

REGULATING THE REGULATOR: ASSESSING THE EFFECTIVENESS OF THE ATO'S EXTERNAL SCRUTINY ARRANGEMENTS

SUNITA JOGARAJAN*

I. INTRODUCTION

In April 2016, the Standing Committee on Tax and Revenue ('SCTR') published its 'Report on the External Scrutiny of the Australian Taxation Office'.¹ The report was the result of concerns raised by the Australian Taxation Office ('ATO') that it faced excessive external scrutiny. The SCTR's terms of reference focused on the issues of duplication and overlap of reviews, cost to government of the reviews, and differential regulation (whether the ATO had demonstrated good risk management and high standards of performance such that differential regulation permitted by the *Public Governance, Performance and Accountability Act 2013* could be extended to reduce its external scrutiny). The SCTR found that the substantial external scrutiny placed on the ATO was warranted in light of the ATO's considerable resources and power, and importance to the general system of government. However, the SCTR only touched on the effectiveness of existing external ATO scrutiny arrangements in its report, as this question was not within its terms of reference.

Given the recognised importance of the ATO's external security arrangements, this paper examines the *effectiveness* of those arrangements using two case studies. The case studies indicate that the external scrutiny arrangements are not always effective and changes to those arrangements are warranted. The paper proceeds as follows. The next section briefly discusses the role of the ATO in the context of a self-assessment tax system while Section III outlines the ATO's existing external scrutiny arrangements. Section IV discusses two case studies which evidence issues with the ATO's existing practice and the ineffectiveness of the existing external scrutiny arrangements. The options for reform to improve the effectiveness of the ATO's external scrutiny arrangements are discussed in Section V, while Section VI provides some concluding remarks on the importance of improving the effectiveness of the ATO's external scrutiny arrangements.

* Melbourne Law School, University of Melbourne. I am grateful to Cate Read for research assistance and to Chantal Morton and the anonymous reviewer for their comments.

¹ Standing Committee on Tax and Revenue, Parliament of Australia, *External Scrutiny of the Australian Taxation Office* (April 2016).

II. SELF-ASSESSMENT AND THE ATO

The ATO was established in 1910 and is the government's principal revenue collection agency.² For the 2015–16 financial year, the ATO had an operating expense budget in excess of \$3 billion and more than 20,000 employees.³ The growth in ATO operations has matched the growth in the number of taxpayers, the rising sophistication of taxpayer arrangements and the increasing complexity of the Australian tax system.⁴

Prior to the introduction of self-assessment in 1986–87, taxpayers would lodge a return containing information from which ATO assessors would determine the amount of tax payable. The taxpayer had the right to object against the assessment. In 1983–84, there were more than 236,000 objections against assessments and it was thought that if the number of disputed returns continued to grow at the prevailing rate, the ATO would ultimately use more staff in reviewing assessments than in processing them.⁵ Further, the data indicated that ATO staff would be required to process 400 tax returns a day and would only be able to spend approximately one minute to assess an individual tax return and four minutes for a business tax return.⁶ Against this backdrop, an Assessing Review Group was established within the ATO in 1985 to explore the introduction of a self-assessment system. The first steps towards self-assessment were taken in 1986–87 with the ATO relieved of the obligation to examine returns at the assessment stage and the freed-up resources reallocated to post-assessment checking and taxpayer advisory services. In 1989–90, full self-assessment was introduced for companies and superannuation funds. These taxpayers were also required to determine their tax payable in addition to their taxable income.

At the time of introduction, self-assessment was mainly viewed as a means of increasing efficiency in the processing of tax returns and enabling ATO resources to be reallocated to targeting tax avoidance and evasion.⁷ However, it was soon recognised that broader reforms would be required to support the shift to full-assessment.⁸ These included the introduction of penalties and interest charges, fixed amendment periods and a system of private and

² Australian Taxation Office, *Commissioner of Taxation Annual Report 2015–16* (2016) 2. For historical background on the ATO and the introduction of self-assessment see, Joint Committee of Public Accounts, Parliament of Australia, *An Assessment of Tax: A Report on an Inquiry into the Australian Taxation Office* (1993) 7–26, 63–74.

³ Australian Taxation Office, *Annual Report 2015–16*, above n 2, 95, 118.

⁴ Leigh Edmonds, *Working for All Australians 1910–2010: A Brief History of the Australian Taxation Office* (Australian Taxation Office, 2010).

⁵ Commissioner of Taxation, *Sixty-Third Annual Report* (1984) 8, cited in Joint Committee of Public Accounts, above n 2, 63.

⁶ Joint Committee of Public Accounts, above n 2, 64.

⁷ Commonwealth, *Parliamentary Debates*, House of Representatives, 20 August 1985, 63–72 (Paul Keating) (Appropriation Bill (No 1) 1985–86, Second Reading).

⁸ It has been said that the true implications of a shift to self-assessment were not fully understood at the time by the then Government, taxpayers or the tax profession: Brian Harmer, 'Self-Assessment Legislation: The Tip of the Taxation Iceberg' (1990) 1 *Revenue Law Journal* 1.

public rulings.⁹ A common theme in the reform projects is the importance of certainty in a self-assessment system:

*[T]he Government is receptive to views ... that areas of the present law, particularly ... taxpayer certainty issues, need to be reviewed as a priority task.*¹⁰

*The Priority Task initiatives are designed to make the taxation system fairer and more certain and, in doing so, to set clear standards for taxpayers in carrying out their tax obligations.*¹¹

*The Review is exploring ways to refine Australia's income tax self-assessment system to provide taxpayers with greater certainty ...*¹²

*The most important recommendations in this report improve certainty ...*¹³

The case studies discussed in Section IV indicate that taxpayer certainty is being eroded by the ATO's conduct. It was also recognised early on that the introduction of self-assessment significantly shifted the balance of power from the taxpayer to the ATO and necessitated the introduction of external scrutiny arrangements.¹⁴ The next section outlines the current arrangements for the external scrutiny of the ATO.

III. EXTERNAL SCRUTINY OF THE ATO

There are broadly five categories of external ATO scrutineers.¹⁵ First, the Australian National Audit Office ('ANAO') undertakes performance audits and financial statement audits of all Commonwealth public sector bodies with the aim of improving Commonwealth public sector administration and accountability. The ANAO's performance audits examine the non-financial performance of government entities and programs to determine whether administration has been carried out economically, efficiently, effectively and in accordance with any particular requirements. The ANAO is currently conducting two performance audits related to the ATO. The first is examining the ATO's implementation of recommendations made by the ANAO and parliamentary committees and the second is examining child support collection arrangements between the ATO and the Department of Human Services.

⁹ For a discussion of the various reforms to self-assessment over the years, see Michael Dirakis and Brett Bondfield, 'ROSA's Last Gasp: The Final Steps in Self Assessment's 21 Year Journey' (2008) 3(2) *Journal of the Australasian Tax Teachers Association* 202, 204–11.

