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Abstract
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Keywords
tax rulings, Australia, independent, rule-maker, tax system

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TAX RULINGS: OPINION OR LAW? THE NEED FOR AN INDEPENDENT 'RULE-MAKER'

*Diana Scolaro**

The taxation ruling system in Australia lacks the necessary independence required to operate fairly for taxpayers. This is because rulings are issued by the Commissioner and, given his primary role as tax collector, his rulings are inherently biased. This bias is problematic because in practice, rulings tend to achieve a 'de facto' law status and therefore, the opinion of the Commissioner is unfairly applied as if it were law. To restore equity in the system, an independent 'rule-maker' is essential. This article examines the need for an independent rule-maker, and puts forward an initiative for the independent administration of Australia's tax ruling system.

Introduction

It is difficult to argue that Australian tax law is anything but complex. In the past decade, the volume of income tax legislation alone has grown dramatically from around 3,500 pages in 1996,[1] to in excess of 10,000 pages today.[2] In addition, there is a growing and excessive quantity of accompanying information to legislation, including explanatory memoranda, court and tribunal decisions, tax law commentary and a variety of other publications released by the Australian Taxation Office ('ATO').[3]

Given this overload of information, it is not surprising that many taxpayers find it difficult to comply with Australian tax law.[4] There is also evidence that tax

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1 M Inglis, 'Taxing Times: Is Self Assessment Working?' (2002) Spring Policy 3, p5.

2 L McBride, 'Let's scrap these Kafkaesque tax laws and start again' *The Australian*, 12 September 2005, p8; R Humphry, 'Tax system reforms will help growth' The Age 19 August 2005, p10. Now spread over three main Acts: Income Tax Assessment Act 1936 (Cth) ('*ITAA*36'), *Income Tax Assessment Act 1997* (Cth) ('*ITAA*97') and *Taxation Administration Act 1953* (Cth) ('TAA').

3 For example, public and private rulings, taxation determinations, interpretive decisions, taxpayer alerts and practice statements.

4 National Tax & Accountants' Association, 'Review of Aspects of Income Tax Self Assessment Discussion Paper' ('ROSA'), Submission No 22, 2004, p1; Chamber of Commerce and Industry of Western Australia, ROSA Submission No 18, 2004, p3.

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practitioners themselves are becoming overwhelmed by the complexity of tax law and by the sheer burgeoning volume of new legislation and accompanying material.[5]

To assist taxpayers and practitioners in navigating their way through the complexities of tax law, the Commissioner of Taxation ('*Commissioner*') issues public and private rulings, which provide his opinion as to the interpretation and application of the law. The reliance on these tax rulings has increased dramatically in recent years, particularly since the introduction of self assessment in 1986-87.[6] In the case of tax practitioners, for example, public rulings now rank just behind tax legislation in frequency of use and ahead of private sector publications, other ATO publications, explanatory memoranda and decisions of courts and tribunals.[7]

Whilst Australia's tax ruling system is a vital component of the tax administration regime, it does not have the necessary independence required to operate fairly for taxpayers. This is because rulings are issued by the Commissioner and, given his primary role as tax collector, his rulings are inherently biased. This element of bias is problematic because rulings are customarily followed by taxpayers and, therefore, in practice they tend to achieve a 'de facto' law status. As a result, the *opinion* of the Commissioner is unfairly applied as if it were law. This, in itself, is not necessarily detrimental to the ruling system; it is its combination with bias that creates the obstacle to fairness. To restore equity in the system, an independent 'rule-maker' is essential.

The notion of an independent ruling system has been brought out in public forums on a number of occasions. In July 1998, the 'Review of Business Taxation' chaired by John Ralph ('*Ralph Review*')[8] received numerous submissions for reform of the ruling system. Later, in November 2003, Treasury conducted a major review of the self assessment regime (including a review of the ruling system), entitled 'Review of

5 Taxation Institute of Australia, ROSA Submission No 26, 28 May 2004, p1.

6 Acknowledged by, for example: Institute of Chartered Accountants in Australia, ROSA Submission No 23, 26 May 2004, p11; R Woellner, 'Private Tax Rulings: some practical problems' Speech delivered at the 50th Anniversary Conference Australasian Law Teachers' Association, 1995.

7 Auditor-General (Australian National Audit Office) 2001, 'The Australian Taxation Office's Administration of Taxation Rulings' Audit Report Number 3 of 2001/02, Commonwealth of Australia, Canberra, para 3.53.

8 Commonwealth of Australia 1998, 'A Strong Foundation: Discussion Paper 1: Establishing objectives, principles and processes' ('*Ralph Review*') November 1998, Commonwealth of Australia, Canberra.

Aspects of Income Tax Self Assessment' ('*ROSA*').[9] Many of the submissions received in response to these reviews, commented on the effectiveness of the ruling system and its limitations in achieving certainty and fairness for taxpayers.

This article draws on those submissions and commentaries in examining the need for an independent rule-maker, and puts forward an initiative for the independent administration of Australia's tax ruling system.

The ruling system

The tax ruling system in Australia is a mechanism through which the ATO provides its view on how tax law should be interpreted or administered.[10] It is a system that is predominantly intended to provide guidance to taxpayers in fulfilling their tax obligations and is also used by the ATO itself in fulfilling its role as tax administrator.[11] The ruling system has evolved over many years to address increasingly complex tax law and now exists as an essential part of Australia's tax law administration process.[12]

Development of the ruling system

In 1982 the Commissioner commenced publishing rulings under an informal, albeit structured ruling system, which was implemented by the ATO to fulfil its obligation under the *Freedom of Information Act 1982* (Cth).[13] These rulings were issued as Income Taxation Rulings and Miscellaneous Taxation Rulings and they continue to apply

9 Commonwealth Treasury 2004, 'Review of Aspects of Income Tax Self Assessment Discussion Paper' ('ROSA Review') March 2004 Commonwealth of Australia, Canberra.

10 Taxation Ruling TR 92/20, 'Income and other taxes: guidelines on the use of date of effect paragraphs in Taxation Rulings and Taxation Determinations' 17 December 1992, Australian Taxation Office, Canberra, para 3.

11 Taxation Ruling TR 92/1, 'Income tax and fringe benefits tax: public rulings' 1 July 1992, Australian Taxation Office, Canberra, para 9.

12 Acknowledged by many commentators, for example: D Bentley, 'A Proposal for Reform of the Australian Ruling system' (1997) 26 *Australian Tax Review* 57, 58; M Carmody, (former Commissioner of Taxation) 'The Integrity of the Private Binding Ruling system' (Speech), Melbourne, 15 November 2000; and R Woellner, above n 6.

13 Section 9 of this Act imposes an obligation on the Commissioner to publicise internal information, publications and documents used by the ATO to apply tax law in assessing taxpayers' tax liability.

today. However, they are an informal set of rulings, in that they have no legislative backing and the Commissioner is not legally bound to follow them.[14]

In 1986-87 the self assessment system was introduced,[15] which shifted the burden of assessing income tax liability from the ATO to taxpayers. As tax law became more complex, the burden on taxpayers to self-assess increased significantly, as did the risk of penalties arising out of post-assessment checks. In 1992, in recognition of this problem, the Government enacted the *Taxation Laws Amendment (Self Assessment) Act 1992* (Cth) ('*SAA*'), which (amongst other things) overhauled the informal tax ruling system, and established a formal ruling system with legislative backing. This Act charged the Commissioner with the power and responsibility to issue rulings on the ATO's interpretation of tax law, and continues to apply to the ruling system that exists today.

Categories of rulings

Under the *SAA*, there are two categories of written tax rulings, which are governed by the *Taxation Administration Act 1953* (Cth) ('*TAA*'). These are public rulings and private rulings.[16]

Public rulings

Public rulings are issued by the Commissioner[17] at his own discretion,[18] and provide the public with his opinion on the way in which tax law[19] applies to a person or class of persons, in relation to an arrangement or class of arrangements.[20] Within the

14 Even so, these rulings are generally treated by the Commissioner as administratively binding: Practice Statement PS LA 2001/4 'Provision of written advice by the Australian Taxation Office' 5 February 2001, Australian Taxation Office, Canberra, para 73.

15 By amendments to various tax related acts, including the *ITAA*36.

16 Public rulings are governed by Part IVAAA of the TAA and private rulings are governed by Part IVAA of the *TAA*. The SAA also establishes a system of formal oral rulings, which are governed by Part 5-5 of Schedule 1 to the *TAA*. The oral ruling system is not considered in this article.

