


## ***BTR/Section3 -***

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## ADMINISTRATION

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# *A more comprehensive rulings system*

## Recommendation

### **3.1 Improved reliability of rulings**

#### *Rulings on administration, procedure and collection, and fact*

- (a) That, consistent with the position outlined in *A New Tax System*, the scope of the public and private ruling systems be expanded, to the extent possible, to provide for the Commissioner of Taxation to be legally bound by rulings on:
  - (i) matters of administration, procedure and collection; and
  - (ii) ultimate conclusions of fact involved in the application of a tax law.

#### *Application of the general anti-avoidance rule*

- (b) That the Commissioner of Taxation be specifically allowed to issue legally binding rulings on the potential application of Part IVA of the 1936 Act (also known as the general anti-avoidance rule) subject to taxpayers:
  - (i) providing sufficient factual details; and
  - (ii) covering the elements of Part IVA in applications.

This recommendation will remedy current limitations in the scope of the public and private rulings systems and provide greater flexibility and certainty to taxpayers.

Under the existing rulings system, the Commissioner is legally bound only to the extent that a ruling deals with the application of a taxation law to a particular arrangement, and then only to the extent that a liability is worked out.

The Review received a number of submissions expressing dissatisfaction that the Commissioner is not legally bound on questions of fact, nor on procedural, administrative or collection aspects of the law that form part of a ruling. The Commissioner adopts the position of being administratively bound in relation to questions on matters of procedure, administration or collection. However, 'rulings' on such matters are an integral part of the tax system, and making them legally binding on the Commissioner would provide greater certainty.

### ***Rulings on administration, procedure and collection***

Recommendation 3.1(a)(i) expands the range of issues on which the Commissioner may rule, so that rulings may be issued on procedural, administrative or tax collection matters. Such an expansion does not cover all issues — including those on which it would be inappropriate for the Commissioner to rule. Such matters include the imposition or remission of a penalty, prosecution action, debt recovery, enquires into the correctness of a return or other information supplied by a person, and other matters that may prejudice or unduly restrict the Commissioner's administration of the tax law.

Under this proposal the Commissioner will be able, but not required, to rule on the application of a section or other provision of any Act administered by the Commissioner unless specifically excluded. This will allow the Commissioner to make rulings relating to such Acts as the *Petroleum Resource Rent Tax Assessment Act* and other administered Acts.

### ***Rulings on fact***

Currently a ruling is legally binding on the Commissioner only to the extent that the ruling deals with the application of a taxation law under which the extent of liability is worked out. The Commissioner should also be bound (Recommendation 3.1(a)(ii)) by any conclusion that is required to be made as a prerequisite to determining a taxpayer's liability (for example, whether the taxpayer is carrying on a business for the purposes of a specific provision of the tax law under which liability is worked out).

Despite this recommended expansion, a change to the underlying facts on which the ultimate conclusion is based may mean that the ultimate conclusion no longer applies. In addition, where the matter is beyond the competence of the Commissioner to deal with (for example, on valuation issues) the Commissioner may still decline to provide a ruling.

One of the issues raised during consultation was whether there is a judicial power to review findings of fact. Advice from the Australian Government Solicitor indicates that the review of a legally binding ruling about a conclusion of fact to determine a taxpayer's taxation liability involves the exercise of a judicial power consistent with Chapter III of the Constitution.

The Commissioner's findings of fact will therefore be subject to review so that a court or tribunal would be in a position to review the ruling application.

### ***General anti-avoidance rule application***

The Review received a number of submissions noting the uncertainty about the ability of the Commissioner to make rulings on the application of the general anti-avoidance rule (GAAR). (Recommendations 6.1 to 6.5 separately

address the GAAR.) This uncertainty arises from judicial comments that question the ability of the Commissioner to issue a ruling on the application of the GAAR to a proposed scheme that is yet to be commenced. The manner in which the scheme was ‘entered into or carried out’ is an element that must be considered by the Commissioner when applying the GAAR. Prior to a scheme being commenced, there may be insufficient information about how it would be ‘entered into or carried out’.