¹⁰ Australian Taxation Office, *A Full Self-Assessment System of Taxation: A Consultative Document* (1990) 2.

¹¹ John Kerin, *Improvements to Self-Assessment Priority Tasks – An Information Paper* (Commonwealth of Australia, 1991) iv.

¹² Australian Treasury, *Review of Aspects of Income Tax Self-Assessment* (Discussion Paper, March 2004) ix.

¹³ Australian Treasury, *Report on Aspects of Income Tax Self-Assessment* (August 2004) 4.

¹⁴ Joint Committee of Public Accounts, above n 2, 307–8, 317.

¹⁵ This section is adapted from Standing Committee on Tax and Revenue, *External Scrutiny*, above n 1, 5–19.

Second, the Inspector-General of Taxation ('Inspector-General') was established in 2003 to review and make recommendations to government on the ATO's systems to administer the tax laws. The establishment of the Inspector-General was in response to complaints about the ATO's administration of mass marketed investment schemes and the business activity statement.¹⁶ The investigative powers of the Commonwealth Ombudsman in relation to individual tax matters was transferred to the Inspector-General from 1 May 2015 on the basis that it was better to provide taxpayers with a dedicated body to investigate and handle complaints about all tax-related matters. The Inspector-General is broadly independent in deciding on its work program but generally confers with the ANAO, tax practitioners, the SCTR, the government, Treasury and the ATO in this regard. Previous Inspector-General reviews have covered areas such as tax disputes, valuations, penalties, transfer pricing, superannuation excess contributions tax, delayed refunds, cash economy benchmarking, and the superannuation guarantee surcharge.

Third, the Commonwealth Ombudsman still has a role in examining complaints about the ATO in relation to public interest disclosure. The *Public Interest Disclosure Act 2013* encourages public officials to disclose suspected wrongdoing in the Commonwealth public sector. The Commonwealth Ombudsman was also briefly responsible for investigating freedom of information complaints (from 1 January 2015 to 30 June 2016) but the Australian Information Commissioner has resumed the investigation of these complaints.

Fourth, the SCTR holds biannual hearings into the ATO's annual report and conducts inquiries referred to it by the Treasurer (such as the abovementioned inquiry into external scrutiny of the ATO). The SCTR has had this role since 2013. The role was previously undertaken by the Joint Committee of Public Accounts and Audit and its precursor, the Joint Committee of Public Accounts. In addition, the Senate Economics Committee has general oversight of Treasury and tax matters. There are also select Senate committees to review specific tax issues such as the Select Committee on a New Tax System in 1999 and the Select Committee on Scrutiny of New Taxes in 2011.

Finally, the courts and the Administrative Appeals Tribunal ('AAT') provide a form of scrutiny in that taxpayers can appeal a decision of the ATO to the courts or the AAT. However, this form of scrutiny is not 'automatic' and depends on action by the taxpayer and involves a direct cost to the taxpayer in most circumstances.¹⁷ The ATO's conduct in disputes is guided by the Commonwealth's (and its agencies) obligation to act as a model litigant.¹⁸ The 'model

¹⁶ Ibid 7.

¹⁷ A small number of cases may not incur a cost for the taxpayer under the ATO's test case litigation program. The program was established to fund cases that have broader implications beyond the individual dispute with the ATO. The program provides financial assistance to taxpayers to meet some or all reasonable litigation costs and in some cases, pre-litigation costs. See Australian Taxation Office, *Test Case Litigation Program* (29 March 2016) <<https://www.ato.gov.au/Tax-professionals/TP/Test-case-litigation-program>>.

¹⁸ Appendix B of the *Legal Services Directions 2005* (Cth) (commonly referred to as the 'model litigant rules'). See also, Gabrielle Appleby, 'The Government as Litigant' (2014) 37 *University of New South Wales Law Journal* 94.

litigant rules' seek to address the power imbalance between the government and private individuals. The obligation requires the Commonwealth and its agencies to act honestly and fairly in handling claims and litigation by:¹⁹

- a) dealing with claims promptly and not causing unnecessary delay in the handling of claims and litigation
- aa) making an early assessment of:
 - i. the Commonwealth's prospects of success in legal proceedings that may be brought against the Commonwealth; and
 - ii. the Commonwealth's potential liability in claims against the Commonwealth
- b) paying legitimate claims without litigation, including making partial settlements of claims or interim payments, where it is clear that liability is at least as much as the amount to be paid
- c) acting consistently in the handling of claims and litigation
- d) endeavouring to avoid, prevent and limit the scope of legal proceedings wherever possible, including by giving consideration in all cases to alternative dispute resolution before initiating legal proceedings and by participating in alternative dispute resolution processes where appropriate
- e) where it is not possible to avoid litigation, keeping the costs of litigation to a minimum, including by:
 - i. not requiring the other party to prove a matter which the Commonwealth or the agency knows to be true
 - ii. not contesting liability if the Commonwealth or the agency knows that the dispute is really about quantum
 - iii. monitoring the progress of the litigation and using methods that it considers appropriate to resolve the litigation, including settlement offers, payments into court or alternative dispute resolution, and
 - iv. ensuring that arrangements are made so that a person participating in any settlement negotiations on behalf of the Commonwealth or a Commonwealth agency can enter into a settlement of the claim or legal proceedings in the course of the negotiations
- f) not taking advantage of a claimant who lacks the resources to litigate a legitimate claim
- g) not relying on technical defences unless the Commonwealth's or the agency's interests would be prejudiced by the failure to comply with a particular requirement
- h) not undertaking and pursuing appeals unless the Commonwealth or the agency believes that it has reasonable prospects for success or the appeal is otherwise justified in the public interest, and
- i) apologising where the Commonwealth or the agency is aware that it or its lawyers have acted wrongfully or improperly.

The next section considers the effectiveness of the ATO's external scrutiny arrangements in the context of specific examples. The examples focus on the effectiveness of the Inspector-General's reviews and the courts and AAT (including the operation of the model litigant rules) as scrutineers. The effectiveness of the ANAO and parliamentary committees as scrutineers is currently the subject of an ANAO performance audit and is due to be tabled in April 2017.

¹⁹ Paragraph 2 of Appendix B of the *Legal Services Directions 2005* (Cth).

IV. CASE STUDIES

This section discusses two specific case studies – the misuse of the fraud or evasion allegation by the ATO and the ATO’s rulings program – to establish the ineffectiveness of the ATO’s existing external scrutiny arrangements.

A. *The (Mis)Use of the Fraud or Evasion Allegation*

One of the key recommendations in the 2004 Report on Self-Assessment was to ‘improve certainty by reducing the periods allowed to the Tax Office to increase a taxpayer’s liability in situations where the revenue risk of doing so is low or manageable’.²⁰ As a result of legislative changes in 2005, the Commissioner generally has two years from the date of assessment to amend an assessment.²¹ This period is extended to four years for taxpayers in particular circumstances. However, where a taxpayer has been involved in fraud or evasion, the fixed amendment periods do not apply and the Commissioner has unlimited time to amend an assessment. For some time, there has been concern that the ATO is misusing the fraud or evasion allegation to amend taxpayer returns beyond the statutory amendment periods.²² As outlined below, the issue has been raised periodically with the ATO’s external scrutineers over the last decade.

