JOINT SUBMISSION

THE DISPUTES RESOLUTION PROCEDURES IN PART IVA OF THE TAX ADMINISTRATION ACT 1994

AND

THE CHALLENGE PROCEDURES IN PART VIIIA OF THE TAX ADMINISTRATION ACT 1994

BY

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AND

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This paper is a joint submission from the Taxation Committee of the New Zealand Law Society ("**Society**") and the National Tax Committee of the New Zealand Institute of Chartered Accountants ("**NZICA**"). Both the Society and NZICA have for some time been concerned about the effectiveness of the disputes resolution procedures and challenge procedures in Part IVA and Part VIIIA of the Tax Administration Act 1994 ("**TAA**"). These procedures have been in place now just over ten years, and it is time for a review. The Society and NZICA have sought the views of practitioners, and taking those views into account, this paper sets out those thoughts, and makes some recommendations for change.

This paper is divided into two parts. We first consider the disputes resolution procedures in Part IVA of the TAA. We then separately consider the challenge procedures in Part VIIIA of the TAA. In each we consider briefly the background to the procedures, then we outline the issues that have arisen in practice which we believe need to be resolved. Finally we provide some recommendations and options for change.

PART IVA OF THE TAX ADMINISTRATION ACT 1994: THE DISPUTES RESOLUTION PROCEDURES

1. BACKGROUND

1.1 The disputes resolution procedures were enacted in late 1996 following a review of Inland Revenue by the Organisational Review Committee, chaired by Sir Ivor Richardson ("**Richardson Committee**") in 1994. The Richardson Committee was established to review Inland Revenue and its activities, which included reviewing the practices leading to tax assessments and the way in which disputes were being managed under the former objection procedures.

1.2 In its report (*Organisational Review of the Inland Revenue Department, April 1994*), the Richardson Committee stated that there were significant deficiencies with the objection procedures then in place, including:

(a) Inland Revenue had a number of chances to reconsider its assessment decision, which caused uncertainty for the taxpayer and reduced the incentive for Inland Revenue to get its assessment correct;

(b) A higher level of technical expertise was required earlier in the process;

(c) Inland Revenue determined both the assessment initially, and the objection (in the words of the report Inland Revenue was both "player" and "referee");

(d) The cost of disputing a tax case was far too high;

(e) Resolution of tax disputes was slow because:

(i) Information withheld by either party resulted in delay;

(ii) There were perverse incentives to withhold information;

(iii) Disputes that should have been settled by discussion and full disclosure of the facts were instead being dealt with by the Courts.

1.3 To address these problems, the Richardson Committee introduced the current disputes resolution procedures and the challenge procedures. The disputes resolution procedures sought to address the above problems by:

(a) Requiring the parties to take steps within strictly prescribed time limits if it was proposed to amend an original assessment;

(b) Focusing on early resolution of disputes;

(c) Imposing an evidence exclusion rule that required the parties to "put all their cards on the table" early in the process or they would be barred from raising facts, evidence or legal arguments in any subsequent litigation;

(d) Proposing that a separate and independent review would be held before an amendment assessment would be issued. In this way the audit investigation and final quantification of liability would be separated, by way of a final adjudication.

1.4 The purposes of the regime as outlined in the Richardson Committee's report were positive and laudable. The rules when designed had those purposes in view and this is enshrined in section 89A of the TAA. A subsequent review of the disputes resolution procedures took place in 2003 and a Discussion Document was issued in July 2003 *Resolving Tax Disputes: A Legislative Review*. However that review was restricted to issues of timeliness and cost, and the changes made to the procedures at that time have not in the Society's and NZICA's view resolved the problems with the disputes resolution procedures.