17 Under sections 14ZAAI(1) and 14ZAAJ of the *TAA*, the Commissioner makes or issues a public ruling by publishing the ruling and by publishing notice of the ruling in the Gazette according to the formal requirements in section 14ZAAI subsections (2) and (3) of the *TAA*.

18 See sections 14ZAAE, 14ZAAF and 14ZAAG of the *TAA*.

19 'Tax law' is defined in section 14ZAAA of the *TAA* to include an income tax law and a fringe benefits tax ('FBT') law, each of which is further defined in that section.

20 Sections 14ZAAE, 14ZAAF and 14ZAAG of the *TAA*. The term 'arrangement' is defined in section 14ZAAA of the *TAA*.

category of public rulings, there are four sub-categories. These are Taxation Rulings (TR series), Taxation Determinations (TD series), product rulings and class rulings.[21] In the 2004-05 financial year the ATO issued a total of 432 public rulings, made up of 147 taxation rulings and determinations, 147 class rulings, 138 product rulings and an additional 136 draft rulings and determinations.[22]

Private rulings

Private rulings are issued by the Commissioner only upon application by a taxpayer.[23] The Commissioner is generally obliged to issue private rulings upon request.[24] These rulings apply only to the applicant taxpayer and provide the Commissioner's opinion on the application of tax law to a specific arrangement that a taxpayer has entered into or proposes to enter into.[25] In the 2004-05 financial year the ATO issued 14,387 private rulings.[26]

Objectives of the ruling system

In his second reading speech to the *SAA*, the then Minister Assisting the Treasurer, the Hon Peter Baldwin MP stated:

The new system of binding and reviewable rulings will promote *certainty* for taxpayers, and thereby reduce their risks and opportunity costs. The new system will

21 Rulings under TR series are the main form of public rulings; rulings under the TD series cover more specific issues or clarify previously issued tax rulings; product rulings rule on the availability of tax benefits from particular investment products; and class rulings deal with tax law that applies to a large number of persons in relation to a particular arrangement. These categories of rulings are all classed as public rulings and are all governed by the same legal framework under Part IVAAA of the *TAA*: Taxation Determination TD 92/100 'Explanation of Taxation Determination system' 28 May 1992, Australian Taxation Office, Canberra, para 1; Practice Statement PS LA 2001/4, above n 14, paras 36-41 and paras 88-92.

22 Australian Taxation Office 2005 'Annual Report 2004-2005' Commonwealth of Australia, Canberra. Note that these statistics are not limited to public rulings issued in relation to income tax law and FBT law.

23 Sections 14ZAF and 14ZAFG of the *TAA*.

24 Section 14ZAL *TAA*. Unless the request falls into one of the exclusions listed in section 14ZAN of the *TAA*.

25 Section 14ZAI of the *TAA*.

26 ATO Annual Report 2004-2005, above n 22. Note that this statistic is not limited to private rulings issued in relation to income tax law and FBT law.

also be *fairer* because taxpayers will be able to object to Private Rulings and have the matter reviewed by an independent tribunal or court.[27]

This statement captures the general consensus that the two key objectives of the ruling system are to provide *certainty* and to ensure *fairness* for taxpayers within the context of the self assessment system.[28] These goals are the reasons for the implementation of the current ruling system and form the basis upon which the effectiveness of the system can be evaluated.

Objective of certainty

The objective of 'certainty' could be interpreted to mean either, certainty as to how the Commissioner will interpret and apply tax law for the purposes of assessing tax liability or, alternatively, certainty as to the operation of the law itself. The distinction is crucial.

Under the existing ruling system, the goal of certainty is framed in terms of providing certainty as to the *Commissioner's view* of the law.[29] However, rulings provide only one interpretation of the law – the ATO's interpretation – and are therefore not *intended* to make the operation of ambiguous law certain.[30] Framing the objective of certainty in these terms recognises that there may be other interpretations of the law which remain valid and arguable, despite being inconsistent with the ruling.

Objective of fairness

The goal of achieving fairness in the ruling system is closely linked with the goal of certainty, particularly in the context of the self assessment regime. Under the current ruling system, fairness can be said to be achieved only to the extent that the Commissioner's interpretation of a law is provided with certainty (through rulings).

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27 Hansard 1992, House of Representatives, Tax Laws Amendment (Self Assessment) Bill 1992 Second Reading speech (emphasis added).

28 Acknowledged by, for example: G S Cooper 'Improving the Operation of the Income Tax Ruling System' Discussion paper prepared for the Australian Society of Certified Practicing Accountants, December 1998, p13; Auditor-General, above n 7, para 43, and Appendix 1, para 32.

29 *Hansard*, above n 27. See also, for example: Inspector-General of Taxation 2003 'Issues Paper Number 3: Self assessment', paras 11-13; Auditor-General, above n 7, para 13; D Bentley, above n 12, 59; G S Cooper, above n 28, 16.

30 See L Jackson, 'The Crackdown' Interview with Michael Carmody, Four Corners, ABC, 18 June 2001.

The fact that rulings are binding on the Commissioner and not on taxpayers, and that rulings are binding on the Commissioner even where they misinterpret the law,[31] goes some way towards achieving the objective of fairness.

However, the alternative construction of 'certainty' – certainty as to the operation of *the law itself* – also impacts on fairness within the ruling system. The current ruling system was not designed to charge the Commissioner with the role of *final* arbiter of ambiguity in the law, nor is it structured to do so – that is the function of courts and other judicial bodies. However, for the reasons analysed in this article, rulings in practice and by their very nature, may assume this function indirectly, and this impacts significantly on the objective of fairness.

Rulings and the law

Rulings are not law and the relevant legislation governing the ruling system does not contemplate that rulings are to be treated as law, or even as a supplement to the law.[32] Although rulings are intended to provide the Commissioner's *interpretation* of tax law, in practice they are often so heavily relied upon by taxpayers and practitioners, that they tend to acquire the status of 'de facto' law. [33] This status arises because of the interaction of the 'objections and appeals provisions'[34] and the 'penalties and interest charges provisions',[35] which operate within the ruling system.

Objections and appeals provisions

Effective objections and appeals provisions are necessary to ensure the ruling system is fair for all taxpayers.[36] However, the objective of fairness cannot be achieved simply by providing a legal right to appeal. As D Bentley asserts in his discussion paper, '*A Proposal for Reform of the Australian Ruling System*' (1997): 'fairness must depend in part

31 This means the ATO is bound to apply a ruling where it is considered 'favourable' to a taxpayer. This principle applies even where a ruling wrongly interprets the law and tax liability assessed in accordance with the 'incorrect' ruling is less than what it would have been assessed at under the law: see sections 170BA of the *ITAA*36 (in relation to public rulings) and 170BB of the *ITAA*36 (in relation to private rulings).

32 Income Taxation Ruling IT 1 'Taxation Ruling system: Explanation and Status' 25 May 1989, Australian Taxation Office, Canberra.

33 See D Bentley, above n 12, 61.

34 These are the 'Taxation Objections, Reviews and Appeals' provisions in Part IVC of the *TAA*.

35 These are the 'Charges and Administrative Penalties for Failing to Meet Obligations' provisions in Part 4-25 of Schedule 1 to the *TAA*.

36 Hansard, above n 27; G S Cooper, above n 28; D Bentley, above n 12, 57, 59.

on the accessibility and effectiveness of the appeals process'.[37] Thus, if there are considerable practical limitations on a taxpayer's right to challenge a ruling, the objective of fairness cannot entirely be achieved.

Challenging public and private rulings

Taxpayers dissatisfied with a private ruling may either lodge an objection against the ruling with the Commissioner, or self-assess in accordance with the ruling and then lodge an objection against the subsequent tax assessment.[38] Taxpayers dissatisfied with a public ruling may only challenge it indirectly by either applying for a private ruling on the same matter and objecting against the private ruling, or following the public ruling and objecting against the subsequent tax assessment.[39]

Once an objection has been lodged, the Commissioner reviews it and makes an 'objection decision', by either allowing the objection in whole or in part, or disallowing it.[40] Taxpayers dissatisfied with an objection decision may challenge it, by applying to the Administrative Appeals Tribunal ('*AAT*') if it is reviewable,[41] or to the Federal Court if it is appealable.[42] In the event of a review or an appeal, the taxpayer bears the onus of proof to show that the ruling is incorrect.[43]

Limitations of the objections and appeals provisions

Although the objections and appeals provisions are in place to ensure fairness in the ruling system, they have been widely criticised as achieving exactly the opposite.[44] G S Cooper comments in his discussion paper, 'Improving the Operation of the Income

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37 D Bentley, above n 12, 60.

