Australian Government
Australian Taxation Office

EXECUTIVE MINUTE

on
JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT
REPORT NO. 410
TAX ADMINISTRATION

Response to the recommendations

Recommendation No. 1, Paragraph 1.78
The Commissioner of Taxation continue to make himself available twice a year to attend public hearings on the administration of the tax system with the JCPAA in order to promote an open dialogue between the ATO and the Parliament

The Tax Office supports this recommendation.

The Commissioner welcomes the opportunity to share with the Committee and through the Committee with the wider community, information on our performance and an early picture of emerging risks and priorities through the biannual hearings. The Commissioner also welcomes the suggestions of the Committee on how we can improve our administration and in areas of emerging risks, and the opportunity for dialogue with the Parliament.

Recommendation No. 9, Paragraph 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 Tax Office supports this recommendation.

We will provide indicative details of total elapsed time for private binding ruling applications in the Commissioner's annual report for 2007-08. We are also looking at whether, in the future, we could identify and analyse time attributed to us, and time attributed to factors outside of our control.

Recommendation No. 10, Paragraph 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.'

The Tax Office supports this recommendation.

We will, in the Commissioner's 2007-08 annual report, be dividing the 'larger businesses' category used for performance reporting of the timeliness of private rulings into 'small to medium enterprises' and 'large businesses'. These categories correspond with our market segments as outlined in our published Compliance Program.

Recommendation No. 11, Paragraph 5.44
Where the ATO has concerns about a judicial decision, it should publicly announce these concerns in the decision impact statement and commit to resolving the issue within 12 months through one or a combination of the following public actions:
- abiding by the initial decision
- appealing the decision and abiding by any subsequent decision
- referring the issue to Treasury as a policy matter

The Tax Office supports this recommendation with qualifications.

We agree with the recommendation, with the qualification that, in line with the Solicitor-General's advice, there may be some rare occasions where it may be appropriate to have a decision re-considered by a higher court in another case.

Following the publication of the Committee's report, we asked the acting Solicitor-General and counsel whether they wished to change the earlier advice they had provided in respect of this issue. The acting Solicitor-General's response is attached. He noted that the "course of action supported by the Committee will normally reflect the position to be taken" and "situations where a different approach is possible are likely to be rare".

We are aware of our responsibilities to apply the law as interpreted by the courts and the importance of certainty for taxpayers. One of our corporate values is to follow the rule of law.

We also accept that in respect of the fringe benefits tax issue which arose in the *Essenbourne* case, it took too long to have the issue decided by the Full Federal Court.

There are various examples of court decisions being overturned in later cases. In the tax field, a notable example is the case of *John v FCT 89 ATC 4101*; (1989) 166 CLR 417), where the High Court overturned its earlier decision in *Curran* v *FCT 74 ATC 4296*; (1974) 131 CLR 409).

Recommendation No. 12, Paragraph 5.53
The ATO develop a policy to support decisions involving periods of grace where it changes its view of the law. Unless there are exceptional circumstances, no period of grace should exceed 12 months

The Tax Office supports this recommendation.

Where we change our view of the law it may sometimes be appropriate to give taxpayers time to change their practices and systems to enable them to comply with the new view. This approach is reflected in our current practice as outlined at paragraph 62 of TR 2006/10 on Public Rulings.

However, we understand the Committee's concern about giving taxpayers too much time in adjusting to a revised view of the law. We agree with the Committee that a period of grace should not exceed 12 months, unless there are exceptional circumstances.

Recommendation No. 13, Paragraph 5.75

The ATO establish and monitor compliance of protocols for determining when an investigation is an audit, when the audit commences, and when the ATO should inform the taxpayer of the audit.

The Tax Office supports this recommendation.

When does an audit commence?

From a taxpayers' perspective, commencement of an audit aligns with the notification of the audit or intention to audit. Their awareness of an audit or intention to audit will be triggered upon receipt of the letter normally sent advising them of the audit or, on occasion, the phone call they receive where arrangements are made to initially meet in regard to the audit. Either of these events will make the taxpayer aware that we have commenced or will commence an audit. Alternately, some audits occur over the phone and the phone call will advise that an audit is occurring.