(a) 2006

The issue was brought to the Inspector-General’s attention in 2006 in the context of possible ATO breaches of the ‘model litigant rules’.²³ Submissions to the Inspector-General provided examples of the ATO re-classifying a case as involving fraud without any proper basis for doing so. The reclassification usually occurred just before the end of the fixed time period for amendment that would normally have applied to the cases. At the time, the Inspector-General recommended that the ATO should develop practical guidelines for staff on the application of the model litigant guidelines.²⁴ The ATO agreed with the recommendation. The Inspector-General’s recommendation was implemented through the publication of Practice Statement Law Administration PSLA 2007/12: Conduct of Tax Office Litigation in Courts and Tribunals (which has since been replaced by Practice Statement Law Administration PSLA 2009/9: Conduct of ATO Litigation and Engagement of ATO Dispute

²⁰ Australian Treasury, *Report on Aspects of Income Tax Self-Assessment*, above n 13, 5.

²¹ *Income Tax Assessment Act 1936* (Cth) s 170.

²² There have also been questions about the ATO’s conduct when alleging fraud or evasion; see, eg, Inspector-General of Taxation, *Review into the Taxpayers’ Charter and Taxpayer Protections* (December 2016) 45.

²³ Inspector-General of Taxation, *Review of Taxation Office Management of Part IVC Litigation* (28 April 2006) 268.

²⁴ *Ibid* 67.

Resolution).²⁵ The Practice Statement stipulates that the ATO must manage litigation in accordance with the model litigant obligation which

*requires the Commonwealth, its officers, solicitors and counsel, to act with complete propriety, fairly and in accordance with the highest professional standards in handling claims, noting that the agency is not to commence legal proceedings unless it is satisfied that litigation is the most suitable method of dispute resolution. Importantly, the obligation requires the Commissioner to not rely on technicalities and to not take advantage of claimants who lack the resources to litigate a legitimate claim.*²⁶

(b) 2011

The issue was raised again with the Inspector-General in 2011.²⁷ Submissions were made to the Inspector-General that, in the absence of evidence, the ATO continued to raise allegations of fraud or evasion to extend the periods of review. The Inspector-General noted that conclusions of evasion were internally reviewed but not suggestions of evasion. The Inspector-General recommended that the ATO should:

*Ensure that any suggestions of evasion are internally reviewed by senior officers before they are communicated to taxpayers and/or used as a reason to investigate matters; and in the event evasion is considered a risk by those senior officers, the case should be referred to the SME technical panel for further action and the taxpayer notified of this action.*²⁸

The ATO agreed with the recommendation but added that '[t]his is our current business process and we will ensure that all staff are aware of this and apply this process to their case work'.²⁹

(c) 2015

The issue was raised again in 2015 with the Inspector-General.³⁰ Submissions to the Inspector-General noted that allegations of fraud and abuse were being made without strong evidentiary bases or proper review, as a means of extending the amendment period. This was despite the publication of an ATO practice statement to curtail such behaviour. The Inspector-General recommended broad reform through the legislative creation of a separate

²⁵ Inspector-General of Taxation, *Follow-Up Review into the Tax Office's Implementation of Agreed Recommendations included in the Six Reports Prepared by the Inspector-General of Taxation between August 2003 and June 2006* (December 2007) 24–5.

²⁶ Australian Taxation Office, *Practice Statement Law Administration: Conduct of ATO Litigation and Engagement of ATO Dispute Resolution*, PS LA 2009/9, 19 December 2013, [13]–[14].

²⁷ Inspector-General of Taxation, *Review into the ATO's Compliance Approaches to Small and Medium Enterprises with Annual Turnovers between \$100 Million and \$250 Million and High Wealth Individuals* (December 2011) 57–8.

²⁸ *Ibid* 58 (Recommendation 3.3).

²⁹ *Ibid* 58.

³⁰ Inspector-General of Taxation, *The Management of Tax Disputes* (January 2015) 45, 120. The Inspector-General's review focused on tax disputes for large businesses and high wealth individuals while the SCTR review (below n 31) focused on individuals and small to medium enterprises.

Appeals Group headed by a new and dedicated Second Commissioner. The new group would be responsible for managing all aspects of tax disputes with all taxpayers. This recommendation was supported by the SCTR. The Government response is discussed below.

(d) 2015

The issue was also raised with the SCTR in 2015.³¹ The evidence to the SCTR regarding the misuse of the fraud or evasion allegation included a statement from a Deputy President of the AAT that the ATO sometimes had not even turned its mind to whether fraud and evasion occurred despite making such allegations. The SCTR recommended that the ATO amend its internal guidance so that findings or suspicion of fraud or evasion could only be made by a Senior Executive Service officer, that the ATO only make allegations of fraud against taxpayers when evidence of fraud clearly existed, and that the ATO ensure that allegations of fraud or evasion were addressed as soon as practicable in an audit or review. In response to the first recommendation, the ATO stated that it was reviewing its existing guidance material and working through how best to provide further clarity for its staff about the responsibilities and necessary considerations for an allegation or finding of fraud or evasion. In response to the second and third recommendations, the ATO stated that it was reviewing its existing guidance and working through how best to reinforce these messages for staff and to better distinguish between the situation of making enquiries, as opposed to making allegations of fraud and/or evasion.³² The SCTR also recommended that the Government introduce legislation to place the burden of proof on the ATO in relation to allegations of fraud and evasion after a certain period of time and to create a separate Appeals Group as per the Inspector-General's recommendation. The Government did not support the two recommendations.³³

(e) 2016

The problems with the fraud and evasion allegation were raised with the SCTR again in 2016.³⁴ The SCTR noted its earlier recommendations and accepted that the ATO is in the process of genuine cultural change which could take years at such a large organisation.

Despite at least 10 years of attention to the issue by the ATO's external scrutineers, ATO statistics indicate that complaints about the misuse of the fraud or evasion allegation are not without basis. In 2015–16, the ATO reported 319 new allegations of fraud, serious misconduct and other criminal activity.³⁵ Of these, 131 (41 per cent) were found to be unsubstantiated. Only 82 (26 per cent) were substantiated while the remaining allegations

³¹ Standing Committee on Tax and Revenue, Parliament of Australia, *Tax Disputes* (March 2015) 31–6, 108.

³² Australian Government, *Australian Government Response to the House of Representatives Standing Committee on Tax and Revenue Report: Tax Disputes* (December 2015) 10.

³³ *Ibid* 5.

³⁴ Standing Committee on Tax and Revenue, *External Scrutiny*, above n 1, 53–5.