1.5 Broadly, the steps in the current disputes resolution procedures are:

(a) The taxpayer self-assesses its tax liability;

(b) Alternatively, during an audit, prior to issuing a Notice of Proposed Adjustment, the Inland Revenue might raise issues by letter, requesting that the taxpayer agree to a schedule of adjustments between the taxpayer and the Inland Revenue;

(c) The taxpayer or the Inland Revenue (**initiating party**) issues a Notice of Proposed Adjustment, which proposes an adjustment to the self-assessment and sets out why the self-assessment is incorrect – this must be issued by the taxpayer generally within four months from the date of the assessment, and by the Inland Revenue within the four year statute bar period (or within any agreed extension to that period);

(d) The other party then responds with a Notice of Response, either accepting or rejecting the Notice of Proposed Adjustment – this must be issued by the other party within two months of the Notice of Proposed Adjustment, or that party is deemed to have accepted the initiating party's Notice of Proposed Adjustment;

(e) The Notice of Response is then accepted or rejected by the initiating party – with, in the case of the taxpayer, this acceptance or rejection being required within two months of the Notice of Response, but there being no time frame in the case of the Inland Revenue. For taxpayer initiated disputes, the taxpayer has no control over the time at which Inland Revenue permits the dispute to progress past the Notice of Response stage. If the taxpayer fails to meet that time frame it is deemed to have accepted the Inland Revenue's position;

(f) If the Notice of Response is rejected, the parties may attend a conference to try to resolve the dispute. The conference is not legislated and is not a compulsory part of the procedures;

(g) If the dispute is unresolved, the Inland Revenue issues a Disclosure Notice – there is no time frame specified in which this must occur and taxpayers do not have the right to issue a Disclosure Notice. The issuing of a Disclosure Notice is a necessary step for the procedures to proceed further whether the Inland Revenue is the initiating party (ie the party which issued the Notice of Proposed Adjustment) or not;

(h) Within two months of a Disclosure Notice the taxpayer is required to issue a Statement of Position, and it is here that the evidence exclusion rule in section 138G of the TAA becomes relevant. The taxpayer is limited to the facts and evidence, and issues arising from them, and the propositions of law, disclosed in its Statement of Position. If the taxpayer fails to meet that two month time frame, it is deemed to have accepted the Inland Revenue's position;

(i) The Inland Revenue should respond to the taxpayer's Statement of Position within two months by providing its own Statement of Position (in which event the evidence exclusion rule in section 138G of the TAA also applies to the Inland Revenue). However, in terms of section 89N(2)(b) all that is required by the statute is that the Inland Revenue considers the taxpayer's Statement of Position, before issuing an amended assessment. It is not required to respond with a Statement of Position. Given that the statute does not require a Statement of Position from Inland Revenue, it is perhaps not that surprising that if Inland Revenue fails to meet the two month time frame there is no sanction – it is not deemed to have accepted the taxpayer's position;

(j) If Statements of Position are exchanged, as a matter of internal practice the dispute may be referred to the Adjudication Unit of the Inland Revenue (which is a part of the Office of the Chief Tax Counsel) for it to review the papers and determine whether an amended assessment will be issued. It is not a requirement of the statute that this referral occur, and there is no time frame by which this should occur (apart from the statutory time bar which is always a requirement on Inland Revenue in terms of issuing amended assessments). Inland Revenue's Standard Practice Statements 08/01 and 08/02 provide that the Inland Revenue's practice is to refer disputes to Adjudication "where practicable" and usually within one month of the date of issue of the Inland Revenue's Statement of Position;

(k) The Adjudication Unit then issues a report providing the reasons for its decision and amends the assessment (if needed). It should be noted that as a matter of internal Inland Revenue practice if the Adjudication Unit's report is in favour of the taxpayer, the decision is binding on the Inland Revenue, but if the Adjudication Unit's report is in favour of the Inland Revenue, the taxpayer may issue challenge proceedings and proceed to Court.

1.6 The contents of the Notice of Proposed Adjustment, Notice of Response and Statement of Position are prescribed in sections 89F, 89G and 89M of the TAA, respectively. Broadly, the Notice of Proposed Adjustment, Notice of Response and Statement of Position are required to identify the proposed adjustment(s), state the facts and law relied upon, describe the grounds for the proposed adjustment or the rejection of the proposed adjustment, state how the law applies to the facts and either provide or outline evidence relied upon.

