

# ADDRESSING SPECIFIC ISSUES IN TAX ADMINISTRATION

---

Problems identified in previous chapters have often shown up as part of the operation of the tax administration. The pressure created on the operation of tax administration has exposed problems which are within the ambit of the Review to address.

These issues include assessments, dispute resolution and rulings. This chapter explores some possible changes in the day-to-day operations of the tax administration in these areas.

The Review sees benefit in the system of tax administration being more responsive to business circumstances. This is particularly so in relation to the resolution of disputes between taxpayers and the Commissioner of Taxation on technical matters and in improvements to the operation of the tax rulings system.

---

<b><i>Why consider administrative processes?</i></b>	<b>119</b>
They are often the focus of taxpayer complaint	119
<b><i>How might key administrative processes be improved?</i></b>	<b>119</b>
Reform of the audit adjustment process may lessen disputation	119
New mechanisms may improve debt collection	121
<b><i>How might disputes be resolved more efficiently?</i></b>	<b>121</b>
By targeted process reforms	121
<b><i>How does the current rulings system operate?</i></b>	<b>123</b>
Public Rulings	124
Product Rulings	124
Private Rulings	124
<b><i>What deficiencies are apparent in the rulings system?</i></b>	<b>125</b>
Powers of key bodies are restricted	125
No scope for cost recovery	125
Lack of transparency	126

***How might the rulings system be improved?***

***126***

By making the system more comprehensive and flexible

126

***Other matters***

***129***

## *Why consider administrative processes?*

They are often the focus of taxpayer complaint

8.1 As the problems described in previous chapters have developed, they have mainly manifested themselves so far as taxpayers are concerned in the day-to-day operation of the tax system. A number of operational areas of tax administration have been subject to taxpayer comment and criticism. To some extent the problems are symptoms of the fundamental problems with the system discussed earlier in this paper. However, particular aspects of the administration also need to be addressed in their own right.

8.2 For example, as the tax legislation has become ever more complex, taxpayers —especially business taxpayers —have felt an increasing need for greater reliance on binding rulings to create certainty in their tax affairs. Rulings have thus become a pressure point in the system and as a result problems in the ruling process have been exposed.

8.3 The purpose of this chapter is to raise such issues for consultation. The Review is not limiting itself to these issues and submissions are invited to draw the attention of the Review to other issues.

## *How might key administrative processes be improved?*

Reform of the audit adjustment process may lessen disputation

8.4 The tax assessment system that operates today had its origins over 60 years ago. Since that time there have been major structural changes in the Australian tax system and more recently technology has been evolving at a staggering pace. In particular, self-assessment, the electronic lodgment of tax returns and information and a binding rulings system have been introduced. As part of the various tax reform initiatives announced by the Government in *A New Tax System*, it is likely that many of the current processes will come under review in any event. The Review is interested in community input in relation to problems in current processes.

### **Self-assessment prevails**

8.5 Generally, a self-assessment system now applies in Australia. A major element of this system is that assessment notices are issued on the

basis of returns lodged, without those returns being examined in detail by the Australian Taxation Office (ATO). In respect of companies and funds an assessment is not issued at all, and the taxpayer's return is deemed to be a notice of assessment. These arrangements were grafted onto a full assessment system, and various other band-aids have since been applied to the law to fit it into a self-assessment environment.

8.6 The ATO has designed wide-ranging programs to monitor taxpayer compliance in this self-assessment environment, and to make adjustments within specified time limits where it is considered that the correct tax position of a taxpayer is not reflected in the tax return. The current arrangements do not allow enough flexibility to accommodate the full range of taxpayer circumstances.

### **Adjustments on audit may have commercial consequences**

8.7 Most disputes between taxpayers and the Commissioner arise from adjustments following an audit of a taxpayer's affairs. Audits may range from a simple check for omitted income or an overclaimed rebate or deduction in the return of an individual taxpayer, to a full review of a large multi-national company for several years of income.