38 Part IVC of the *TAA* contains standardised objections, reviews and appeals provisions in relation to tax decisions, including private rulings and assessments of tax. Section 14ZAZA(1) of the *TAA* provides that a rulee may object against a private ruling in the manner set out in Part IVC of the *TAA*. Section 14ZU of the *TAA* prescribes how taxation objections are to be made.

39 ROSA Review, above n 9, 27.

40 Section 14ZY of the *TAA.*

41 Section 14ZZ(b) of the *TAA*. The term 'reviewable' is defined in s 14ZQ of the *TAA*.

42 Section 14ZZ(c) of the *TAA*. The term 'appealable' is defined in s 14ZQ of the *TAA*.

43 Sections 14ZZK (AAT) and 14ZZO (Federal Court) of the *TAA*.

44 See for example: D Bentley, above n 12, 60; R Woellner, above n 6; Corporate Tax Association and Ernst & Young, ROSA Submission No 27, 27 May 2004, 11; Institute of Chartered Accountants in Australia, above n 6, 10; Taxation Institute of Australia, above n 5, 8.

Tax Ruling System' (1998), that 'the mechanism for challenging Private Rulings is proving unworkable',[45] and concluded that rulings are often 'incontestable in reality'.[46]

One of the major impediments to accessing the appeals provisions is the cost involved in pursuing an appeal.[47] Although such costs are a feature of any judicial system they can be prohibitive, particularly where the amount of tax involved is not significant enough to justify an appeal. Furthermore, smaller taxpayers (individuals and small businesses) may not have the necessary time and financial resources to appeal even in cases where the tax at stake *is* significant.[48]

A further practical restriction is the likely perception of power imbalance between the taxpayer and the ATO. Many taxpayers contemplating an appeal, particularly smaller taxpayers, perceive the ATO as a powerful adversary with access to far greater resources and finances than the taxpayer.[49]

Hence, realistically, appeals are only likely to be entered into by taxpayers who have the necessary resources, are sufficiently confident of success and have a significant amount of tax at stake.[50]

Additionally, there are further restrictions on taxpayers wishing to challenge a ruling which are unique to the ruling system. Many of these are minor technical issues,[51] however, one significant restriction is that the AAT or the Federal Court can only consider facts as set out in the ruling application itself.[52] If additional facts are required, the court or tribunal must remit the matter back to the Commissioner for

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45 G S Cooper, above n 28, 34 (citations omitted). See also D Bentley, above n 12, 59, 60.

46 G S Cooper, ibid, 44. See also Corporate Tax Association and Ernst & Young, above n 44.

47 Acknowledged by, for example, Institute of Chartered Accountants in Australia, above n 6, p10; Taxpayers Australia Inc, ROSA Submission No 2, 5 March 2004, p7.

48 A Fabro, 'ATO tactics to be investigated' Australian Financial Review 19 August 2004, p5.

49 ROSA Review, above n 9, 74.

50 Institute of Chartered Accountants, above n 6, 8.

51 Many of which were acknowledged in various submissions to ROSA and in other commentaries.

52 *FC of T v McMahon* (1997) 97 ATC 4986 (Lockhart, Beaumont and Emmett JJ). This is because the power to request additional facts is only conferred upon the Commissioner and not upon the court: *Payne v FC of T* (1994) 94 ATC 4191, 4198 per Hill J. See also *CTC Resources NL v FC of T* (1994) 94 ATC 4072, 4088 per Gummow J and at 4074 per Jenkinson J.

him to obtain the additional facts and reconsider the ruling request.[53] This unfortunate operation of the appeals provisions adversely affects taxpayers by prolonging the appeal process and increasing associated costs.[54]

Practical implications of restrictions on appeals

Although there is a *legal* right to appeal rulings, this right has significant practical restrictions for many taxpayers. Cooper concludes that 'Many taxpayers will, therefore, quite rationally, choose to abandon their rights rather than spend their time and money in a challenge that is weighted against them',[55] and Bentley further contends that this may occur 'even where taxpayers are convinced that they are right'.[56] After deciding to abandon their appeal rights, many taxpayers may feel they are bound to follow rulings they perceive to be wrong, so as to avoid the risk of incurring penalties and interest charges.

Penalties and interest charges provisions

Where the ATO contends that a taxpayer has understated its tax liability, significant penalties and interest charges may be imposed[57] on the tax shortfall amount. These charges are imposed in cases where the taxpayer has not taken reasonable care in preparing their income tax return,[58] or does not have a 'reasonably arguable position' in relation to the tax shortfall on a large income tax item.[59]

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53 Above n 52; Commonwealth of Australia 1999, 'Review of Business Taxation: A tax system redesigned' ('Ralph Report') July 1999, Commonwealth of Australia, Canberra, p142.

54 *Payne v FC of T* (1994) 94 ATC 4191, 4198 per Hill J; see also Taxpayers Australia Inc, above n 47, para 2.J.

55 G S Cooper, above n 28, 34 (citations omitted). See also Auditor-General, above n 7, para 3.77.

56 D Bentley, above n 12, 60 (citations omitted). See also ROSA Review, above n 9, 74.

57 Penalties and interest charges are imposed under Part 4-25 of Schedule 1 to the *TAA*. In the 2003-04 year, revenue from penalties and interest charges totalled $1,466 million and taxation revenue in the same year totalled $4,902 million: Australian Taxation Office 2004 'Annual Report 2003-2004' Commonwealth of Australia, Canberra, p62.

58 Sections 284-75(2) and 284-90(1) Item 3 of Schedule 1 to the *TAA.*

59 Sections 284-75(2) and 284-90(1) Item 4 of Schedule 1 to the *TAA*. This item applies only where the tax shortfall amount exceeds the greater of $10,000 or 1% of tax payable by the taxpayer.

Until recently, penalties were also imposed on taxpayers who did not follow a private ruling.[60] Almost all submissions to ROSA recommended removal of this penalty[61] – an opinion echoed by various commentators.[62] Treasury's recommendation in the final report following ROSA concurred with these opinions and in June 2005 the penalty was removed.[63]

Penalties and the reasonably arguable position

The base penalty for not having a reasonably arguable position on large tax items is 25% of the tax shortfall amount.[64] According to s 284-15(1) of Schedule 1 to the *TAA*:

A matter is ***reasonably arguable*** if it would be concluded in the circumstances, having regard to relevant authorities, that what is argued for is about as likely to be correct as incorrect, or is more likely to be correct than incorrect.[65]

The 'relevant authorities' that may be relied upon to establish a reasonably arguable position include tax legislation, explanatory memoranda, second reading speeches, a decision of a court, the AAT or a Board of Review and public rulings.[66]

Notably, the list of relevant authorities does not include the opinions of accountants, lawyers or other professionals, but does include public rulings. On this issue, one commentator stated:

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60 The penalty was applied automatically as a base amount of 25% of the tax shortfall amount: s 284-75(4) of Schedule 1 to the *TAA* (now repealed).

61 See for example: Resolution Group Australia, ROSA Submission No 20, 21 May 2004, p9; National Tax & Accountants' Association, above n 4, 2; Taxation Institute of Australia, above n 5, 8; Corporate Tax Association and Ernst & Young, above n 44; cf CPA Australia, ROSA Submission No 9, May 2004, 7; Taxation Ombudsman, ROSA Submission No 21, 21 May 2004, 7.

62 See for example: GS Cooper, above n 28, 52. This was also recommendation 3.4 of the Ralph Review, above n 8.

63 Through enactment of Schedule 2 to the Tax Laws Amendment (Improvements to Self Assessment) Act (No 1) 2005 (Cth) ('ISAA').

64 Above n 59. This base penalty amount will be increased to 50% of the shortfall if a taxpayer is reckless as to the operation of a tax law (s 284-90(1) Item 2 of the *TAA*) and 75% of the shortfall if a taxpayer intentionally disregards a tax law (s 284-90(1) Item 1 of the *TAA*). Note that under sections 284-220 and 284-225 of Schedule 1 to the *TAA*, these base penalty amounts can be varied up or down by the ATO through its power of remission under s 284-215(1).

