 shows that approximately 80% of individuals' requests were handled within a total elapsed time of 28 days. This figure dropped to 45% for small business and less than 30% for large business. Approximately 25% of large business applications took more than 232 days.⁶⁴
- 4.78 The ATO first released updated figures in response to RoSA recommendation 2.14 in its 2006-07 annual report. The percentage within the ATO's 28 day service standard exceeded 90% for all categories.⁶⁵ At first glance, this is a high level of performance. However, the ATO appears to have restructured its categories. In its 2005-06 Annual Report, the 'Large Business and International' business line issued 261 private rulings and the 'Small Business' business line issued 2,782 private rulings. In the ATO's 2006-07 Annual Report, the 'larger business' category completed 1,069 cases and the 'micro enterprises' category completed 2,174 cases.⁶⁶ Against the general trend of reduced volume in private rulings, it appears that rulings from medium enterprises have been transferred from 'Small Business' to 'larger business.'
- 4.79 The effect of this potential transfer has been to group the large business private ruling applications (approximately 250) with the more voluminous medium business applications (approximately 750). On average, large business applications are the most problematic. Therefore, if the ATO is still having difficulty in managing the timeliness of these large applications, it is less likely to be shown by the new data in the annual reports. While the Committee acknowledges the achievement by the ATO in implementing this recommendation from RoSA, the community and the Parliament will have greater assurance about the ATO if its performance in relation to large business is individually reported.

63 Treasury, *Report on aspects of income tax self assessment* (2004) Commonwealth of Australia, p 18.

64 The sample period for large business was 1993 to 2000. ANAO, *The Australian Taxation Office's Administration of Taxation Rulings*, Audit Report No. 3 2001-02, 17 July 2001, pp 151-52.

65 ATO, *Annual Report 2006-07*, p 112.

66 ATO, *Annual Report 2006-07*, p 112, ATO, *Annual Report 2005-06*, p 118.

Recommendation 10

- 4.80 The ATO divide the 'larger businesses' category used for its performance reporting of the timeliness of private rulings into 'medium businesses' and 'large businesses.'

Conclusion

- 4.81 The rulings system has been subject to review and refinement since its introduction with self assessment in 1986. These reviews have become more positive over time. In 2001, the ANAO found that the ATO's processes for public rulings were sound but expressed concern over private rulings. In 2008, the Inspector-General of Taxation made a positive finding overall for the processes for private rulings. Further, the Committee received evidence from stakeholders that the public ruling system is working well overall. Therefore, the Committee did not find it necessary to raise technical issues about rulings in the report.
- 4.82 The timeliness of private rulings was the main issue raised in evidence about rulings. A number of factors are responsible for the delays. Under self assessment, taxpayers are expected to fully understand the tax implications of their financial affairs. However, tax laws are so complex that taxpayers have significant potential demand for private rulings from the ATO. Because the rulings are free, private rulings could potentially be a similar drain on the ATO as administrative assessment was in the early 1980s.
- 4.83 The delays act as a deterrent to taxpayers obtaining private rulings. Many taxpayers, especially in business, have a narrow time frame in which to make financial decisions. The delays in private rulings make them much less attractive to taxpayers.
- 4.84 Combined with poor communication and a lack of transparency by the ATO, these delays have led to perceptions of bias about private rulings. The Committee's recommendations in this chapter have been aimed at improving the ATO's performance reporting so that the debate can focus on the proven issues such as delays, rather than perceived issues such as bias.
- 4.85 Although delays are an issue, the Committee notes that the ATO is responding in various ways, such as applying case management practices to priority applications. However, the ATO is constrained by the

legislative framework that Parliament gives it. Simplifying tax laws, as discussed in chapter three, will give taxpayers more certainty, reduce the potential demand for rulings, and give the ATO more scope to implement a fair and efficient tax system.