8.8 Assessments (or amended assessments) issued to taxpayers to give effect to the ATO's views following an audit can have significant effects on taxpayers. For example, listed companies may be obliged to notify the stock exchange of the issue of the assessment requiring payment of a material amount of tax. This could have an immediate effect on the company's share price. In the case of private companies and individuals engaged in business, the issue of an assessment may cause lenders to the business to call in securities or otherwise seek to recover amounts owing. Satisfactory resolution of the subsequent dispute offers little comfort for taxpayers faced with these potential impacts on issue of the assessment.

### **Process reform may limit recourse to litigation**

8.9 In order to minimise such disproportionate effects from the issue of assessments, a revised process may better allow the parties to focus on the issues (and amounts) in dispute before the assessment which gives effect to the adjustment is formally issued —thus triggering the existing dispute resolution mechanism. Such a process would allow for more consideration of the issues, reduce cases of multiple assessments that sometimes occur because of the inflexibility of the amendment provisions and time constraints under the current law, and permit more negotiation before litigation becomes necessary. Some informal processes of this kind currently exist, such as position papers in large audits. In developing such mechanisms, the relationship with time limits would need to be dealt with.

## New mechanisms may improve debt collection

8.10 A *New Tax System* proposes a Pay As You Go instalment system. However, more general reforms may be appropriate in the area of tax collection procedures many of which have remained essentially unchanged for a long period.

8.11 At present collection of debts due to the Commonwealth (including tax) is beset with considerable delay and cost because of varying procedures in State courts. It may therefore be appropriate to allow the Federal Court to give judgment for the tax debt at the same time as it considers any appeal against assessments. In addition, some form of Federal Magistrate's Court may be appropriate to facilitate collection of tax and other debts due to the Commonwealth. The Attorney-General has foreshadowed the creation of such a court.

8.12 Additionally, so as to overcome difficulties in the collection of Australian tax payable by non-residents of Australia, some consideration could be given to a system —possibly a general withholding at source —to ensure prompt and effective payment.

## *How might disputes be resolved more efficiently?*

### By targeted process reforms

8.13 Dispute resolution between the ATO and taxpayers is currently dealt with by the objection and appeal processes. These processes, that are linked to the assessment process, were also created when the world was very different from the current environment.

#### **Objections**

8.14 Where an assessment has been issued, the dispute resolution process begins with an objection to the assessment. The period within which a taxpayer can object against an assessment is generally four years from the time of the assessment. Notice of the Commissioner's decision on the objection must be given to the taxpayer. If a decision is not made within 60 days of lodgment of the objection, the taxpayer may require the Commissioner to make a decision on the objection within a further 60 day period. If the Commissioner does not decide the objection within this period the objection is deemed to be disallowed.

8.15 If an assessment issues in accordance with the return of income lodged by the taxpayer, arguably the objection process is now of little value. The position is even more questionable for companies which effectively object against their own self-assessment. The taxpayer may have followed (but may wish to challenge) the Commissioner's view of the law as contained in a public ruling. Upon objection it would be expected that the review officer would follow the ruling; thus the objection process serves to delay the appeal process (and sometimes the collection process). An alternative might be to provide the taxpayer with an immediate remedy of appealing directly to a tribunal or court.

8.16 If, on the other hand, the ATO has determined its position on a matter after fully considering it either in the course of an audit of the taxpayer's affairs or during preparation of a private binding ruling, it should not need a second chance to get it right. Again the taxpayer should have an immediate remedy.

8.17 A direct appeal process would not restrict opportunities for negotiation and settlement. Most references to a tribunal and appeals to courts are settled in the early stages of the dispute process. On lodgment of either a reference or an appeal, the process is then under tribunal or court oversight, helping to create a more dynamic process for dispute resolution.

## Reviews and appeals

8.18 A taxpayer dissatisfied with the Commissioner's objection decision has the option of either:

- applying to the Administrative Appeals Tribunal (AAT) for a review of the decision (handled by the Taxation Division of the Tribunal); or
- appealing to the Federal Court against the decision (the Federal Court does not have a specialist tax section even though it hears a significant number of tax appeals).

8.19 An alternative avenue of review exists in that a taxpayer may elect that a matter be dealt with by the Small Taxation Claims Tribunal (which is part of the AAT) if the amount of tax in dispute is less than \$5,000.