65 Section 284-15(1) of Schedule 1 to the *TAA* (emphasis in original).

66 Prescribed by s 284-15(3) of Schedule 1 to the *TAA*.

As a public ruling is merely the Commissioner's opinion … [it is] anomalous that opinions expressed by tax advisers such as accountants, lawyers and barristers are not regarded as falling into the same category.[67]

It is not in the interests of fairness for taxpayers to be prevented from relying on the opinions of tax and legal professionals to establish a reasonably arguable position.

Whilst taxpayers have the right to object against the imposition of penalties and interest charges, it is unlikely the Commissioner would accept that a taxpayer has a reasonably arguable position, given that an applicable ruling was disregarded. Such a decision by the Commissioner can of course be appealed; however, taxpayers may run into the same problems in challenging penalties and interest charges in these circumstances, as they would in challenging the ruling itself. In these cases, it is increasingly likely that a taxpayer would acquiesce to the Commissioner's direction provided in a ruling, even if they disagree with it. This further hinders the ability of the ruling system to achieve its objective of fairness.

'De facto law' status of rulings

The practical operation of the objections and appeals provisions together with the penalties and interest charges provisions is that many taxpayers feel bound to apply rulings as if they were the law. In a situation where a taxpayer disagrees with a ruling, the ruling may be appealed or simply disregarded. However, because of the practical restrictions on challenging the ruling and the risk of penalties for disregarding it, the taxpayer is effectively bound to follow it.[68] This may cause taxpayers to perceive rulings as something they must adhere to, rather than simply as one of the sources of information available to them in undertaking their task of self assessment. Thus, the practical status of rulings can be said to have been elevated from the Commissioner's opinion, to a type of ATO de facto law.

The ability of the ATO to make virtual law through rulings, even if only in practice, causes the tax administration system to operate unfairly for taxpayers. This has been recognised in a number of submissions to ROSA and the Ralph Review. For example,

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67 S Young, 'Defects of the self assessment system' (2004) 14 CCH Tax Week, 236, 236. See also Corporate Tax Association and Ernst & Young, above n 44; Taxation Institute of Australia, above n 5, p8; International Banks and Securities Association of Australia, ROSA Submission No 24, 26 May 2004, p8.

68 This situation was recognised in G S Cooper, above n 28, 35.

the Taxation Institute of Australia asserted: '[rulings] have attained a status of 'de-facto' law [that] … is well beyond their intended status',[69] and Arthur Anderson commented: 'the ATO tends to distort its Rulings process to become a de facto lawmaker – which we believe is undesirable'.[70]

If rulings were prepared by an independent rule-maker, the fact that they operate in practice as de facto law would not be of significant consequence, and would not negatively impact on taxpayers. However, under the current system, rulings are issued by the ATO and therefore, the crucial problem with the de facto law status of rulings is the presence of bias in the ruling system.

Bias in the ruling system

As the ATO's primary role is to collect tax revenue, it can be argued that the Commissioner has a pecuniary interest in the rulings he issues. It is therefore logical to conclude that he is likely to err on the side of the revenue when interpreting law for the purpose of issuing rulings. This could be seen as an inherent form of pro-revenue bias within the ruling system, which has the potential to taint all rulings with bias, whether perceived or actual.

Inherent bias in the ruling system

In 2003 when Treasury conducted its review of the self assessment regime through ROSA, a number of submissions were made that recognised the existence of inherent bias within the ruling system. It was contended in several of these submissions that this form of bias occurs naturally and is due to the ATO's concurrent roles as tax collector and ruling system administrator. For example, the Institute of Chartered Accountants in Australia stated: "Anecdotal feedback is that there is a pro-revenue bias in the Tax Office, however this would seem inevitable given the role of the Tax Office".[71] Similarly, Resolution Group Australia[72] submitted: 'As the collector of

69 Taxation Institute of Australia, above n 5, 2.

70 T Stolarek, Arthur Andersen, Ralph Review Submission No 9, 31 December 1998, p17 and see also pp28, 29 where this comment is discussed further. See also the Corporate Tax Association and Ernst & Young, above n 44, 5; Law Council of Australia, ROSA Submission No 28, 31 May 2004, 7.

71 Institute of Chartered Accountants in Australia, above n 6, 7.

72 This organisation represents and assists taxpayers and their accounting and legal representatives in dealing with tax disputes.

revenue it is understandable that where the ATO is uncertain they will opt to protect the revenue rather than give advice that allows revenue to be lost'.[73]

In relation to claims of a pro-revenue bias in the ATO's activities and decisions, even the former Commissioner (Michael Carmody) commented: 'I am always somewhat bemused by this claim. After all if the Tax office is not concerned with collecting taxes – that is, revenue – what is it concerned with?'.[74]

Given that inherent bias is a characteristic of the current ruling system, it is necessary to examine whether rulings themselves display elements of actual bias and, if so, the effect this has on taxpayers and the objective of fairness.

Actual bias within rulings

It is unlikely that actual bias within rulings will exist on a large scale, particularly for rulings concerning smaller amounts of tax and non-complex tax matters. However, some of the more complex rulings, involving ambiguous but important tax law, have been subject to allegations of actual bias.

Examples of rulings proven wrong

A frequent criticism of the ruling system is that, in relation to rulings on more complex and ambiguous tax law, the ATO tends to apply an interpretation of the law that favours the revenue. This criticism was acknowledged by Treasury (through ROSA) when it stated:

It has been argued by some taxpayers and practitioners that, rather than being objective, there is a systematic "pro-revenue" bias in Tax Office advice on complex and contentious issues.[75]

Many submissions to ROSA concurred with this argument of bias. The Taxation Institute of Australia was particularly emphatic in its assertion of bias, stating:

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73 See also, for example: Resolution Group Australia, above n 61, p7; CPA Australia, above n 61, 6; D Bentley, above n 12, 69; G S Cooper, above n 28, 36.

74 M Carmody (former Commissioner of Taxation) 1998 'The State of Play Five Years On' Address to Taxation Institute of Australia, Victoria, 3 February 1998.

75 ROSA Review, above n 9, p24. See also Auditor-General, above n 7, para 3.78.

The Taxation Institute is concerned about situations where the interpretation of the law is in doubt and the ATO is known to take the pro-revenue view as a matter of course, even if it is at odds with the policy objectives of the law.[76]

The Institute further submitted: 'It is felt that the ATO will often rule to protect the revenue rather than to provide a fair view of the law'.[77] Furthermore, claims of bias were also made in various submissions to the Ralph Review. For example, Arthur Anderson stated: 'the Tax Rulings process has been distorted. As a result the rulings are often geared to … revenue maximisation at the expense of economic and system efficiency'.[78]

Assertions of bias by various commentators are supported by a number of examples of rulings that demonstrate actual bias in the form of interpretations and directions that are later proven by courts to be incorrect. Some of these examples are outlined below.

Airline frequent flyer schemes

Taxation Rulings TR 93/2 and TR 94/15 and Taxation Determinations TD 95/61 and TD 96/15, stipulated that certain benefits received through airline frequent flyer schemes, and arising as a result of business travel, were assessable income. These rulings remained in force until 1996, when they were proven wrong as a result of the Federal Court case of *Payne v FC of T*.[79] In this case, Forster J applied an interpretation of the relevant law that did not concur with the rulings. These rulings have since been withdrawn; however, while they were applied, it is likely that they caused many taxpayers to pay more tax then required at law.

Lease incentives

Income Tax Ruling IT 2631 (issued in August 1991) unequivocally prescribes that cash incentives paid to a taxpayer to encourage entry into a lease of business premises, are income to the taxpayer. Subsequent decisions on this issue[80] have revealed significant qualifications to this principle, which were not expressed in the ruling. Despite these

76 Taxation Institute of Australia, above n 5, 5.

77 Taxation Institute of Australia, above n 5, 2.

78 T Stolarek, above n 70, 31. See also D Bentley, above n 12, 61; A Fabro, 'Tax bias claims reviewed' *Australian Financial Review* 26 August 2005, p16.

79 (1996) 32 ATR 516.

80 In particular *Selleck v FC of T* (1997) 36 ATR 558, *Montgomery v FC of T* (1998) 38 ATR 186 and *Lees & Leech Pty Ltd v FC of T* (1997) 36 ATR 127.

decisions, the ruling continues to apply unamended,[81] and therefore, taxpayers who adhere to the ruling could pay excess tax where they fall into one of the exceptions identified in the case authorities.