However, where the scheme is entered into or carried out in the manner described by the taxpayer in the ruling application, the Commissioner may be bound by a ruling as to how the GAAR applies. To obtain a ruling on the potential application of the GAAR, it would be necessary for an applicant to provide the Commissioner with sufficient details about the manner in which the scheme is to be entered into or carried out.

Recommendation 3.1(b) will allow the Australian Taxation Office (ATO) to give binding rulings on the application of the GAAR and improve the reliability of the rulings system.

### ***Hypothetical arrangements***

In some instances a taxpayer cannot commercially afford to proceed with a transaction until its taxation implications are settled beyond doubt.

Submissions to the Review highlighted a concern about the current private rulings system, which can result in recipients of some adverse private rulings being unable to have those rulings reviewed by the courts.

This may occur where, through the normal processes of applying for and issuing a private ruling, and then arranging for it to be challenged in court, the proposed transaction start date is passed and a new tax year commences. As a result, the matter is deemed to become hypothetical. In these circumstances the courts are barred by the Constitution from hearing any challenge to the ruling.

The problem cannot be corrected through legislative amendment to the taxation laws alone, since the issue relates to the Constitutional inability of the courts to hear matters which are hypothetical in nature — no matter how likely it is that those prospective transactions will proceed once the tax issues are settled.

The Commissioner has advised the Review that in such situations, and where an arrangement remains in serious contemplation, current practice is to issue a private ruling for the transaction in a subsequent year to enable the matter to be reviewed.

### ***Material difference***

In response to a recent court decision, some submissions expressed concern over the extent to which a ruling may be relied upon where a particular taxpayer's arrangement varies from that described in a ruling.

One way of dealing with this concern would be to define specifically the term 'material difference' in the taxation law. However, this matter was canvassed and explained in the explanatory memorandum that accompanied the bill for the establishment of the rulings system in 1992. Whether an arrangement is 'materially different' is a proposition that must be looked at on a case-by-case basis and will be influenced by individual circumstances. In view of the coverage in the explanatory memorandum and the practical application of the system, legislative change is not considered necessary.

## **Recommendation**

### **3.2 Improved certainty and timeliness of private rulings**

#### ***Default issue of private rulings***

- (a) That the tax law be amended to establish a default system for the issuing of private rulings — under which the Commissioner would be deemed to have given a ruling adverse to the taxpayer if the Commissioner has failed to make a ruling within a specified period.**

#### ***Use of facts from other sources***

- (b) That when making a private ruling the Commissioner be allowed in certain circumstances to rely on information other than that provided by the applicant, with the effect that:**
  - (i) the Commissioner be able to use information readily available, in addition to the facts provided by the applicant;**
  - (ii) such information be made known to the applicant before being used to make the ruling; and**
  - (iii) where the Commissioner cannot convey this information to the applicant (for reasons of privacy or confidentiality):**
    - the Commissioner be unable to provide a ruling, and**
    - the taxpayer be advised accordingly.**

### *Taxpayer to bring new evidence*

- (c) **That, consistent with the recommendations to expand the scope of the rulings system and allow rulings on the ultimate conclusion of fact, taxpayers be allowed to introduce new facts or evidence to the Commissioner after the issue of a private ruling but before judicial review.**

### *Public information on ATO technical decisions*

- (d) **That a legislative amendment be made to allow the publication by the Commissioner of technical decisions and administrative advice in a form protecting taxpayer privacy and confidentiality.**

### *Default issue of private rulings*

The Review received a number of submissions which expressed dissatisfaction about the delays in securing a private ruling. Recommendation 3.2(a) will provide taxpayers with a method of hastening a reviewable decision from the Commissioner. The system could be broadly modelled on the current mechanism under which a person may require the Commissioner to determine an objection.