2. THE DISPUTES RESOLUTION PROCEDURES HAVE NOT CURED THE PROBLEMS

2.1 The Society and NZICA believe that the procedures as enacted following the Richardson Committee's report and the subsequent amendments made in 2004 have not cured the problems identified by the Richardson Committee. All the problems identified by the Richardson Committee still exist with the current system, in a different form. For instance:

(a) Inland Revenue can still change the basis upon which it assesses a taxpayer. Under the disputes resolution procedures, the Inland Revenue need only consider a Statement of Position issued by *a taxpayer* before issuing an assessment (section 89N(2) of the TAA). As a consequence of the evidence exclusion rule and the decision in *C of IR v Zentrum Holdings Limited* (2006) 22 NZTC 19,912, if Inland Revenue does not itself issue a Statement of Position (and it need not do so as there is no sanction on it for failing to do so),

it is not bound to any particular facts, evidence, legal issues or basis of assessment.

(b) The separation envisaged by the Richardson Committee between the audit investigation and the final quantification of an amended assessment has not occurred. The disputes resolution process operates between the taxpayer and the investigator entirely throughout and it is only at the absolute end of the process that there is any potential independent review by the Adjudication Unit within the Inland Revenue. At all points in the process when the taxpayer's arguments are considered it is the investigator that considers those arguments. In addition, as has been seen in recent occasions, that independent review by the Adjudication Unit is considered a discretionary decision of the Commissioner, and may not take place in any event.

(c) Similarly, the Inland Revenue is still both "referee" and "player" – the person issuing a Notice of Proposed Adjustment and/or determining whether a taxpayer Notice of Proposed Adjustment or Notice of Response is rejected, is the same person who undertook the audit. That same person manages the disputes resolution process throughout the exchange of documents. The current processes do nothing to address this issue.

(d) The costs involved in pursuing a tax dispute through the disputes resolution procedures first, and then the challenge procedures have increased since the introduction of the procedures. The impact of the evidence exclusion rule, and the nature of the documents that are exchanged in the disputes resolution processes has led to increased cost for taxpayers, rather than reduced costs. The increased costs apply to taxpayers across the board - small claims and also those in larger cases. In addition, when disputes reach the Courts, there is duplication between the requirements under the TAA and those of the court processes. This leads to even greater cost. Taxpayers are choosing not to pursue disputes as a consequence.

The Richardson Committee noted (under the old system) that many taxpayers, once aware of both the costs and delays of objections to tax assessments, decided to drop the dispute. That situation has been exacerbated by the disputes resolution procedures which increase the costs on taxpayers (in preparing the formal documents that are part of the procedures), in any form of dispute with the Inland Revenue. Our experience is that in effect Inland Revenue may issue questionable matters below the $25,000 with impunity, as Inland Revenue knows that it will cost the taxpayer more than that proceed through the disputes resolution procedures and to challenge the Inland Revenue's position in Court. Effectively taxpayers are "burned off" by the high costs imposed by the disputes resolution procedures. The Richardson Committee noted (in respect of the old system) that:

> *The resulting perception, of paying too much tax by default, may lead disgruntled taxpayers who undoubtedly tell other people and who may not be willing compliers in the future.*

The effect of the increased costs under the new system is reflected in the statistics – in the year ended 30 June 1996 there were 64 cases taken to the Taxation Review Authority. By 2006 this had dwindled to 13. In the eleven years from 1996 to 2006, the Inland Revenue advises there were six cases heard by the Taxation Review Authority in its small claims jurisdiction. NZICA and the Society do not believe these taxpayers are having their disputes

resolved under the disputes resolution procedures, rather the costs are too high. Further details of our views in this area are in Appendix A.