Goodwill and leases

According to Income Tax Ruling IT 2535 (issued in May 1989), when the lease of a hotel business is transferred, the portion of the consideration received that relates to goodwill is to be treated as a lease premium and is therefore assessable as a capital gain. The Commissioner's interpretation of the relevant law in this ruling was found to be incorrect by the full court of the Federal Court in *FC of T v Krakos Investments Pty Ltd* (1996).[82] As pointed out by Bentley, 'the Commissioner's interpretation [in this ruling] had been applied as the law for some six years, despite criticism of the interpretation by tax professionals'.[83] As a result of this case, the ruling was withdrawn.

Examples of rulings inconsistent with case law

Bias within rulings is also evident where rulings prescribe an interpretation of tax law that is inconsistent with major case authorities. According to the Inspector-General of Taxation David Vos, this form of bias is 'one of the most serious concerns identified by the tax professions'.[84]

Examples of rulings that ignore or selectively apply case law are discussed below.

Trade-in of leased equipment

At the time of its release, Draft Taxation Ruling TR 95/D28 required amounts credited to taxpayers on the trade-in of leased equipment to be treated as assessable income. The Commissioner adopted this interpretation of the law, despite a previous inconsistent decision of the full court of the High Court in *AL Hamblin Equipment Pty*

81 Cooper notes that this ruling is even referred to extensively as an authority in subsequent rulings, such as Taxation Ruling TR 96/6 'Income tax: Assessability of benefits arising from the purchase or order of new aircraft' 28 February 1996, Australian Taxation Office, Canberra; G S Cooper, above n 28, 34.

82 61 FCR 489. The case was not appealed.

83 D Bentley, above n 12, 61, footnote 40 (citations omitted).

84 Inspector-General of Taxation, above n 29, para 64. See also, Taxation Institute of Australia, above n 5, p5; A Fabro & F Buffini 'All Not Equal Before the ATO' Australian Financial Review 7 May 2004, 22, p22; L McBride, above n 2.

Ltd v FC of T (1974).[85] This case held, by majority of the Court, that the relevant trade-in credits were not assessable income.

In the final ruling (Taxation Ruling TR 98/15), the Commissioner acknowledged the *AL Hamblin Equipment* case, but maintained that his interpretation of law, as prescribed in the draft ruling, was correct. This ruling continues to apply today, even though it is inconsistent with the highest authority that exists on the relevant law.[86]

Receipts from partnership retirement

The case of *Crommelin v DFC of T* (1998)[87] involved an appeal by the taxpayer of the Commissioner's tax assessment, which required certain amounts received by the taxpayer upon retirement from a partnership to be on revenue account and, therefore, subject to tax. In this case, the taxpayer correctly applied Income Taxation Ruling IT 2551, which prescribed that the receipts of this type were not income. However, the Commissioner argued that his own ruling was incorrect, because the relevant authorities did not support its legal principles.[88] Ultimately, Foster J upheld the Commissioner's argument finding that the ruling was indeed incorrect.[89]

Employee benefit trusts

Taxation Ruling TR 99/5 deals with Fringe Benefits Tax ('*FBT*') and employee benefit trusts in relation to non-complying superannuation funds. In principle, the ruling prescribes that contributions to certain employee benefit trusts are subject to FBT. In *Essenbourne Pty Ltd v FC of T* (2002),[90] Keifel J interpreted the law inconsistently with the interpretation prescribed in the ruling and found in favour of the taxpayer.

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85 130 CLR 159.

86 G S Cooper, above n 28, 34, 36.

87 98 ATC 4790.

88 In particular, the authorities of *Stapleton v FC of T* (1989) 20 ATR 996 and *FC of T v Grant* (1991) 22 ATR 237 and *Crommelin v DFC of T* (1998) 98 ATC 4790, 4791 and 4798. (Although the IT ruling series are not legally binding on the Commissioner, they are generally treated by the Commissioner as administratively binding: Practice Statement PS LA 2001/4, above n 14.)

89 Although the Commissioner was successful in his argument, in recognition of the unusual circumstances of the appeal, his Honour required each party to bear their own costs of appeal: *Crommelin v DFC of T* (1998) 98 ATC 4790, 4800. The ruling was subsequently withdrawn, but not until 1998.

90 51 ATR 629.

Despite this case authority, the inconsistent ruling was not withdrawn or amended. In fact, the ATO subsequently advised that 'it's views and opinions in that ruling would continue to be applied, notwithstanding the judgement of Keifel J in the Essenbourne case'.[91] Thus, the ruling, although inconsistent with the highest authority on the interpretation of the relevant law,[92] continues to be applied unfairly to taxpayers involved in these arrangements.

Professional bodies have voiced their concern about this inconsistency.[93] In March 2003, the National Tax Liaison Group requested the Commissioner give reasons for not withdrawing the ruling and in response, the Commissioner stated: 'the Court's construction of the FBT provisions is not correct and [is] inconsistent with the Tax Office's understanding on the intent of the FBT law'.[94] Interestingly, the *Essenbourne* case itself was not appealed by the Commissioner to resolve the issue. Instead, the Commissioner stated: 'it is the Tax Office's intention to seek clarification of the FBT law through litigation of other cases'.[95]

Bias and de facto law

In theory, rulings are only intended to provide certainty as to the Commissioner's interpretation of the law. In practice, however, rulings go further in that they tend to be perceived as prescribing the law; thus attaining the so-called 'de facto' law status. It is for this reason that the existence of bias within the ruling system is of such great consequence for taxpayers – it creates unfairness and detracts from the greater benefits that the system might otherwise provide.

One of the most important attributes of any responsible tax system is equity. An effective tax system must not only *be* equitable, it must also be *perceived* to be equitable.[96] Whether actual bias is present within the ruling system or not, the perception of bias alone can negatively impact on taxpayers and impede the systems ability to achieve fairness. When rulings operate as de facto law, the presence of any form of bias also has other consequences for taxpayers and arguably for the ATO itself. Not only does this situation erode taxpayers' confidence in the system, it also

91 National Tax Liaison Group, Minutes of Meeting 26 March 2003, Item 3 'Employee Incentive Trusts and Essenbourne's case'.

92 As recognised in Inspector-General of Taxation, above n 29, paras 65-68.

93 National Tax Liaison Group, above n 91.

94 Ibid; Inspector-General of Taxation, above n 29, paras 65-68.

95 National Tax Liaison Group, above n 91.

96 Taxation Institute of Australia, above n 5, (i); D Bentley, above n 12, 63.

creates tension in the relationship between taxpayers and the ATO.[97] Feelings of resentment towards the ATO by taxpayers and tax practitioners are also likely to arise,[98] which does little to promote voluntary compliance[99] and is clearly not in the interests of the ATO or Treasury.

The presence of *actual* bias within rulings that operate as de facto law has even greater consequences for taxpayers. This is because the ATO effectively has the potential to, and allegedly does, cause taxpayers to pay tax according to the Commissioner's view of the law. As a result, rulings issued by the Commissioner may compel taxpayers to acquiesce paying more tax than they are legally required to, as some of the examples discussed above demonstrate.

The competence to impose income tax rests with the Federal Parliament.[100] Any tax collecting authority that issues rulings, which although not delegated legislation[101] tend to be treated as if they were law, would effectively be usurping the sovereignty of Parliament.[102] This is obviously inequitable for taxpayers, because unlike statutory law, rulings are not issued by an independent and democratically elected body and their content is not debated objectively in a public forum.

This issue was also acknowledged in a number of submissions to the Ralph Review. For example, the Taxation Institute of Australia stated: '[As rulings] do not have the direct endorsement of passage through Parliament, they are to be despised as a poor substitute for legislation in a democratic system',[103] and the Australian Society of

97 Institute of Chartered Accountants in Australia, above n 6, 7.

98 Ibid.

99 Perceptions of fairness of the system will affect the level of voluntary compliance by taxpayers: ROSA Review, above n 9, 7. According to Taxpayers Australia Inc, the aim of improvements to the ruling System should be to promote voluntary compliance: above n 47, 5.

100 Section 51(ii) of the Commonwealth Constitution of Australia Act empowers Parliament to make laws for peace, order and good government of the Commonwealth, with respect to taxation. (This power is not exclusive to the Federal Parliament: there is no Commonwealth constitutional restriction against state income tax legislation.)

101 Commonwealth Treasury 2004 'Report on Aspects of Income Tax Self Assessment' ('ROSA Report') August 2004 Commonwealth of Australia, Canberra, p16.