In special cases, where no prior notice is given to the taxpayer of the audit, notification of the commencement of the audit occurs when we first visit seeking access to premises and records.

When should the ATO inform the taxpayer of the audit?

Consistent with the above response to 'When does an audit commence?', in most cases a taxpayer will be advised either by letter or phone call that we have commenced an audit. In limited circumstances, where no prior notice is provided, the taxpayer will be informed at the time of the first visit by our staff.

Establishing and monitoring compliance of these protocols.

The protocols surrounding advising taxpayers that they are being audited are published in a number of Tax Office publications, and we will continue to monitor compliance with these protocols. These include "*If you are subject to enquiry or*

audit", "*Large business and tax compliance 2006" and "Wealthy and wise: A tax guide for Australia's wealthiest people*".

We will also be reviewing our correspondence to taxpayers and revising the Taxpayers' Charter Booklet, 'If you are subject to enquiry or audit', to provide further clarity.

Recommendation No. 14, Paragraph 5.86
The ATO amend its policies to limit the practice of issuing assessments that are contingent on each other, and specify in what circumstances such assessments may be validly issued. In the absence of administrative change, the Government introduce legislation to this effect.

The Tax Office supports this recommendation.

The Committee is seeking greater clarity on the circumstances where alternative assessments by validly be issued. Practice Statement PS LA 2006/7 outlines our approach when alternative (contingent) assessments are made in respect of the same income, benefit or transaction for one or more taxpayers. It provides guidance to our staff on the limited circumstances in which we can issue alternative or contingent assessments, what tax can be collected under those assessments and details the text of additional letters that must accompany the various assessments issued. This practice statement refers to contingent assessments as alternative assessments (the term for such assessments derived from relevant case law).

Given the Committee's recommendation, we will review the Practice Statement to see what more can be said.

When can Alternative Assessments be issued?

As an administrative control on the issue of alternative assessments, paragraphs 12 to 17 of PS LA 2006/7 only allow them to be issued in the following circumstances:

- Alternative assessments may be issued in respect of the same amount of income, benefit or transaction under more than one taxing act. The alternative assessments may be issued to one or more taxpayers.
- Where it is unclear which taxpayer should be assessed on an amount of income, alternative assessments may be issued to different taxpayers in relation to the same amount of income.
- Where it is not clear in which income year an amount of income has been derived, alternative assessments may be issued to the same taxpayer for different years of income.

The practice statement cites case authorities which support the issue of alternative assessments in particular circumstances. For example paragraph 13 refers to *DFC of T v Richard Walter Pty Ltd* (1995) 183 CLR 168 where the High Court held that the Commissioner could issue assessments to two different taxpayers relating to the same income in respect of the same year of income.

In relation to employee benefit schemes, the Federal Court in *Walstern v FC of T* [2003] FCA 1428 upheld an assessment made under the *Income Tax Assessment*

Act 1997 denying a deduction for a superannuation contribution made by a company and an assessment of Fringe Benefits Tax under the *Fringe Benefits Tax Assessment Act* 1986 in respect of the same contribution.

Collection of Tax

Based upon relevant case law, paragraphs 8, 9 and 17 to 21 of PS LA 2006/7 specify that the Commissioner will normally only pursue collection under the primary assessment he has issued.

The practice statement requires our staff to identify one of the assessments to be made as the primary assessment. The alternative assessments are protective alternative assessments which will only be pursued if later litigation shows it is not appropriate to pursue the primary assessment.

The practice statement requires that our staff provide clarity to taxpayers when alternative assessments are made. At paragraph 7 the practice statement instructs our staff that *...a letter will be sent to the relevant taxpayer/s prior to the issue of the primary assessment and alternative assessment/s...* explaining whether the assessment is the primary or an alternative assessment and that the Commissioner only intends to collect tax under the primary assessment.

This approach is supported by judicial guidance that the Commissioner is authorised only to collect on one assessment of income tax on a single source of income in a given year. See High Court decisions in *Richardson v FCT* (1932) 48 CLR; (1932) 2 ATD 19 and *DFC of T v. Richard Walter* (1995) 183 CLR 168; 95 ATC 4067; (1995) 29 ATC 644.