³⁵ Australian Taxation Office, *Annual Report 2015–16*, above n 2, 83.

were considered indeterminable or actioned in other ways (60) or were still open at year-end (46). In 2014–15, the ATO reported 295 new allegations of fraud, serious misconduct and other criminal activity.³⁶ Of these, only 27 (9 per cent) were substantiated after investigation. More than 40 per cent (121) were found to be unsubstantiated while 109 were considered interminable or actioned in other ways and 38 were still outstanding at year-end. The difficulty in determining the true extent of the problem is that most disputes do not proceed to a hearing. The Inspector-General has found that 88 per cent of all litigated disputes referred to the AAT are resolved without any hearing, generally in the taxpayer's favour.³⁷

One recent example suggests that the ATO continues to misuse the fraud and evasion allegation. Over a period of almost two years (2015–16), the ATO maintained an allegation that a taxpayer's conduct constituted evasion which therefore enabled the ATO to amend 10 years of tax returns, resulting in a tax bill of approximately \$500 000 including interest and penalties.³⁸ However, just 10 days before the matter was due to be heard by the Federal Court, the ATO's solicitor wrote to the taxpayer's solicitor advising that

*[T]he Commissioner had reviewed his position in relation to the assessments and no longer contended that there had been evasion on the part of the taxpayer and thus would be taking steps to issue amended assessments reversing the adjustments which had been affected in the amended assessments the subject of the application.*³⁹

As described by Pagone J, the ATO's position was a 'damp squib' and there was 'no gunpowder in the cracker'.⁴⁰ By all accounts, the ATO was not provided any further information which resulted in the change of position and the allegation of evasion was unjustified. The taxpayer in this example benefited from the support of his professional organisation and press attention in refuting the allegation.⁴¹ The concern is that most taxpayers would not have the financial or mental strength to confront the ATO. Ten years of external scrutiny and recommendations does not appear to have had an impact on ATO conduct.

³⁶ Australian Taxation Office, *Commissioner of Taxation Annual Report 2014–15* (2015) 80.

³⁷ Inspector-General of Taxation, *Part IVC Litigation*, above n 23, 6.

³⁸ Robert Gottlieb, 'Landmark Case Will Reveal the Extent of the ATO's Cultural Problem', *The Australian*, 29 September 2016; Robert Gottlieb, 'ATO Attacks Mum and Dad Partnerships', *The Australian*, 19 October 2016. These facts are based on the statement of claim and are unverified as the case did not proceed.

³⁹ Transcript of Proceedings, *Douglass v Federal Commissioner of Taxation* (Federal Court of Australia, NSD 1700, Pagone J, 28 November 2016) 2 (O'Meara).

⁴⁰ *Ibid* 5.

⁴¹ See above n 38.

B. The Rulings System

[T]axpayers are more reliant upon the Tax Office to provide summarised, understandable statements that taxpayers may rely upon. In a system of self-assessment taxpayers expect that these statements will be timely, accurate and objective acknowledging court and tribunal decisions.⁴²

A key element of the Australian self-assessment regime is the system of public and private rulings which was introduced to improve certainty of the law in a self-assessment environment.⁴³ Although rulings are not binding on taxpayers, it has long been recognised that there is a general perception in the community that rulings are ‘quasi-law’ as taxpayers commonly follow rulings in order to avoid penalties.⁴⁴ As such, the external scrutiny of the rulings regime, tasked to the AAT and courts, is fundamental to the operation of the self-assessment system.⁴⁵ The ineffectiveness of the AAT and the courts as scrutineers in this regard was laid bare by the Court’s comments in *Indooroopilly*.⁴⁶ In that case, Allsop J (as the Chief Justice then was) said:⁴⁷

I wish, however, to add some comments about the attitude apparently taken by, and some of the submissions of, the [ATO]. From the material that was put to the Full Court, it was open to conclude that the [ATO] was administering the relevant revenue statute in a way known to be contrary to how this Court had declared the meaning of that statute. Thus, taxpayers appeared to be in the position of seeing a superior court of record in the exercise of federal jurisdiction declaring the meaning and proper content of a law of the Parliament, but the executive branch of the government, in the form of the [ATO], administering the statute in a manner contrary to the meaning and content as declared by the Court; that is, seeing the executive branch of government ignoring the views of the judicial branch of government in the administration of a law of the Parliament by the former. This should not have occurred. If the [ATO] has the view that the courts have misunderstood the meaning of a statute, steps can be taken to vindicate the perceived correct interpretation on appeal or by prompt institution of other proceedings; or the executive can seek to move the legislative branch of government to change the statute. What should not occur is a course of conduct whereby it appears that the courts and their central

⁴² David R Vos and Tasos Mihail, ‘The Importance of Certainty and Fairness in a Self-Assessing Environment’ (Speech delivered at the 7th International Tax Administration Conference, Coogee, 20–21 April 2006) quoted in Inspector-General of Taxation, *Review into Improving the Self-Assessment System* (August 2012) 17.

⁴³ Australian Taxation Office, *A Full Self-Assessment System of Taxation*, above n 10, 12–17; Kerin, above n 11, 10. See also, Duncan Bentley, ‘A Proposal for Reform of the Australian Rulings System’ (1997) 26 *Australian Tax Review* 57, 57–61; A H Slater, ‘Tax in Australian Society: An 80 Year Perspective’ (2007) 81 *Australian Law Journal* 681, 688–9.

⁴⁴ Joint Committee of Public Accounts, above n 2, 107. For discussion on the impact of the rulings system on the rule of law in Australia, see Geoffrey Walker, *The Tax Wilderness: How to Restore the Rule of Law* (Centre for Independent Studies, 2004) 4–6; Diana Scolaro, ‘Tax Rulings: Opinion or Law? The Need for an Independent Rule-Maker’ (2006) 16 *Revenue Law Journal* 109, 120–1, 128–30; Jennifer Batrouney, ‘Editorial Message: Rulings and the Rule of Law’ (2006) 10 *Tax Specialist* 2.

⁴⁵ Peter Harris, ‘Private Tax Rulings: An Advanced System’ (1994) 23 *Australian Tax Review* 22, 33; Bentley, above n 43, 60.

⁴⁶ *Federal Commissioner of Taxation v Indooroopilly Children Services (Qld) Pty Ltd* (2007) 158 FCR 325.

⁴⁷ *Ibid* 326–7 [3]–[7]. Edmonds and Stone JJ agreed with Allsop J’s comments in this regard.

function under ... the Constitution are being ignored by the executive in carrying out of its function under ... the Constitution, in particular its function under s 61 of the Constitution of the execution and maintenance of the laws of the Commonwealth.

It is the function of the courts exercising federal jurisdiction to declare the meaning of statutes of the Commonwealth Parliament in the resolution or quelling of controversies. To quote Marshall CJ in *Marbury v Madison* 5 US (1 Cranch) 137 (1803) at 177:

It is, emphatically, the province and duty of the judicial department to say what the law is.