102 This was recognised by prominent MP Bronwyn Bishop in A Probyn 'Tax genie's out – and clamouring for change' The West Australian, 30 September 2005, p19.

103 K Spence, Taxation Institute of Australia 'Submission No 23' Ralph Review, 24 December 1998, p11.

Certified Practicing Accountants stated: 'Reliance on rulings to fix the problems of defective law make those rulings quasi-law and usurps the role of Parliament'.[104]

By issuing de facto law through rulings, the ruling system is indirectly providing certainty *as to the law*, rather than simply providing certainty as to the Commissioner's interpretation of the law. This is problematic because the ruling system was not structurally designed to support this version of the certainty objective; the Commissioner was never intended to be the final arbiter of ambiguity in the law. Hence, the practical operation of the current ruling system undermines the very rationale for its implementation and exacerbates the problem of inequity that it was designed to remedy. As the University of NSW stated in its submission to the Ralph Review:

[I]t is clear that the current system where the ATO performs the dual roles of statutory interpretation and revenue collection involves an unsustainable conflict of interest. The revenue collection function should be separated from the technical legal interpretative function, as a matter of priority.[105]

Conflicting roles of the ATO

Prior to 2002, the ATO was charged with the dual role of collecting tax revenue, and designing tax law and tax policy. This dual responsibility was criticised by the Law Council of Australia, which claimed that it resulted in 'an understandable implicit pro revenue bias in ATO management of issues'.[106] Other groups made similar claims of bias, which contributed to the Government's decision in 2002 to devolve the role of tax law and tax policy design to Federal Treasury.[107] This transfer of responsibility was intended to ensure the task of tax law design would be carried out neutrally and independently, 'without fear or favour' for the revenue.[108]

104 A Ryan, Australian Society of Certified Practicing Accountants 'Submission No 76' Ralph Review, 13 April 1999, p13.

105 T Rumble, University of NSW, Ralph Review Submission No 30, 31 December 1998, p41. See also J Churchill, BDO Nelson Parkhill, Ralph Review Submission No 27, 14 December 1998, p6.

106 Law Council of Australia, above n 70, 9.

107 Corporate Tax Association and Ernst & Young, above n 44, 5; Law Council of Australia, above n 70, 9.

108 Law Council of Australia, above n 70, 9.

Notwithstanding the 2002 initiative, the ATO continues to prescribe tax law through the practical operation of rulings. Consequently, similar claims of bias persist today in relation to the ATO's concurrent roles of tax collector and rulings administrator. If conflicting roles held by the ATO were worthy of attention and remedy in 2002, the similar conflict that exists under the current ruling system deserves the same degree of attention and also requires resolution. Following from the 2002 initiative, the problem could be addressed by devolving the ATO's rulings administration function to an independent and impartial body.

Reform and the need for independence

Although the current ruling system has significant flaws, it is generally better than no system at all.[109] However, alternative systems could be considered, which would more adequately fulfil the expectations of taxpayers and practitioners.[110] In considering alternative systems, a number of approaches could be explored, with the essential feature being a focus on independence.

Value in a ruling system

The ruling system is an essential element in the operation of the self assessment system. In fact, the ruling system is arguably more necessary now than it was upon its introduction in 1992, simply because of the significant increase in complexity of tax law over recent years.

It can be argued that there would be little need for a ruling system if the interpretation of tax law was a simple process and the law itself was certain. However, the reality is that Australian tax law is not simple and is often far from clear. Although simplification of the law may seem an obvious solution, recent attempts have had little success, and in some cases have even resulted in increased complexity.[111] Whilst simplification of the law should be a continuous pursuit, it is unlikely that it would be achievable to such an extent that the ruling system would no longer be required. Given the current complexity of the law, and the self assessment environment, an

109 G S Cooper, above n 28, 50. See also R Woellner, above n 6; D Bentley, above n 12, 64.

110 G S Cooper, above n 28, 50.

111 The most significant example is the Tax Law Improvement Program in 1993, which attempted to simplify the Tax Act by rewriting *ITAA*36 in *ITAA*97. It began eight years ago and is still not complete today, with the consequence the there are now two overlapping acts which are required to be read in tandem.

effective ruling system is therefore vital.[112] It is equally important that the system operates equitably, for the revenue and taxpayers alike.

Existing measures addressing bias

Claims that the current ruling system displays elements of bias are not new and have been the subject of debate since the introduction of the system in 1992. Over the years the Commissioner has responded to these claims by introducing various measures within the ATO, which aim to improve the objectivity of rulings – for example, the standardised Public Rulings Process requires public rulings to be subject to independent review by a Public Rulings Panel during their preparation,[113] and provides for community consultation on draft rulings.[114] However, with respect to private rulings there is no form of independent review or external consultation at all;[115] although applicant taxpayers do have the opportunity to express their view in the ruling application itself.[116]

There is no doubt that these measures are commendable and have made some inroads into improving objectivity within the ruling system. However, their effectiveness is limited,[117] predominantly because these measures do not have legislative backing and hence, the ATO is not legally bound to employ them. The Commissioner therefore retains discretion to either apply or ignore these administrative measures and, consequently, they cannot realistically ensure the objectivity of rulings.

112 Auditor-General, above n 7, 2; D Bentley, above n 12, 64.

113 These measures are prescribed at Stages 4 and 7 of the ATO's standardised Public Rulings Process: Australian Taxation Office 2005 'Public Rulings Process' Australian Taxation Office, Canberra. For a detailed description of these processes see: Auditor-General, above n 7, paras 3.1-3.84.

114 Stage 5 of the Public Rulings Process, above n 113. The preparation of some public rulings may also involve specific consultation with affected stakeholders at Stage 3 of the Public Rulings Process.

115 For a detailed explanation of the private ruling production process, see Auditor-General, above n 7, paras 4.1-4.103.

116 Australian Taxation Office 2005 'Application for a private ruling for individuals' Australian Taxation Office, Canberra, Item 9; Australian Taxation Office 2005 'Application for a private ruling (tax professionals)' Australian Taxation Office, Canberra, Item 10.

117 See, for example: Taxation Institute of Australia, above n 5, 8; G S Cooper, above n 28, 37.

Improving the current system

ROSA outcomes

It was somewhat disappointing that after considering over 30 written submissions concerning, amongst other things, the practical issues with the tax ruling system, ROSA made only limited impact on reform in this area.[118] In addressing the issue of pro-revenue bias in tax office advice, very little was mentioned in the final report following ROSA.[119] This is surprising, given the numerous submissions that expressed concern on this very issue. Despite the ROSA outcome, there remains an overwhelming body of opinion from individuals, professionals and industry groups, that more independence within the ruling system is not only desirable, but necessary.[120]

Eliminating bias

The interaction of the de facto law status of rulings with the presence of bias, is responsible for the inequity that taxpayers endure under the current ruling system. This result is the antithesis of why the ruling system exists in the first place. To realign the system with its fairness objective, either the practical de facto law status that rulings have acquired must be removed, or bias must be eliminated.

The de facto law status that rulings have customarily acquired is the result of taxpayers' perception that rulings must be followed, particularly in light of the appeal procedures and penalty provisions of the *TAA*. Removing the de facto law status

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118 Although a number of recommendations for improvement of the ruling system were made, most of these concerned only technical and procedural issues. Perhaps the most notable exceptions were the recommendations for removal of the automatic penalty to taxpayers for disregarding a private ruling and the instigation for review of bias in the private ruling system by the Inspector-General of Taxation: ROSA Report, above n 101, 44, recommendations 4.3 and 2.13. The Government has adopted both of these recommendations. A review by the Inspector-General of bias in the private ruling system is currently underway: Inspector-General of Taxation 2005 'Inspector-General to Examine Revenue Bias in Private Binding Rulings' media release, Sydney, 25 August 2005.

119 The only discussion and recommendation on this issue was in relation to rulings and ATO advice concerning Part IVA (the anti-avoidance provisions): ROSA Report, above n 101, 15, recommendation 2.10.

120 See, for example: G S Cooper, above n 28, pp 3, 31, 53; Taxation Institute of Australia, above n 5, 2-8; Resolution Group Australia, above n 61, pp7,9; Institute of Chartered Accountants in Australia, above n 6, pp 6, 8, 10; Corporate Tax Association and Ernst & Young, above n 44, p12; Taxpayers Australia Inc, above n 47, 4; CPA Australia, above n 61, 6; J Churchill, above n 105, 6, 7.

requires dispelling this perception amongst taxpayers. However, this is not a practical solution, as it would involve repealing the penalty provisions and addressing the practical limitations on taxpayers' ability to appeal rulings.