Under the objection model, following the later of:

- 60 days after lodgment of the objection, or
- if the Commissioner requests further information within this period, 60 days after the Commissioner receives that information,

the taxpayer can give the Commissioner written notice requiring the Commissioner to determine the objection. If, after being given the written notice, the Commissioner had not determined the objection within a further 60 days, the Commissioner is taken to have disallowed the objection. The taxpayer can then appeal that decision.

The Review notes that the current mechanism in relation to determining objections has rarely been used, but still considers it would be valuable to allow taxpayers to have a similar mechanism available for private rulings.

### *Use of facts from other sources*

The current law requires the Commissioner to rule only on the information provided in the taxpayer's application. This means that, where the Commissioner has access to additional information that might or might not be readily available to the applicant, the Commissioner cannot use it but instead must request the applicant to provide it. Removing the need for the Commissioner to request the information, when that information is readily available to the ATO, will allow the arrangement to be more accurately

clarified in less time. This will provide greater certainty to the arrangement in question and reduce the potential for delays.

Nevertheless, it should remain the responsibility of the taxpayer to provide the Commissioner with sufficient facts, as early as possible, to describe accurately the arrangement upon which a ruling is sought. The Commissioner will not be required to investigate all evidence from other sources that may be relevant to the application. Nor would the Commissioner be taken to have considered, for the purposes of the ruling, all information that may be in possession of the Commissioner.

Recommendation 3.2(b) allows the Commissioner's decision to be based on facts other than those given by the applicant, provided that the taxpayer is given the opportunity to consider these additional facts prior to any ruling being made. However, where third party confidential information is available to the Commissioner, privacy principles may prevent the ATO from making this information known to the applicant. In these circumstances, the Commissioner would be unable to provide a ruling — and the taxpayer should be advised accordingly.

### ***Taxpayer to bring new evidence***

Currently, where taxpayers object to a private ruling, judicial review is limited to the arrangement as set out in the ruling. Occasionally, the facts on which a ruling is considered are insufficient to satisfy a court or tribunal that the matter can be decided. In these cases the court or tribunal may only remit the matter to the Commissioner to request further information.

Recommendation 3.2(c) would allow the Commissioner to take into account additional facts provided by taxpayers at the objection stage. Taxpayers would be able to clarify their position so that all the necessary information is presented to support the case for review of the decision. As is the case currently, where the arrangement identified by the taxpayer is materially different, the applicant should be advised to make a fresh application.

### ***Public information on ATO technical decisions***

The ATO has developed a public database of decisions made in response to requests for private rulings, advance opinions and other technical and administrative advice. These are in the form of summaries to protect taxpayer privacy and confidentiality.

The public availability of information on how the Commissioner interprets and applies the tax laws is a fundamental element of the rulings system under self-assessment. Publishing private rulings summaries and other guidance — Recommendation 3.2(d) — will reinforce this element by providing taxpayers with greater certainty on the tax implications of their arrangements. However,



taxpayers desiring a binding ruling should still apply for a private ruling on their specific situation.

#### Recommendation

### 3.3 No class order rulings

**That no provision be made for any form of ‘class order’ private rulings.**

The suggestion to allow some form of a ‘class order’ ruling to apply to a number of taxpayers affected by a common tax issue was raised for comment in *A Strong Foundation* (page 128).

That taxpayers affected by a ruling must have notice of that ruling is fundamental to the rulings system. For this reason, public rulings are published widely, and advertised in the Government Gazette, and private rulings must be served upon the taxpayer requesting the ruling.

It would not be possible to guarantee that all taxpayers affected by a ‘class order’ private ruling could be advised of its existence. In the case of a favourable ruling this may mean some taxpayers would miss the benefit allowed. On the other hand, in the case of an unfavourable ruling, this may mean some taxpayers, under existing penalty arrangements, would be subject to a tax shortfall penalty as a result of a ruling they had no knowledge of and did not seek.