8.20 The Commissioner or the taxpayer may appeal to the Federal Court from a decision of the AAT but only on a question of law. This means that the court often has to refer a matter back to the Tribunal to make appropriate findings of fact after it has decided the question of law. Similarly, because of different powers of the review tribunals, taxpayer decisions on the avenue of appeal to pursue may be based on tactical grounds. For example, the Federal Court is more restricted in its reconsideration of the exercise of discretions by the ATO.

8.21 The announced government proposal for establishment of the Administrative Review Tribunal to replace the AAT includes retention of a specialist tax division, including the Small Taxation Claims Tribunal, but with the possibility of some expansion of its role.

8.22 Possibilities for reform of the current appeals system include:

- reducing the possible avenues of appeal;
- making jurisdiction and powers on appeal uniform;
- ensuring that there is an appropriate body of tax expertise on appeal; and
- ensuring that there are suitable appeal procedures for small business taxpayers (that is, designing the appeal procedures to fit appropriately with different types of taxpayers).

### Mediation

8.23 More fundamentally, the amount of disputation in the tax area still generates hundreds of pages of tribunal and court decisions each year. Even though down from peak levels, this raises the question of whether alternative dispute mechanisms may be appropriate.

8.24 The Commissioner has announced interest in extending use of alternative dispute resolution for tax matters, including the proposed establishment of a panel of mediators. This change could be effected by administrative means. However, the law relating to the objection and appeal processes reflects and encourages an adversarial mindset. It may be desirable to provide legislative encouragement for wider use of alternative dispute resolution approaches. Mediation processes might usefully be employed in areas such as private rulings and audit adjustments where there is potential for disputes to arise.

## *How does the current rulings system operate?*

8.25 A system of public and private rulings was introduced on 1 July 1992, and is an important element in the self-assessment system. Public and private rulings, which are concerned with how liability to tax is worked out, may be legally binding on the ATO if favourable to taxpayers. Rulings that are not legally binding are treated as administratively binding except in certain circumstances. Rulings are provided free of charge.

## Public Rulings

8.26 The criterion for the issue of a public ruling is that it provides a new or revised guideline on a tax question of public importance. A public ruling is a ruling that sets out the Commissioner's opinion as to the way in which a tax law applies to a person or class of persons in relation to an arrangement or a class of arrangements. To be a public ruling, the Commissioner must publish it in the Commonwealth Gazette and the ruling must state that it is a public ruling for the purposes of the income tax legislation.

8.27 The Commissioner is bound to follow public rulings, thus providing certainty in the application of the law in circumstances that match those covered in the public ruling.

8.28 There is no right of objection against a public ruling. However, taxpayers are not obliged to follow public rulings if they believe them to be incorrect or inapplicable in the circumstances relevant to the taxpayer.

## Product Rulings

8.29 In June 1998, the Commissioner announced the introduction of product rulings under which the ATO will publicly rule on the availability of claimed tax benefits in relation to investments that might broadly be described as tax-effective arrangements, financial arrangements or insurance arrangements. Product rulings are thus a subset of public rulings.

8.30 To obtain a product ruling, promoters of investments provide the ATO with full details of the arrangements that apply to the investment. Product rulings serve to protect and guide investors, as long as the arrangements are carried out in accordance with the promoter's original advice to the ATO.

## Private Rulings

8.31 A private ruling is specific to the particular taxpayer(s), tax law(s), income year and transaction, act or event. Generally, a taxpayer may object against an unfavourable private ruling in the same way as an objection can be made against an income tax assessment.

8.32 If a private ruling covers the same topic as a public ruling the taxpayer can object, but the grounds for objection are confined to the material on which the private ruling was based, rather than the full range of information on which the public ruling may have been based.



## *What deficiencies are apparent in the rulings system?*

### Powers of key bodies are restricted

8.33 Under present law, the ATO cannot rule on questions of fact or on procedural, administrative or collection matters. A change to cover such issues has been actively sought by taxpayers and practitioners particularly in relation to the Prescribed Payments System and Pay As You Earn arrangements.