In pursuing the objective of fairness, a more favourable approach is to accept the practical operation of rulings as de facto law, but at the same time guarantee equity by eliminating bias. This can be achieved by ensuring that the ruling system is administered independently of the ATO and that the interpretation of tax law contained in rulings is fair and objective. In this way, the system will be correctly and fairly structured to provide taxpayers with certainty *as to the law itself*.

Reform options

Reform of the ruling system to ensure independence can be conducted under a variety of models. Three alternatives are presented below, of which the third is advocated as the preferable and most beneficial option.

The first model involves establishing a statutory body that operates independently of the ATO and comprises members solely from the private sector, such as tax practitioners and tax law professionals. Under this model, the responsibility for administration of the ruling system would be transferred from the ATO to the independent body. Whilst this would eliminate claims of pro-revenue bias in the ruling system, it would probably result in the opposite form of bias – that is, rulings are likely to favour tax minimisation and therefore be biased towards taxpayers.

Consequently, such a system is not in the interests of the ATO or the revenue and will not achieve fairness or equity in the ruling system. In any case, it is likely that under such a system, the Commissioner will continue to issue his own rulings, thus reverting to the initial problem.

The second reform model involves establishing an independent statutory Review Board (similar to the independent body in the first model). This Board would be responsible for issuing rulings in conjunction with the ATO. Under this model, the ATO would continue issuing rulings through its existing process and final versions would be transferred to the Board for review. The Board would be charged with the power to accept or reject rulings based on their objectivity, and any ruling containing bias, whether for or against the revenue, would be rejected. Thus, effectively the Board would have the power of veto with respect to the issuance of rulings. Rulings rejected by the Board would be remitted back to the ATO for amendment.

This second model is preferred over the first, as it is more likely to achieve equity; however, its chief disadvantage is the inherent prospect that 'stalemate' situations could occur. It is likely that rulings drafted by the ATO, particularly those on important and contentious issues of tax law, would continue to contain elements of bias. If the Board blocks such rulings, the ATO may be unwilling to compromise its view, thus creating an administrative impediment to the issue of these rulings.

The third model for reform involves lifting the responsibility for administering the ruling system from the ATO and transferring it to an independent statutory body. This model is advocated as the preferred reform solution and is discussed in detail below.

The preferred solution

Many countries throughout the world employ a tax ruling system that is based on administrative procedures similar to Australia's.[121] An alternative model exists in Sweden where the tax ruling system goes beyond an administrative regime and instead, is the responsibility of an independent statutory body. Examination of the Swedish system is useful in the development of a potential model for a successful and viable independent ruling system in Australia.

The Swedish model

The Swedish tax system, like Australia's tax system, incorporates a formal and structured ruling system for the interpretation of tax law. However, unlike the Australia system, the Swedish model employs a statutory body, which operates independently of the Swedish National Tax Board ('NTB') – the Australian equivalent of the ATO. Until 1991 the NTB, like the ATO, was responsible for issuing rulings and administering the ruling system. At that time, the NTB was criticised for not being objective and independent enough in its administration of the ruling system and this led, in part, to reform of the system in 1991.[122] Under this reform, the responsibility for the ruling system was transferred from the NTB to a new independent body called the 'Council for Advance Tax Rulings' ('Council'). The Council provides a judicial process for the issuance of rulings and is actually recognised as forming part of the Swedish

121 Countries that use a taxation ruling system include Canada, New Zealand, the United Kingdom and the United States: ROSA Review, above n 9, 5.

122 E Fransberg, 'The Swedish Advance Tax Ruling Regime' Article, Stockholm School of Economics, 2002, 4; D Bentley, above n 12, 62.

court system.[123] The Council is successfully operating in Sweden today and is an integral component of the tax system in that country.[124]

The Council consists of 14 members who are drawn from the private and public sectors (including the NTB)[125] and from the administrative courts.[126] All members are appointed by Parliament and are highly qualified in tax law.[127] The Council's sittings generally consist of the chair and five other members.[128] The Council is assisted by a secretariat, comprising highly experienced lawyers who liaise with applicants to ensure that all necessary information and relevant legal arguments are included in the ruling request.[129]

The Council makes rulings upon the request of an individual or the NTB itself.[130] Under this system, applicants are required to pay a fee for a ruling, the amount of which is determined at the discretion of the Council.[131] When a taxpayer submits a ruling request, it is first sent to the NTB, which communicates initial comments directly to the taxpayer for consideration.[132] The secretariat then reviews the application and prepares a comprehensive report, including a recommendation as to how the Council should rule.[133] The application is then submitted to the Council in conjunction with the secretariat's report and the NTB's initial comments.[134] When ruling on the application, the Council may request further information or seek further argument from the applicant.[135] The Council then prepares its decision and issues a ruling on the application. Dissatisfied applicants cannot object to the Council itself

123 E Fransberg, above n 122, 6; D Bentley, above n 12, 64.

124 E Fransberg, above n 122, 31; D Bentley, above n 12, 69.

125 As a guide, on an eight-member section, two members are drawn from the NTB: D Bentley, above n 12, 64.

126 The Council also has ten deputies: E Fransberg, above n 122, 6.

127 E Fransberg, above n 122, 6.

128 Ibid. However, fewer members can sit, provided three of them, including the chair, agree on the outcome of the ruling decision. This enables more members to be called in situations of a deadlock.

129 D Bentley, above n 12, 64.

130 D Bentley, above n 12, 65; E Fransberg, above n 122, pp 13, 14.

131 In 2002, fees were between 600 and 10,000 Kroner (about A$100 – A$1,800): E Fransberg, above n 122, 17 and D Bentley, above n 12, 68, footnote 92.

132 D Bentley, above n 12, 64.

133 Ibid.

134 Ibid.

135 Ibid.

against a ruling; however, both the taxpayer and the NTB can appeal rulings to the Supreme Administrative Court (the highest administrative court in Sweden).[136]

Under the Swedish system the NTB is not prevented from making its own informal rulings as to how they will apply the law to certain transactions.[137] In issuing these informal rulings, Bentley notes: 'The NTB takes a practical, cooperative approach to the interpretation of the law … and does not focus aggressively on making revenue-saving decisions'.[138] This is a logical approach, as taxpayers dissatisfied with informal rulings from the NTB are able to take their issue to the Council where the matter can be decided independently.

Applying the Swedish model to the Australian system

Reform of the Australian tax ruling system requires the development of an alternative model, which promotes independence and is more aligned with the objectives of an effective and efficient ruling system. This would not be a simple task and would involve a number of significant structural changes. The Swedish model, whilst not wholly suitable for the Australian system, possesses a basic structure that could underpin a successful alternative for Australia's current ruling system.

This proposal is also advocated by Bentley and Cooper, who both suggest that the Swedish model could be adapted to the Australian ruling system. Bentley states that this alternative would 'overcome the problem of bias in Australia'[139] and also suggests that such reform would result in a ruling system that is fair and offers certainty to both the ATO and taxpayers.[140] Cooper provides further support for the argument, stating: 'the Swedish system could be considered as it has the potential to bring even greater benefits for taxpayers and for the perceived integrity of the Ruling System'.[141]

A 'Taxation Rulings Council'

Adapting the Swedish model to the Australian system would involve the establishment of a statutory body, similar to that in Sweden, which would operate within a legislative framework (for practical purposes, this body is given the title of 'Taxation Rulings Council'). The Council must be independent of the ATO; however,

136 Ibid 65.
137 Ibid; E Fransberg, above n 122, 6.
138 D Bentley, above n 12, 65.
139 Ibid 57.
140 Ibid.
141 G S Cooper, above n 28, 53 (citations omitted).

it would have ATO representation. It would be comprised of members drawn from the ATO together with individuals from the private sector and all members would be appointed by Parliament. Private sector members should ideally be drawn from professional bodies and from a pool of appropriately experienced tax practitioners. ATO representation on the Council should not exceed 50% and a member who is impartial, objective and preferably one with judicial experience, should chair the Council.[142] The Council could be supported by a secretariat, similar to that employed in the Swedish system; however, its power should be limited to assisting applicants with administrative and procedural issues, and it should not be capable of influencing the Council's decisions.