This passage has been recognised as central to the administration of justice and to the relationship between the judiciary and executive in this country: *Attorney-General (NSW) v Quin* (1990) 170 CLR 1 at 35–36; *Corporation of the City of Enfield v Development Assistance Commission* (2000) 199 CLR 135 at [42]–[44] and *Truth About Motorways Pty Ltd v Macquarie Infrastructure Investment Management Ltd* (2000) 200 CLR 591 at [116].

Considered decisions of a court declaring the meaning of a statute are not to be ignored by the executive as *inter partes* rulings binding only in the earlier *lis*. As Mahoney J (as his Honour then was) said in *P & C Cantarella v Egg Marketing Board (NSW)* [1973] 2 NSWLR 366 at 383:

The duty of the executive branch of government is to ascertain the law and obey it. If there is any difficulty in ascertaining what the law is, as applicable to the particular case, it is open to the executive to approach the court, or afford the citizen the opportunity of approaching the court, to clarify the matter. Where the matter is before the court it is the duty of the executive to assist the court to arrive at the proper and just result.

There was some inferential suggestion in argument that the [ATO] was somehow bound by legislation (not specifically identified) to conduct [the] administration of the relevant statute by reference to [its] own view of the law and the meaning of statutory provisions, rather than by following what the courts have declared. It only need be said that any such provision would require close scrutiny, in particular by reference to issues raised by s 15A of the Acts Interpretation Act 1901 (Cth).

Prior to the Full Federal Court's decision in *Indooroopilly*, there were five judgments at first instance of different judges of the Federal Court. Chronologically, these were *Essenbourne*,⁴⁸ *Walstern*,⁴⁹ *Spotlight Stores*,⁵⁰ *Caelli Constructions*,⁵¹ and *Indooroopilly*.⁵² An issue in each of the cases was whether an employer's contribution to a trust or fund constituted a 'fringe benefit' for the purposes of the *Fringe Benefits Tax Assessment Act 1986*. The existence of a

⁴⁸ *Essenbourne Pty Ltd v Federal Commissioner of Taxation* (2002) 51 ATR 629 (Kiefel J, now of the High Court of Australia).

⁴⁹ *Walstern Pty Ltd v Commissioner of Taxation* (2003) 138 FCR 1 (Hill J).

⁵⁰ *Spotlight Stores Pty Ltd v Federal Commissioner of Taxation* (2004) 55 ATR 745 (Merkel J).

⁵¹ *Caelli Constructions (Vic) Pty Ltd v Commissioner of Taxation* (2005) 147 FCR 449 (Kenny J).

⁵² *Indooroopilly Children Services (Qld) Pty Ltd v Federal Commissioner of Taxation* (2006) 63 ATR 106 (Collier J). By the time the appeal in *Indooroopilly* was heard, the principle in *Essenbourne* was accepted as correct in a sixth Federal Court decision: *Cameron Brae Pty Ltd v Federal Commissioner of Taxation* (2006) 63 ATR 488 (Ryan J).

'fringe benefit' is fundamental to the imposition of fringe benefits tax. In *Essenbourne*, Kiefel J found that such a contribution was not a 'fringe benefit' as it was not paid in respect of any particular employee. The subsequent cases accepted the principle in *Essenbourne* that the existence of a 'fringe benefit' required the benefit to be provided to a particular employee. However, despite the principle established in *Essenbourne*, which had been accepted as correct by four other Federal Court judges, the ATO continued to administer the law in accordance with its interpretation set out in Taxation Ruling TR 1999/5 (ie. a 'fringe benefit' could arise in such situations although the benefit to the trust or fund was not provided in respect of a particular employee). The then Commissioner even publicly stated that the ATO did not accept the Court's comments in *Essenbourne* as correct.⁵³ For five years, until the Full Federal Court's decision in *Indooroopilly*, taxpayers were in the untenable position of having to accept the ATO's interpretation of the law, which the judiciary had stated was incorrect, or incurring the costs of challenging the ATO's position.⁵⁴ Rather than promote certainty, the ATO's public ruling only gave rise to increased uncertainty. Much has been written about the ATO's conduct in *Indooroopilly*, the Commissioner's response,⁵⁵ and the rule of law implications.⁵⁶ This is an important discussion but beyond the scope of this paper which is only concerned with the effectiveness of the ATO's external scrutiny arrangements. The following examples reveal that *Indooroopilly* was not an isolated occurrence and reform is necessary.

A long-standing example of the ineffectiveness of the external scrutiny of ATO rulings is Taxation Ruling TR 92/3 on whether profits on isolated transactions are income. In that ruling, the ATO adopts the view that, for an amount to be income

⁵³ Michael Carmody, 'Tensions in Tax Administration' (Speech delivered at the ICAA NAB Gala Luncheon, Melbourne, 14 March 2003) quoted in Inspector-General of Taxation, *Part IVC Litigation*, above n 23, 160.

⁵⁴ Broadly, the ATO felt unable to appeal the earlier Federal Court decisions to the Full Court as there was a related issue regarding the deductibility of the payments for income tax purposes and the ATO was successful on that issue (the deductions were denied). *Indooroopilly* only involved the fringe benefits tax question. Note, in *Caelli Constructions*, Kenny J accepted the principle in *Essenbourne* but held that fringe benefits tax was payable because the facts in that case were distinguishable from *Essenbourne*.

⁵⁵ The Commissioner defended the ATO's conduct on the basis of three advice opinions from the Commonwealth Solicitor-General, the Chief General Counsel of the Australian Government Solicitor and other legal counsel: Michael D'Ascenzo (Commissioner of Taxation), 'The Rule of Law: A Corporate Value' (Speech delivered at the Law Council of Australia Rule of Law Conference, Brisbane, 1 September 2007). However, writing extra-judicially, Edmonds J notes that even by its own criteria in the advice opinions, the ATO was not entitled to refuse to follow the single judge decisions as prompt action was not taken to clarify the position: Richard Edmonds, 'Recent Tax Litigation: A View from the Bench' (2008) 37 *Australian Tax Review* 79, 93. A former Commonwealth Ombudsman has previously raised concerns regarding government agencies not following single judge decisions: Dennis Pearce, 'Executive versus Judiciary' (1991) 2 *Public Law Review* 179, 189–91.

⁵⁶ Inspector-General of Taxation, *Part IVC Litigation*, above n 23, 159–66; Mark Robertson, 'A Disregard of the Law: Commissioner of Taxation v Indooroopilly Children Services (Qld) Pty Ltd' (2007) 41 *Taxation in Australia* 635; Mark Robertson, 'The Dangers of the ATO's 'Policy Intent' Approach to the Construction of Tax Acts' (2014) 43 *Australian Taxation Review* 22, 27–30; David Bloom, 'The Indooroopilly Saga' (2016) 45 *Australian Taxation Review* 78, 83–7.