8.34 The rulings system can currently restrict the ATO's ability to rule confidently on the arrangement under contemplation. In a number of cases an applicant will not know the full extent of the arrangements proposed (for example, taxpayers who enter into pre-packaged arrangements sold by promoters, although the new product rulings discussed above are directed at these situations). There are also problems for the ATO with secrecy and privacy in regard to using third party information in relation to rulings. These limitations can make the ATO reluctant to rule in particular cases or at least to rule on all the issues that the taxpayer desires.

8.35 At present, the Commissioner can rule only on the information provided in the application. Further, the tribunal's or court's ability to settle the real issues between the Commissioner and taxpayers is restricted. The only information that can be considered in an objection and appeal on a private ruling is that in the ruling request itself, even if the parties agree that the facts are otherwise. A number of appeals have been ineffective for this reason.

### No scope for cost recovery

8.36 The rulings process currently includes everything from very simple enquiries, through to extremely complex multi-billion dollar deals. The provision of binding advice in more complex cases requires the use of high level technical expertise over an extended period. This represents a significant cost to the ATO and to the community.

8.37 Different taxpayers require different levels of comfort in their tax affairs and so many private ruling requests are made on non-controversial issues. Further, private rulings may have a commercial value in that they are often required before financiers will advance funds for a project or before a particular transaction can be completed. In order to provide a cost benefit restraint on ruling requests and for the public to capture some of the private benefit created by rulings, it has been suggested that a charge be made for rulings in appropriate cases.

8.38 From time to time questions have also been raised about the timeliness and independence of the rulings process. Some would argue that the current processes do not provide the necessary discipline to bring rulings to a prompt conclusion, and that rulings can have a revenue bias, whereas they are intended to state the ATO view of the law. The board proposed in Chapter 7 may have a role in relation to reporting on the ruling process.

### Lack of transparency

8.39 Finally, the technical content of private rulings is not available to the public even though other taxpayers may wish to obtain a private ruling on the same issue as one already provided to another taxpayer. There have also been suggestions of forum shopping by taxpayers to obtain favourable rulings from different offices of the ATO.

## *How might the rulings system be improved?*

### By making the system more comprehensive and flexible

8.40 The Government has indicated in *A New Tax System* that some of the current issues in the rulings system will be addressed. The Review seeks views on these and other issues relating to rulings. In particular, the following possibilities may be considered for dealing with current problems.

#### **Rulings on fact and procedure**

8.41 The Government is broadening the scope of the private ruling system to give greater certainty to taxpayers about the application of tax laws to their arrangements. Under the proposal which is currently being implemented, the ATO may properly rule on an ultimate question of fact forming a part of a provision on which a ruling is given (for example, residency status, in determining if income is assessable).

#### **Charging for selected rulings**

8.42 The Review seeks submissions on charging for rulings as indicated in *A New Tax System*. The criterion for charging for a ruling could have regard to the extent to which a particular ruling is for the benefit of an individual taxpayer or is of wider benefit to participants in the tax system. Under such an approach, private rulings with significant commercial value for the taxpayer concerned would be a candidate for charging. Product

rulings, which benefit the promoter of a particular product, might also be subject to a similar charge. This type of private benefit test would ensure that any charging regime was suitably constrained. It is likely that the law would need to be amended specifically to authorise charging, and clear guidelines would need to be established.

8.43 The method of charging could be lump sum, purely time based or some combination of the two. A standard application fee could apply and charging could be based on an hourly fee plus disbursements. Consideration could be given to a *de minimis* rule which would ensure that the charging regime did not unduly restrict access to the ruling system. The quantum of charges should reflect the marginal cost to the ATO of providing the ruling. An upfront quotation could be provided within an acceptable period after the application. Additional costs could then be negotiated. Charging may allow the ATO to increase its use of external consultants for expert advice in order to improve quality and give taxpayers more confidence in the rulings process.

### Use of other sources of information

8.44 To overcome information difficulties the Review raises the question whether the ATO should be allowed to find and use facts from any source before providing a ruling.

8.45 Similarly, tribunals and courts could be allowed to review private rulings on the basis that the facts are not as set forward in the private ruling request. Taxpayers and the ATO could agree on new evidence at the hearing stage to allow the real issues to be resolved on appeal. Whether unilateral presentation of new information should be permitted is a further matter on which the Review seeks input. Taxpayers may have to bear some financial consequences if they seek to raise new facts at the appeal stage in order to ensure that the full facts are presented with the ruling request so far as possible.