Types of rulings to be governed by the council

It is notable that the Swedish system is designed to focus on private rulings as opposed to public rulings.[143] On tax issues involving uncertainty amongst large groups of taxpayers in Sweden, it is the responsibility of the NTB to lobby the Government for clarification of the law, rather than for the Council to issue public rulings.[144] Given the significance of public rulings in the Australian system, it is considered essential that an Australian Ruling Council be empowered to issue not only private rulings, but also public rulings. In its administration of the tax system, the ATO regularly identifies issues that require the attention of a public ruling and under a reform proposal the value of public rulings should not be undermined. When the ATO identifies tax issues of concern, it should be motivated to apply to the Council for a public ruling to be formulated and issued on the matter.

Whilst the ATO would retain the right to issue its own informal rulings and other non-binding advice, it is unlikely that this would have any significant impact on taxpayers' behaviour and would only serve to inform taxpayers. This is because taxpayers who disagree with ATO informal advice could effectively challenge that advice by applying to the Council for a private ruling. The ATO should also be statutorily obliged to advise taxpayers, who are seeking advice from the ATO, of their right to apply to the Council for an independent ruling.

142 As suggested by Bentley, a senior tax judge would be an appropriate choice: D Bentley, above n 12, 67.

143 E Fransberg, above n 122, 15.

144 D Bentley, above n 12, 65.

Penalties and appeal rights

Both taxpayers and the ATO should have the right to apply to the Council for a private ruling. Issued rulings would effectively be binding on both parties in terms of penalties and interest charges that would apply if the ruling is not followed. In this context, both public and private rulings issued by the Council would need to be included in the list of 'relevant authorities',[145] for the purpose of establishing a reasonably arguable position. Private rulings issued by the Council should include reasons for the ruling decision and should also be accompanied by details of any arguments put forward by dissenting members.[146] Both taxpayer and the ATO must then have the right to appeal to the AAT or the Federal Court if dissatisfied with the ruling. Public rulings on the other hand, cannot be directly appealed; however, in order to challenge a public ruling, taxpayers could apply for a private ruling on the same matter and subsequently appeal the private ruling.

If the Council interprets an uncertain law in a way that the ATO believes to be contrary to Parliamentary intention, then the ATO would have the usual right to appeal. In the meantime the ATO would be encouraged and expected to lobby the Government to change the law in question[147] and this should be the only other avenue available to the ATO in addressing its concern.

The consultation process

A feature of the current procedure for issuing public rulings is the consultative process that the ATO *may* undertake with stakeholders and the wider community. However, the ATO is not obliged to engage in such consultation, nor is it legally bound to consider submissions received. Under a reform proposal, the Council must engage a consultative procedure in issuing public rulings and this requirement should be enshrined in legislation. This would further add to the objectivity of rulings when they are issued.

Delays in issuing rulings

A well recognised difficulty with the Swedish system is the delays that applicants experience in receiving ruling decisions.[148] However, even the current system in Australia has its own problems with regard to such delays. This was clearly brought

145 Defined in s 284-15(3) of Schedule 1 to the *TAA*. See discussion above.

146 As is the procedure under the Swedish ruling system: E Fransberg, above n 122, 7.

147 As was suggested by D Bentley, above n 12, 69.

148 D Bentley, above n 12, 64, 67; E Fransberg, above n 122, 7, 23, 24. This was also mentioned in the Ralph Review, above n 8, 127.

out by the Inspector-General in his Issues Paper on self assessment in 2003, where he stated:

[W]hile the 28-day standard was met for many [private rulings], a significant proportion of small and large business [private rulings] took over a year to complete, with some complex large business [private rulings] taking nearly three years.[149]

BDO, in its submission to the Ralph Review, suggested that delays might be acceptable, stating:

[H]aving an independent and objective assessment of a taxpayer's merits would outweigh any small time delay [and] … [t]he time delay in issuing of the ruling itself should not be the only measure by which an independent assessment process is deemed desirable or otherwise.[150]

Furthermore, Bentley professed that delays could actually be improved, stating that under an independent model, there is no reason why the time taken to give a ruling should not be faster than at present. It would simply require adequate staffing of the rulings body and an efficient management of the process.[151]

This approach is conceivable; however, the issue of costs would become the focal point given the resources that would undoubtedly be required.

Funding options

Funding for a Taxation Rulings Council could be provided by Government, private enterprise or a combination of both. Government funding is likely to be the preferred approach amongst taxpayers, however the impact on the federal budget would no doubt be carefully scrutinised by Treasury and the public sector. In this regard, the Government could redirect the ATO's current annual budget allocation to fund the new system. Alternatively, the Council could be entirely funded through formal application fees; however, this is also likely to be met with resistance and may discourage taxpayers from using the system. A more feasible approach would be to

149 Inspector-General of Taxation, above n 29, para 42 (citations omitted), see also paras 19-20 in relation to delays in issuing public rulings. The issue of delay was also addressed in the *Ralph Report*, above n 53, recommendation 3.6.

150 J Churchill, above n 105, pp 6, 7.

151 D Bentley, above n 12, pp 67, 68 (citations omitted).

introduce a scale of fees that could range, for example, from a nominal amount to a more significant amount that would take into account such factors as the size and type of taxpayer and the amount of tax involved. The scale of fees would ultimately be determined by an analysis of the running costs of such a body, taking into account the amount of Government funding provided.

Accessibility of the Council

It is important that the Council be accessible by all taxpayers and that the design of the application process be relatively straightforward. Taxpayers may employ the services of professional practitioners to assist in the application process; however, this should not be a limitation for taxpayer applicants who do not have the necessary resources to engage such assistance. In these situations, the services of the secretariat could be made available to applicants who satisfy a set of predetermined criteria.

Other considerations

Whilst the Council would operate under a formal and legal framework, it must not have the power, legally or in practice, to usurp the judiciary or indirectly change tax law. The Council would act only as interpreter of the law, with the function of making and changing law remaining entirely with the Parliament.

Finally, and perhaps most importantly, the independence of the Council must be maintained at all times – not only in its initial conformation, but also in its continuous operation. In this regard, the integrity of the Council's membership is vital and the process of appointing members must be open and transparent.

Conclusion

The tax ruling system in Australia has developed over a number of years into an essential and necessary mechanism for assisting taxpayers in fulfilling their tax obligations, particularly when viewed in the context of self assessment. The objectives of certainty and fairness of the ruling system have been discussed in this article and used to evaluate the effectiveness of the system, as it exists today.

The goal of certainty in the ruling system currently tends to focus on certainty as to the Commissioner's opinion of the law. It was argued that certainty as to the law itself is a more useful goal, but one that cannot be achieved fairly under the current system: the reason for this conclusion being the existence of inherent bias within the system. Given the so-called 'de facto' law status that rulings have acquired, the existence of

bias seriously encumbers the pursuit of fairness and must be eliminated as a matter of priority. In achieving this end, the argument for independence was made, and a model for reform premised on this argument was recommended.

The recommended model for reform is based on the ruling system that currently operates in Sweden. The Swedish model was delineated in this article and then adapted to develop an appropriate model for Australia. This model was advocated as the preferred solution, as it was found to be consonant with fairness and able to deliver maximum certainty as to the law, without usurping the judiciary.

The motivation for the reform model proposed in this article is the need for independence. Under an independent Taxation Ruling Council, taxpayers should have much greater confidence in, and respect for rulings. This should lead to reduced pressure on the judicial system,[152] because taxpayers are likely to be more accepting of rulings, given their objectivity. Transferring the responsibility for administration of the ruling system to an independent body will place taxpayers and the ATO on equal footing with respect to rulings. This in turn, should serve to improve the relationship between taxpayers and the ATO.

It is also likely that the proposal would promote voluntary compliance by taxpayers, which could have associated benefits for the revenue.

Ultimately, the proposed model for reform of the ruling system will achieve the objectives of certainty and fairness by eliminating bias and ensuring independence. The goal of certainty as to the Commissioner's interpretation of tax law will become obsolete. Instead, the reformed system will provide certainty *as to the law itself* and not just the ATO's interpretation of the law. The de facto law status of rulings under this system is therefore likely to be heightened; however, and more importantly, it will also be less problematic. With independence being the focal point, the reform model will provide a new 'rule-maker' that will ensure all future rulings, whether viewed as de facto law or not, are objective and equitable.

152 As suggested by, for example, J Churchill, above n 105, 6, 7.