Recommendation No. 15, Paragraph 6.29
The ATO increase its benchmarks for the technical quality reviews of penalty and other debt decisions.

The Tax Office supports the principle behind the recommendation, but notes that benchmarks already apply uniformly across the system.

The existing technical quality review process applies the same benchmarks to penalty and debt decisions as applies to other matters.

The technical quality review system has both a 'Pass' rating and an 'A' rating. Each reviewed decision (including decisions on penalties) is rated against four criteria, two of which are deemed critical (correct identification of the issue and technical correctness). A decision is rated as either meeting or not meeting each criterion. Decisions meeting all four are rated as an 'A' result. Decisions that meet the two critical criteria are rated as a 'Pass'. (Plainly, 'pass' ratings include cases rated as an 'A').

The current benchmarks for technical quality reviews (including penalties and other debt decisions) are 95% for pass ratings and 85% for 'A' ratings. That is, we expect at least 95% of all reviewed technical decisions, including penalty and debt decisions, to get a 'Pass' result and at least 85% of all such decisions to get an 'A' result.

Recommendation No. 16, Paragraph 6.69
The ATO explain the reasoning behind its settlement offers for large scale disputes in its public statements.

The Tax Office supports this recommendation.

The recommendation is already part of our revised approach.

Following an announcement on 18 November 2004 in relation to a range of administrative matters, the Widely Based Settlement Panel comprising senior tax officers was set up to consider the situations where widely based settlement offers are appropriate.

The role of the Panel and guidance on the settlement of widely-based tax disputes is set out in Practice Statement Law Administration PS LA 2007/6 which was published after a period of public consultation. The practice statement is to be read in conjunction with the *Code of Settlement Practice* which provides general guidance about settlement of taxation disputes.

Paragraph 34 of the practice statement provides that we will publish on our internal homepage (*www.ato.gov.au*) the general terms of widely-based settlements and the factors and principles applied.

While a number of widely-based settlement offers and the reasoning behind those offers are currently on our website, the information is being updated. This update is being done in conjunction with a redesign of this area of the website and is expected to be completed shortly. This redesign may provide more relevant information about widely-based settlements currently available (including the reasoning behind the offers), as well as providing links to historical widely-based settlement offers.

Recommendation No. 17, Paragraph 6.98
The ATO publish in its annual report additional statistics in relation to settlements, such as the revenue collected through settlements and the proportion of amended assessments that taxpayers agree to pay. The ATO should also comment on significant variations across business lines.

The Tax Office supports this recommendation.

We will provide additional statistics and commentary on settlements for future Annual Reports from 2007-08, including a breakdown of settled amounts and commentary on any significant variations. We are evaluating if this is more appropriately reported by market segment, consistent with our Compliance Program, rather than across the various business lines.

In addition, we are looking at what other practices and procedures could be introduced to give which we will publish so the community even greater assurance that settlements have a high level of integrity.

This is in addition to the checks and balances already in our Code of Settlement Practice.

Recommendation No. 18, Paragraph 6.102
The ATO include in its annual report performance information about the amount of revenue collected through penalties and interest and the amount of revenue (divided between penalties and interest) remitted back to taxpayers. Where appropriate, this should be accompanied by discussion.

The Tax Office supports this recommendation with qualifications.

We currently report consolidated penalty and interest information relating to net imposition and collections in the Commissioner's annual report, (2006-07, Results, pages 106 – 108) according to:

- revenue product
- market segment
- channel.

Our current systems do not provide the break-up requested by the Committee. However, we will progressively seek to meet the thrust of the recommendation to the extent that we can, subject to computer systems limitations.

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OBLIGATION OF TAX OFFICE TO APPLY JUDICIAL DECISIONS

OPINION

1. The Australian Taxation Office (ATO) asks my for comments on Report 410 of the Joint Committee of Public Accounts and Audit (JCPAA) into Tax Administration. In particular, I am asked whether the comments in the report on litigation (paras 5.17-5.44) would cause me to alter in any way my previous opinions on the obligation of the ATO to follow judicial decisions.