### Timeliness and independence of rulings process

8.46 The Review sees the timeliness and independence of the rulings process as related issues. A likely outcome of any move to make the rulings process independent of the ATO would be that time delays in issuing rulings are likely to increase. The Review understands that extended delays occur in countries (such as Sweden) where —for reasons going well beyond the tax law and its administration —rulings are issued by an independent body. Moreover, a process of that kind would be at odds with our system of an independent tax administration, with the Commissioner generally bound by day-to-day operations, actions and decisions.

8.47 A practical alternative is to make the rulings process more specialised within the ATO to ensure that the best knowledge of the law is reflected in the ruling. The Review notes that tax experts external to the ATO are directly involved in finalising the Commissioner's view on public rulings through their work on the rulings panels.

8.48 It would be possible to amend the legislation to provide for a set time limit within which the ATO will have been deemed to rule either in a positive or negative sense. While such a provision would have the advantage of bringing matters to finality within a reasonable timeframe, it has potential disadvantages:

- possibly increased disputes over whether ruling applications satisfy technical requirements of the legislation and when further information was sought and/or received;
- increased possibility of issuing an incompletely considered ruling, which is quickly reconsidered and withdrawn; and
- duplication of mechanisms already in place to force decisions (such as the *Administrative Decisions (Judicial Review)* legislation).

### Public information on private rulings

8.49 The ATO is planning to make available to the public a database of decisions made on taxpayers' specific enquiries. These will be in the form of summaries to protect taxpayer privacy and confidentiality. A permissive legislative amendment may be desirable to provide protection for the publishing of this information and to ensure the maximum availability.

8.50 At present only the particular taxpayer who applies for a private ruling can rely on it. However, there are situations where a number of taxpayers are affected by a common tax issue. For example, all parties in a partnership may desire clarification of whether a particular deduction is allowable, or all members of a union may wish to confirm that certain expenses do not require substantiation. At present, each of those taxpayers must separately apply for a binding private ruling, at considerable cost to both taxpayers and the ATO.

8.51 Some form of 'class order' private ruling to alleviate this situation may be desirable. It is possible that the Product Ruling model could be used as a basis for the 'class order' ruling model.

## *Other matters*

8.52 As noted at the outset of this chapter, not all issues of day-to-day tax administration are covered here. The Review is conscious that tax administration is the subject of a great deal of comment, being the public face of the tax system. The Review is prepared to receive submissions on any tax administration matter.



# THE WAY AHEAD

## Suggested reforms are subject to consultation and testing

In this first discussion paper the Review has proposed suggestions for building a stronger foundation for Australia's business tax system. The Review believes that addressing reform of this nature is a necessary prerequisite to addressing the specific policy matters raised in *A New Tax System* or in the Review's terms of reference.

The suggestions put forward in this paper will serve as input into the consultative processes following the release of the current discussion paper. To this end the Review will be presenting public seminars, one in each capital city, throughout December 1998. Details of the seminars will be advertised, and are also available on the Review's website <http://www.rbt.treasury.gov.au>.

The Review invites submissions on any of the framework or process matters raised in this discussion paper, or on related matters, by no later than 31 December 1998. The Review expects that the consultation process will lead to refined proposals to be reflected in the Review's final recommendations. Because of the broad nature of these matters, the Review has decided not to formulate specific issues as the basis for its consultations. Procedures for making submissions are set out at *page v* of this paper.

A second discussion paper setting out issues for consultation in relation to the Government's previously announced reform strategies is expected to be released at the end of January 1999, with a two month period then provided for consultation and submissions.

In addition, the revised framework and proposed design process, especially the detailed accountabilities at agency and steering committee levels, will be further refined through testing. The concurrent drafting of exposure legislation —under integrated design processes being developed in conjunction with the Office of Parliamentary Counsel and the Australian Taxation Office —in relation to the Government's announced business tax reforms will serve as a pilot application of the proposals. That draft exposure legislation is intended to be available to the Government when the Review makes its final report.

This process of consultation and testing will allow the Review to make focused and workable recommendations to the Government in its final report, due no later than 30 June 1999.