#### Recommendation

### 3.4 Application of penalties

**That the penalty provisions be amended so that taxpayers who decline to follow a private ruling are subject to the same penalty regime as those who decline to follow a public ruling.**

Under Australia’s self-assessment tax system, taxpayers are required to take reasonable care in relation to their tax affairs and to adopt positions which are at least ‘reasonably arguable’. That is, where several tax treatments are possible in relation to a taxpayer’s circumstances, the taxpayer may adopt a position which is ‘about as likely as not correct’ when all the facts, case law, explanatory memoranda and public rulings are taken into account. A taxpayer may decline to follow a public ruling and still have a reasonably arguable position, provided there is sufficient support for the position adopted by the taxpayer.

Taxpayers who adopt a reasonably arguable position in these circumstances, but who are later found to have been in error, are not subject to penalties — although they will generally be required to pay interest on any tax owing.

Taxpayers who do not adopt a reasonably arguable position in their tax affairs (for example, if they ignore the clear law) are subject to penalties, commencing at 25 per cent of the tax shortfall.

This contrasts with the position of taxpayers who seek a private ruling from the ATO on their circumstances. Such taxpayers can find themselves in a significantly worse position regarding penalties than those who do not seek ATO assistance. Taxpayers who receive an adverse private ruling and decline to follow it automatically face a 25 per cent penalty. It is not relevant that they may have a reasonably arguable position or can show that their position is ‘about as likely as not correct’ using case law, explanatory memoranda or public rulings.

The Review considers that the inconsistency between penalties for ignoring a public ruling and for ignoring a private ruling is not justified. Although a private ruling would be relevant in considering penalties, it should not be determinative. The criteria for invoking the penalty regime should be concerned solely with considerations of whether the taxpayer has taken reasonable care and whether a reasonably arguable position has been adopted. Where this can be demonstrated, no penalties should apply — though interest should continue to be payable on any tax shortfall. Where this cannot be demonstrated, there is no reason to suggest that a penalty regime is inappropriate.

The ATO should give consideration to implementing a cost effective system which would require taxpayers to indicate in their returns whether or not they have complied with a ruling.

## Recommendation

### 3.5 Fee for selected rulings

- (a) **That, as proposed in *A New Tax System*, the taxation law be amended to allow the Commissioner to charge a fee for the provision of selected rulings.**
- (b) **That such fee collections be retained by the ATO to maintain suitably skilled professional resources able to provide timely, quality advice.**

Taxation rulings can confer valuable and significant commercial advantages on the recipient. ATO resources required to consider such ruling applications can be significant. In such circumstances — where all other advisors to the taxpayer are earning proper professional fees from their advice — it is reasonable for the Commissioner to seek commercial rates given the certainty provided by a legally binding ruling.

The retention of funds received from charging will enable the Commissioner to maintain skilled resources, both internal and external, and adopt a more specialised approach that will provide more timely, accurate and consistent rulings.

Public guidelines on the following matters will be developed by the ATO in response to the recommendation:

- circumstances when a charge would be made;
- the basis for calculation of the charges;
- terms of a typical contract for service, particularly relating to the timing and (estimated) total fee; and
- the information required to be provided by the applicant, including possibly a draft of the proposed private ruling and relevant research materials.

Rulings subject to a fee will include only those where significant amounts of tax are at stake or significant ATO time and resources will be involved and where the ability of the taxpayer to pay the charge is clear. The Board of Taxation (see Recommendation 1.4) will have a role in monitoring the application of the charging regime to ensure that the policy for imposing fees is appropriate.

#### Recommendation

### 3.6 Rulings a function of the ATO

#### **That the rulings process continue to be administered by the ATO.**

The Review raised for comment the related issues of timeliness and independence in the rulings system. A number of submissions were received in support of an independent body to issue rulings. However, experience overseas suggests that such an approach results in delays which would be unacceptable in the Australian context (*A Strong Foundation*, page 127).