[i]t is not necessary that the profit be obtained by a means specifically contemplated (either on its own or as one of several possible means) when the taxpayer enters into the transaction ... It is sufficient ... if a taxpayer enters into the transaction with the purpose of making a profit by one particular means but actually obtains the profits by a different means.⁵⁷

Later in Taxation Ruling TR 92/3, the ATO states:

We also consider that an assessable profit arises if a taxpayer enters into a transaction or operation with a purpose of making a profit by one particular means but actually obtains the profit by a different means. Thus, a taxpayer may contemplate making a profit by sale but may ultimately obtain it by other means (such as compulsory acquisition, through a company liquidation or a distribution in specie) that was not originally contemplated.⁵⁸

In the relevant case on the issue, Hill J (Gummow and Lockhart JJ concurring) stated:⁵⁹

[W]here a transaction falls outside the ordinary scope of the business, so as not to be a part of that business, there must exist, in my opinion, a purpose of profit-making by the very means by which the profit was in fact made. So much is implicit in the decision of the High Court in Myer.

The ATO addresses the inconsistency between Taxation Ruling TR 92/3 and Hill J's comments as follows:

Dicta of Hill J in Westfield have been cited as being contrary to this view. However, our view follows from the earlier Full Federal Court decision in Moana Sand Pty Ltd ...In any event, the law on the issue ... is not clear and, in our view, needs further judicial elucidation.⁶⁰

The ATO did in fact apply to the High Court for special leave to appeal prior to publishing Taxation Ruling TR 92/3. Counsel for the ATO stated that 'this case raises the question whether it is appropriate to place a limitation on what was said by [the High Court] in *Myer Emporium* and, if so, what limitations should be applied to the observations in that case'.⁶¹ In refusing the application for special leave, Mason CJ stated:⁶²

The Full Court of the Federal Court is the ultimate court of appeal in taxation matters subject only to the exceptional cases in which this court grants special leave to appeal. It follows that a question of fundamental principle must arise for decision in such a matter before this court will grant special leave.

Although the Commissioner contends that the decision of the Full Court of the Federal Court rests on a misinterpretation of this principle enunciated by this court in the Myer Emporium case, we consider that this case turns on its own facts and does not call for the grant of special leave to appeal.

⁵⁷ Australian Taxation Office, *Income Tax: Where Profits on Isolated Transactions are Income*, TR 92/3, 30 July 1992, [14].

⁵⁸ *Ibid* [57].

⁵⁹ *Westfield Limited v Commissioner of Taxation* (1991) 28 FCR 333, 344.

⁶⁰ Australian Taxation Office, TR 92/3, above n 57, [58].

⁶¹ *Federal Commissioner of Taxation v Westfield Ltd* (1991) 22 ATR 400, 401.

⁶² *Ibid* 402.

In a later case, counsel for the ATO submitted that ‘what Hill J said in [*Westfield*] was obiter, the views of only one judge, and wrong’.⁶³ The commentary in Taxation Ruling 92/3 was submitted in support of those assertions. The AAT responded that ‘those assertions are all wrong ... [Hill J’s comments] was not obiter ... [was] consistent with ... *Myer Emporium* ... and must therefore be taken to represent the law in this country. The relevant paragraphs in Taxation Ruling TR 92/3 are wrong and should be rewritten’.⁶⁴ Nonetheless, almost twenty-five years later, the ATO continues to deny the authority of Hill J’s pronouncement in *Westfield*.⁶⁵ A recent case suggests that the ATO still applies the law according to its interpretation and taxpayers must incur the costs to prove otherwise. In *Rosgoe*,⁶⁶ the ATO assessed the profit on the sale of a property as ordinary income and not a capital gain even though, on the ATO’s description of the facts, the property was acquired not for sale at a profit but rather for the carrying out of a profit-making scheme which later came to be abandoned.⁶⁷

Taxation Ruling TR 92/3 is not an isolated example of an ATO ruling being inconsistent with judicial authority.⁶⁸ More recently, two Draft Taxation Determinations were not withdrawn by the ATO until three months after the High Court reached the same conclusion as the Federal Court and the Full Federal Court.⁶⁹ The relevant question was whether a trustee or agent has an obligation to retain monies under paragraph 254(1)(d) of the *Income Tax Assessment Act 1936* prior to an assessment being issued. Logan J, at first instance, answered the question in the negative. The Full Federal Court and the High Court reached the same conclusion.⁷⁰ However, Draft Taxation Determination TD 2012/D6, which stated that the obligation to retain an amount under paragraph 254(1)(d) could arise in respect of tax that

⁶³ Case [1999] AATA 66; Case 1/99 (1999) 41 ATR 1117, 1122 [17].

⁶⁴ Ibid.

⁶⁵ For additional commentary on the inconsistency between Taxation Ruling TR 92/3 and judicial authority see, Robert Allerdice, ‘Ruling TR 92/3: The Voice of the Profit’ (1993) 27(7) *Taxation in Australia* 408; Julie Cassidy, ‘The Taxation of Isolated Sales Under Section 25(1) ITAA: TR 92/3 v Joint Submission’ (1994) 4 *Revenue Law Journal* 1; Jeff Waincymer, ‘If At First You Don’t Succeed ... Reconceptualising the Income Concept in the Tax Arena’ (1994) 19 *Melbourne University Law Review* 977, 1011; Rami Hanegbi, ‘Isolated Transactions: Current Income Tax Implications’ (2006) 35 *Australian Tax Review* 248, 256–7; Neil Young, ‘The Historical Significance of the High Court’s Decision in *Federal Commissioner of Taxation v The Myer Emporium Ltd*’ (2007) 31 *Melbourne University Law Review* 266, 285.

⁶⁶ *Rosgoe Pty Ltd v Federal Commissioner of Taxation* [2015] FCA 1231.

⁶⁷ The Federal Court (Logan J) concluded that the profit on sale was not assessable income but remitted the matter to the AAT for further hearing as there were other issues involved.

⁶⁸ For other examples of ATO rulings which are inconsistent with case law see, Scolaro, above n 44, 123–5.

⁶⁹ Australian Taxation Office, *Decision Impact Statement: Commissioner of Taxation v Australian Building Systems Pty Ltd (In Liquidation)* (23 March 2016).

⁷⁰ The High Court agreed with the Full Federal Court’s conclusion but found that Edmonds J’s reasoning as to the capacity in which liquidators are assessed was not quite in accord with the High Court’s decision in *Federal Commissioner of Taxation v Bamford* (2010) 240 CLR 481. At the Full Federal Court, Collier J concurred with Edmonds J’s judgment while Davies J generally agreed with Edmonds J’s reasons and conclusions but adopted different reasoning as to the capacity in which liquidators are assessed.

has not yet been assessed, and Draft Taxation Determination TD 2012/D7, which adopted the same view, were not withdrawn until after the High Court decision.