BACKGROUND

2. In its Report 410 JCPAA has referred to the issues raised by the Full Federal Court in the *Indooroopilly* case in respect of which I and the former Solicitor-General have previously given joint opinions to the ATO. In our most recent opinion of 18 June 2007 we confirmed earlier advice that the ATO is not required to follow a single instance decision of a judge "if there are good arguments that, as a matter of law, that decision is incorrect and action is being taken to clarify the position" (see paragraph 68). See also earlier opinions of 15 December 2005 and 16 January 2006.

3. The JCPAA discusses this issue, including our joint opinions, at paragraphs 5.17 to 5.44 of its report. It concludes by recommending that the ATO should adopt a policy of abiding by an initial judicial decision or appealing the decision and abiding by any subsequent decision, or referring the issue to Treasury as a policy matter (see recommendation 11). This represents a stricter view than that adopted by the ATO based on our earlier advice. If the JCPAA approach is adopted, the consequence would be that there would be no opportunity to overturn wrongly decided cases which were not appealed. This does not seem to the ATO to be appropriate. Even if an appeal to test an issue is desirable, in some cases this will not, for various reasons, be possible. The JCPAA recommendation does not recognise this.

4. Following receipt of the joint opinion last year the ATO publicly stated that "in the rare circumstances where the Commissioner does not appeal a decision which is considered incorrect, the Tax Office will seek to take prompt action to test the issue before the Full Court". The ATO have made it clear that it would follow the advice given in the joint opinions in such cases.

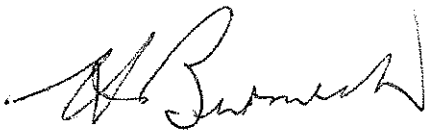
5. Before responding to the JCPAA recommendation, the Commissioner is seeking my comments about the JCPAA report and recommendation 11. In particular, the ATO wants to know whether the comments in the Report cause us to alter in any way our previous opinions on this issue.

6. In my opinion, the JCPAA Report does not require reconsideration of our earlier advice. The views of the Committee, mirrored in some judicial comments (reflecting as they do basal rule of law principles), is the reason why in our earlier advices we have stressed that if the ATO considers a particular decision to be wrong, it needs to take prompt action to have the issue reviewed by an appeal or early test case and put those potentially affected on notice while the matter is promptly resolved. It cannot simply refuse to accept a decision and act as if it did not exist. As the extracts in the Report from particular cases show, unless another judge considers an earlier decision clearly wrong, he or she is likely to follow

the earlier decision. This is one reason why our earlier advices have emphasized the need to first obtain legal advice as to whether any decision to test further a particular interpretation is appropriate. This advice needs to consider the prospects of a different interpretation being adopted. It is only if there are real prospects of an alternative interpretation being accepted that a failure not to treat a single judge's decision as applicable for resolving all similar cases will be defensible. If there are not real prospects and a particular interpretation has become settled, legislative amendment needs to be promptly pursued if the interpretation is thought to be wrong as a matter of tax policy.

7. The course of action supported by the JCPAA will normally reflect the position to be taken. Only if all the requirements set out in our earlier advice are met, is the ATO likely to be able to defend its failure to adopt an interpretation of the tax law given by a single judge or the AAT. The ATO appears to accept that it is only in 'rare' cases that this normal position will not be adopted.

8. Even if the requirements we outlined are met for not immediately accepting a judicial interpretation for all future cases, this may not ensure no criticism is forthcoming. The attitude of the JCPAA, and of many judges, will remain that, once a particular interpretation has been adopted and not appealed in that particular case, the ATO's only option is legislative change. We continue to consider that too strict a view. However, the situations where a different approach is possible are likely to be rare. As we have indicated, in order to avoid criticism, any decision to test the issue also needs to involve putting those affected on notice and so far as possible delaying decisions while the position is clarified as quickly as possible. On this basis, there is no reason to alter our earlier advice.



Henry Burmester QC
Acting Solicitor-General

20 August 2008