Moreover, the Commissioner is responsible for applying the law to the facts of the case and would continue to do so even if an independent body issued rulings. This separation of responsibility would be likely to give rise to greater uncertainty rather than less.

# Modernising administrative procedures

## Recommendation

### 3.7 Redesigning procedures for determining taxpayer liability

**That the assessment, objection and dispute resolution regime under which a taxpayer's liability for taxation is finally determined be redesigned:**

- (i) on a 'whole-of-transaction' basis, embracing the totality of actions from the time a transaction is initiated until a legally enforceable final decision is reached with respect to its taxation consequences, and any consequential liability is discharged;**
- (ii) in accordance with the integrated taxation design process; and**
- (iii) in consultation with the Board of Taxation.**

A piecemeal approach has applied historically to each process — that is, each ruling, objection, appeal and judicial review. Each of these have been largely discrete exercises based on the separation of responsibilities and 'independent' review processes associated with the assessment system that existed prior to the commencement of self-assessment in 1986. The issues, and the processes, need to be considered on an integrated — that is, a 'whole-of-transaction' — basis, in order that the best possible administrative regime can be designed and implemented. This administrative regime will be one that is seamless and keeps disputes — and their associated costs and delays — to a minimum.

Concerns with the current system were addressed at length in Chapter 8 of *A Strong Foundation*. They are critical to taxpayer perceptions of fairness and hence impact on levels of voluntary compliance. A redesign of the administrative regime will assist in addressing these perceptions.

The objective of such redesign is to:

- improve the quality and timeliness of interactions between taxpayers and the taxation administration and reduce the likelihood of, and grounds for, dispute; and
- significantly simplify post-return processes and provide incentives to all parties to resolve disputes quickly.

Recommendation 3.7 is intended to provide improved, streamlined and less costly interaction between business and the ATO and to assist in building trust between the business community and the taxation administration. Such reform of the administrative regime is integral to the package of proposals arising from the Review and should be seen as a significant outcome of the

Review. It should provide a platform for ongoing improvements to tax administration and ongoing increases in the levels of voluntary compliance.

It is important that the redesign of administrative procedures be undertaken on a consultative basis, in accordance with the integrated taxation design process (see Recommendation 1.1). The Board of Taxation should be brought into this consultative process at an early stage, as it will be well placed to assist with and advise on the features of the new arrangements.

## Recommendation

### 3.8 Improved dispute resolution

**That improved mechanisms to resolve disputes — incorporating provision for negotiation, mediation/arbitration and new or improved litigation and court processes — be features of the redesigned administrative regime.**

Existing arrangements for resolving disputes between taxpayers and the Commissioner regarding tax liability were established well before the introduction of self-assessment and have long passed their use-by date. They are needlessly tortuous, often unacceptably slow and costly, and intrinsically overly adversarial. They do not encourage open and direct communication between the parties, or the timely exchange of relevant information. They can cause taxpayers, especially business taxpayers, and the ATO frustration, not to mention avoidable expense.

The deficiencies in the dispute resolution arrangements were discussed in detail in *A Strong Foundation* (Chapter 8), and have since been a focus in submissions and comments made at the Review's public forums. It is essential they be addressed effectively in the proposed redesign of administrative arrangements.

A key aspect of the redesign should be a shift in emphasis from adversarial structures (based for example on objections and appeals) to arrangements that employ concepts of dialogue, mediation/arbitration and expanded small claims procedures, with consideration to be given to more specialist tax litigation arrangements and court processes.

The streamlining of dispute arrangements should ensure that disputes are identified at the earliest possible stage and dealt with on a timely basis. When it is clear a matter will not be able to be resolved by dialogue or mediation, provision should exist for the matter to move quickly to resolution through an appropriately skilled and informed independent tribunal or court.