Although not involving a ruling, recent ATO conduct indicates that there is still an issue with ATO acceptance of Federal Court decisions. In *Financial Synergy Holdings*,⁷¹ the ATO received an unfavourable outcome at the Full Federal Court and was refused leave to appeal by the High Court.⁷² The Full Federal Court decision was handed down on 10 March 2016 while the High Court leave to appeal was heard on 7 October 2016. However, the relevant ATO advice (ATO ID 2014/14) which contains incorrect views has not been withdrawn as of December 2016.⁷³ The issue raised by these two examples is not the delay in withdrawing the ATO documents but the fact that they remained publicly as the ATO interpretation of the law despite judicial pronouncements to the contrary. In light of the abovementioned comments in *Indooroopilly*, the Draft Determinations and ATO ID should have been withdrawn immediately after a contradictory judgment, even if there was an appeal afoot.⁷⁴ Where there is no appeal on foot, the ATO appears to be addressing the implications of a contradictory decision as soon as is practicable.⁷⁵

The recent examples of *Australian Building Systems* and *Financial Synergy Holdings* raise the separate issue of the ATO's delay in amending its advice in response to court decisions. This appears to be an issue even when the ATO receives a favourable outcome in court proceedings. By way of example, Goods and Services Tax Ruling GSTR 2001/8: 'Apportioning the Consideration for a Supply that includes Taxable and Non-Taxable Parts' is still under review although the High Court refused the taxpayer's special leave to appeal in the relevant case in October 2014.⁷⁶ Similarly, Goods and Services Tax Ruling GSTR 2006/9: 'Supplies' is still under review although the related High Court judgment was handed down in December 2014.⁷⁷ The delay is undoubtedly a resourcing issue but the problem is that having rulings

⁷¹ *Financial Synergy Holdings Pty Ltd v Federal Commissioner of Taxation* (2016) 243 FCR 250.

⁷² Transcript of Proceedings, *Commissioner of Taxation v Financial Synergy Holdings Pty Ltd* [2016] HCATrans 232 (7 October 2016).

⁷³ Although not a ruling, ATO IDs set out a precedential ATO view and offer penalty and interest protection to taxpayers who rely on them: Australian Taxation Office, *Practice Statement Law Administration: ATO Interpretative Decisions*, PS LA 2001/8, 9 June 2016.

⁷⁴ These are only two examples from a review of the ATO's decision impact statements for 2015 and 2016 (35 in total). A broader review of the cases will no doubt reveal others.

⁷⁵ Australian Taxation Office, *Decision Impact Statement: Davies v Commissioner of Taxation* (23 September 2015). The ATO withdrew Taxation Determination TD 2014/21 approximately six weeks after receiving an unfavourable decision from a single judge (Perram J) of the Federal Court.

⁷⁶ Australian Taxation Office, *Decision Impact Statement: ATS Pacific Pty Ltd v Commissioner of Taxation* (12 November 2014).

⁷⁷ Australian Taxation Office, *Decision Impact Statement: Commissioner of Taxation v MBI Properties Pty Ltd* (22 December 2014).

which are ‘under review’ for a prolonged period does not provide taxpayer certainty which is the essential purpose of the rulings program.

The ATO’s rulings system was once described as a ‘world’s best’ by former Commissioner Michael D’Ascenzo.⁷⁸ However, the examples in this section suggest that the rulings program is failing in its primary purpose of providing taxpayer certainty. The current external ATO scrutiny arrangements are not adequate and the next section examines possible reform options.

V. OPTIONS FOR REFORM

This section canvasses a number of reform options to improve the effectiveness of the ATO’s external scrutiny arrangements. However, a detailed examination of the options for reform is beyond the scope of this paper. The options discussed here are not mutually exclusive and most likely a combination of reforms will be necessary.

One option for reform is to improve the effectiveness of the ‘model litigant rules’. Commentators have argued that the ATO’s conduct in *Indooroopilly* and the preceding Federal Court cases failed to comply with the model litigant rules.⁷⁹ However, the breach appears to have had little or no lasting consequence on the ATO’s conduct. The problem of compliance with the ‘model litigant rules’ due to difficulties in enforcement and sanction was identified by the Productivity Commission as an issue in its inquiry into access to justice arrangements.⁸⁰ The Productivity Commission recommended that ‘compliance should be monitored and enforced, including by establishing a formal avenue of compliance to government ombudsmen for parties who consider model litigant obligations have not been met’.⁸¹ In the context of the ATO, the Inspector-General is ideally placed as the appropriate avenue for receiving and monitoring complaints about any ATO breach of the ‘model litigant

⁷⁸ Michael D’Ascenzo, ‘Tax Administration into the 21st Century’ in Michael Walpole and Chris Evans (eds), *Tax Administration in the 21st Century* (Prospect Media, 2001) 4.

⁷⁹ Robin Woellner and Julie Zetler, ‘Judge Not Lest Ye Be Judged: The Trials of a Model Litigant’ (2013) 6 *Journal of the Australasian Law Teachers Association* 189, 194–7. Woellner and Zetler also provide the example of the ATO’s conduct described in *LVR (WA) Pty Ltd v Administrative Appeals Tribunal* [2012] FCAFC 90 as another example of the ATO’s failure to comply with the ‘model litigant rules’. In that case, the ATO’s counsel failed to advise the judge at first instance that the AAT’s reasons for its decision were almost entirely copied verbatim from the FCT’s submissions, without attribution. See also, Ron Jorgensen and Megan Bishop, ‘The Rule of Law and the Model Litigant Rules’ (2011) 45(11) *Taxation in Australia* 678. For a list of examples of possible breaches of the model litigant rules raised in submissions to the Inspector-General, see Inspector-General of Taxation, *Part IVC Litigation*, above n 23, 267–8. For a summary of previous reviews on the ATO and the model litigant rules, see Inspector-General of Taxation, *Taxpayers’ Charter*, above n 22, 99–116; Standing Committee on Tax and Revenue, *Tax Disputes*, above n 31, 43–8. For examples of failure to comply with the model litigant rules in other contexts, see Appleby, above n 18, 114–21.

⁸⁰ Productivity Commission, *Access to Justice Arrangements* (Productivity Commission Inquiry Report No 72, 5 September 2014) vol 1, 429–42. On the inadequacy of the current enforcement of the model litigant rules, see also Appleby, above n 18, 121–4.