The Review noted in *A Strong Foundation* that disputation in the tax area generates hundreds of pages of tribunal and court decisions each year, contributing to delays and uncertainty. Therefore, the prompt referral of a

dispute to a tribunal or court is not in itself a solution. Therefore, given this, the tribunal and court arrangements applying to tax disputes need themselves to be reviewed and all options for improvement considered.

Consideration should be given to reforms in this area, including for example:

- the establishment of a specialist taxation tribunal to facilitate effective tax dispute resolution, possibly as a division of the proposed Administrative Review Tribunal or Federal Magistrates Court; or
- the creation of a dedicated Tax Court, possibly as part of the Federal Court, presided over by judges with specialist tax knowledge.

New arrangements should include provision in certain circumstances (for example, where all parties agree an issue will not be resolved through dialogue or mediation) for taxpayers to by-pass administrative processes and refer a dispute directly to the appropriate independent tribunal or court.

#### Recommendation

### 3.9 Small claims

**That arrangements be introduced to shorten the time and reduce the cost of resolving disputes involving small amounts of tax.**

There is a compelling argument for extending dedicated, streamlined arrangements for dealing with taxation matters where the amount of tax in dispute is small (up to, say, \$50,000 rather than the current \$5,000). In the absence of such arrangements, disputes can drag on for long periods and involve costs both to the taxpayer and to the government (not the least in the form of administrative costs) out of all proportion to the amount at issue.

Such new arrangements should focus on mediation/arbitration, be non-precedential and provide limited avenue for further review or appeal by the parties concerned.

## *Addressing the need for adequate information*

#### Recommendation

### 3.10 Provision of expanded taxpayer information

- (a) **That requirements of business taxpayers to provide routine information to the Commonwealth regarding their business**

**activities be expanded, in order to facilitate improved formulation of taxation policy and legislation.**

- (b) That this be part of an information collection strategy to be developed by the Australian Taxation Office in consultation with the business community through the Board of Taxation.**

This recommendation is made against the background of a difficulty faced by the Review in the formulation of its recommendations: a lack, in many areas, of readily available information. More complete information would have made the task of developing policy options easier and would have assisted in better assessing the impact of change.

Coherent, integrated business taxation policy depends significantly for its development on access to reliable aggregate data that can be used to establish the impact and revenue effects of proposed policy changes. The purpose of this recommendation is to establish a process to assist in ensuring that, in future, information that is both relevant and adequate is available in the integrated process of formulating tax policy advice and in the subsequent decision making process drawing on that advice. Advisers and decision makers need to be well informed.

The availability of current and reliable information will assist the integrated teams in their future work. It also will assist tax administrators in monitoring trends in taxpayer compliance and behaviour, for example, in response to changes in the economy or taxation policy. This is particularly important given the extent of change proposed by the Review.

It is in the national interest that our taxation system be kept in tune with business and commercial developments and that sufficient information be available to those responsible for the maintenance and development of the system. The availability of adequate information will help to ensure both the integrity of our tax system and that the system remains current. With improved overall quality of tax data, legislation and administrative and compliance systems will improve as a result.

Increased acquisition of taxpayer information must be balanced against:

- the need to protect taxpayers' privacy and commercially sensitive information; and
- the cost, both to taxpayers and the Commonwealth, of collecting the data.

This said, taxpayers benefit from the development of good taxation policy and law, a benefit which entails an obligation to provide information properly required for this purpose.

The information in question would be collected from individual taxpayers and aggregated. There are a number of ways it might be obtained, the most obvious being from:

- tax returns;
- census and surveys conducted by the Australian Bureau of Statistics; and
- one-off surveys.

These options are not mutually exclusive; potentially, they all have a part to play. A key issue, however, is the need for items of information to be available on a regular ongoing basis so that trends and correlations can be identified and assessed. It is essential, therefore, that a considered review be undertaken of data capture from business and that an ongoing collection regime be settled upon.

Because of the potential impacts on the business community, the Board of Taxation should monitor the information collection strategy and its underlying policy.