⁸¹ Productivity Commission, above n 80, 442.

rules'.⁸² In its response to the Productivity Commission's recommendation, the Government has stated that 'the question of compliance with ... the Model Litigant Obligations, is a matter between the Attorney-General and the relevant Commonwealth agency or Department'.⁸³ A necessary first step in any future reform to strengthen the enforceability of the 'model litigant rules' is to ensure the reliability of the information rather than relying on anecdotal evidence. Making the Inspector-General the forum for receiving and monitoring breaches of the 'model litigant rules' by the ATO will serve this purpose. Further, external monitoring and public reporting of any breaches of the 'model litigant rules' may in itself serve as an effective control on ATO conduct. However, it should be noted that the ATO has disagreed with a recommendation from the Inspector-General that the ATO should publicly report on allegations of breaches of the model litigant rules, the outcome of investigations and any remedial action.⁸⁴

Another possibility is to introduce a legislative amendment or legal directions which stipulate that the ATO must follow the decisions of a single judge of the Federal Court in all instances. The ATO could still appeal the decision to the higher courts but taxpayers would receive the benefit of the doubt in the interim. The benefit in increased taxpayer certainty should outweigh any revenue or administrative concerns. However, this approach would represent quite a shift from the present position.⁸⁵ A compromise solution could be to require that the ATO obtain external legal advice prior to controverting a single judge decision. In defending the ATO's conduct in *Indooroopilly*, the then Commissioner noted that the ATO was not required to follow a single judge decision if, on the basis of legal advice (including internal ATO legal advice), there were good arguments that the decision was incorrect.⁸⁶ The efficacy of such a measure would be improved if the external legal advisors were chosen by an independent authority (such as the Inspector-General) rather than the ATO. This is not to suggest that there is any bias or error in internal ATO legal advice but to remove any such perception. The perception of fairness by the ATO is fundamental to taxpayer compliance.⁸⁷

A third possibility is to introduce a system of binding reviews or recommendations by the Inspector-General. For example, allegations of fraud or evasion could be referred to the

⁸² The Rule of Law Institute of Australia has made a similar suggestion: Rule of Law Institute of Australia, Submission on Model Litigant Rules, *Review into the Taxpayers Charter and Taxpayers Protections*, 17 December 2015.

⁸³ Australian Government, *Productivity Commission Recommendations Implemented by the Australian Government* (4 April 2016).

⁸⁴ Inspector-General of Taxation, *Taxpayers' Charter*, above n 22, 116.

⁸⁵ The ATO does not consider a legal position contained in a ruling to be impacted by a court decision until the legal process is completed.

⁸⁶ D'Ascenzo, 'The Rule of Law', above n 55.

⁸⁷ Australian Taxation Office, *Taxpayer Perceptions of Fairness Research* (30 September 2016) <<https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Annual-research/Perceptions-of-Fairness-in-Disputes-survey>>.

Inspector-General for a 'substantiation review'. Similarly, inconsistencies between ATO positions and judicial authority could be referred to the Inspector-General for review. In both cases, the results of the review should be binding on both parties. There is strong support from almost all stakeholders for the position of the Inspector-General and this approach should receive taxpayer support.⁸⁸ However, it may not receive ATO support as there are already problems with the quality of the communication between the Inspector-General and the ATO.⁸⁹ There is also a question as to whether this recommendation would go beyond the Inspector-General's existing mandate and legislative intervention (and adequate resourcing) may be required if this recommendation is considered worthwhile.

It is not considered appropriate to recommend any particular reform measure at this time as the ANAO is currently reviewing the effectiveness of the ANAO and parliamentary committees as scrutineers. Any proposal for reform should only be considered once the results of the ANAO's review are known. Further, the reform options considered in this section are limited to improving the effectiveness of the ATO's external scrutiny arrangements in the context of the existing system. Another approach would be to reform the system itself. For example, some commentators have recommended transferring the rulings function to a new independent rulings body.⁹⁰ Alternatively, the ATO could be required to refrain from publishing or to immediately withdraw any rulings which express an opinion which is contradictory to judicial authority.⁹¹

VI. CONCLUSION

*Particularly in a self-assessment system, it is vital that taxpayers are afforded some degree of certainty about how to calculate their own liabilities through the information provided by the ATO. The Ombudsman is of the view that certainty should be seen as fundamental to tax administration.*⁹²

This paper has argued for a change in the ATO's external scrutiny arrangements on the basis that the current arrangements are proving ineffective. It is acknowledged that the argument is based on a small number of case studies and the author certainly does not wish to suggest that there are widespread problems at the ATO. However, these examples demonstrate the

⁸⁸ Standing Committee on Tax and Revenue, *External Scrutiny*, above n 1, 44.

⁸⁹ *Ibid* 41.

⁹⁰ Bentley, above n 43, 64–9; Scolaro, above n 44, 132–40. The Henry Review considered the possibility of introducing a separate rulings body but ultimately concluded that it would be better to improve the existing system: *Australia's Future Tax System: Report to the Treasurer* (Commonwealth of Australia, December 2009) vol 2, 658–9.

⁹¹ This was one of the earliest recommendations for improving the rulings system: Joint Committee of Public Accounts, above n 2, 103.

⁹² Catherine McPherson, 'Improving the Avenues for Providing Taxpayer Certainty and Redress: The Commonwealth Ombudsman's View' in Michael Walpole and Chris Evans (eds), *Tax Administration in the 21st Century* (Prospect Media, 2001) 110.

ineffectiveness of the ATO's external scrutiny arrangements over an extended period of time. The ATO's external scrutiny arrangements are a costly exercise for the scrutineers and for the ATO which must divert significant resources to respond to the scrutineer's work.⁹³ This cost ultimately falls on the Australian taxpayer and therefore it is in the interests of all parties to introduce reforms to improve the effectiveness of the scrutiny.

As discussed in Section II and illustrated by the quote above, taxpayer certainty is central to an effective self-assessment system. The ATO conduct indicated by the case studies in Section IV erodes taxpayer certainty and should be addressed. The very first review into the administration of taxation laws in Australia found that the ATO had grown to ignore the people it served and that public perception of the ATO was one of the organisation's greatest challenges.⁹⁴ The review's suggestion that 'time alone will not alter those perceptions' is proving prescient.⁹⁵ Improving the effectiveness of the ATO's external scrutiny arrangements should assist in changing those perceptions. This is particularly important as research indicates that 'perceptions of procedural justice strongly shaped views about the legitimacy of the Tax Office'.⁹⁶ Further, 'feelings of legitimacy determine the level of cooperation exhibited by citizens; those who view an authority as having more legitimacy are more likely to cooperate and comply with that authority'.⁹⁷ Building taxpayer trust in the ATO continues to be one of the ATO's stated goals.⁹⁸ It is hoped that this paper will contribute to the discussion and action on reforming the effectiveness of the ATO's external scrutiny arrangements to assist the ATO in achieving that goal.

⁹³ Standing Committee on Tax and Revenue, *External Scrutiny*, above n 1, xvii.

⁹⁴ Joint Committee of Public Accounts, above n 2, vii.

⁹⁵ *Ibid.*

⁹⁶ Kristina Murphy, 'Regulating More Effectively: The Relationship between Procedural Justice, Legitimacy and Tax Non-Compliance' (Working Paper No 71, Centre for Tax System Integrity, June 2005) 28.

⁹⁷ *Ibid.*

⁹⁸ Australian Taxation Office, *ATO Corporate Plan 2015-19* (2015) 3.