Effectively, taxpayers with disputes over small amounts, have no forum for their disputes to be considered because of the cost in taking those disputes through the disputes resolution procedures in the first place. It is important to realise that 89% of New Zealand businesses employ five or fewer people. The disputes resolution procedures do not cater for the majority of New Zealand businesses or individuals. The use of money interest regime is also a significant factor in this regard.

(e) Resolution of disputes is still slow. This is not because parties withhold information, rather the opposite. The evidence exclusion rule has had the effect that parties add arguments, facts and evidence, rather than narrowing the issues to the core matters in dispute. Both parties have to respond to each other's arguments, even if the arguments do not seem to have substance. For example, if the Inland Revenue alleges that a taxpayer is subject to the general anti-avoidance provision, the taxpayer is committed to a large dissertation on case law; because if the taxpayer does not raise those arguments at that stage, the taxpayer is not able to defend that allegation when the matter goes to court. In addition, resolution is slow because the time frames imposed by the disputes resolution procedures generally only apply to taxpayers, and the Inland Revenue is generally not subject to times frames, apart from the four year statutory time bar. This means the disputes resolution process is just as slow as the former procedures which the Richardson Committee considered were not operating effectively.

(f) Cases which should be resolved still reach the Courts. This is because there is no actual resolution process built into the disputes resolution procedures. The part of the disputes resolution procedures where the Inland Revenue and taxpayers meet to discuss the issues (the conference) is not part of the formal statutory procedures, and often does not take place at all. In addition, no guidance has been provided to Inland Revenue officials as to their settlement powers, and as a consequence both pre-assessment and post-assessment it is extremely difficult to reach sensible commercial settlements with Inland Revenue.

2.2 The Society and NZICA have joined together as the professional bodies most affected by this legislation. We are seeking some fundamental changes to the legislation which we believe are necessary to make the disputes resolution procedures achieve their objectives and operate in a workable way.

3. SPECIFIC ISSUES WITH THE DISPUTES RESOLUTION PROCEDURES IN PRACTICE AND SUGGESTIONS FOR CHANGE

3.1 While the current disputes procedures try to rectify some of the deficiencies of the former objection procedures, the experience of NZICA and Society practitioners after ten years of the operation of these procedures is that they have significant deficiencies of their own. In particular the Society and NZICA believe that in a number of respects the current disputes resolution procedures are not operating as was intended and are not meeting the purposes enshrined in section 89A of the TAA. We outline our concerns further below.

Improving the accuracy of disputable decisions made by the Inland Revenue

3.2 Section 89A(1)(a) of the TAA provides that one of the purposes of the disputes resolution procedures is to improve the accuracy of disputable decisions made by the Inland Revenue. The experience of practitioners is that the disputes resolution procedures have the positive intention of requiring Inland Revenue to record its propositions of law, its view of the facts and the evidence it is relying upon. However by formally recording those matters practitioners believe Inland Revenue often takes entrenched positions. This leads to the purpose of the procedures to resolve disputes (as outlined in section 89A(1)(d) of the TAA) not being met.

3.3 In addition, when Notices of Proposed Adjustment or Notices of Response are issued by Inland Revenue, they can be extremely lengthy, raise numerous issues which are not substantive, and can at times be incoherent. Taxpayers do not always seek the advice of experienced tax practitioners and simply cannot always afford to do so. Documents issued by Inland Revenue should promote understanding of the tax matters at issue. Unfortunately Notices of Proposed Adjustment and Notices of Response issued by Inland Revenue can lead to misunderstanding, the entrenchment of positions, or, due to incoherency, can simply cause taxpayers not to dispute a position taken by the Inland Revenue even where Inland Revenue's position is inaccurate. While we recognise that the standard of Notices issued by taxpayers may at times also be problematic, the Society and NZICA believe that Inland Revenue's role as tax administrator requires it to produce higher quality documents to promote early resolution and enhance understanding of the tax system. Inland Revenue has resources, experienced staff, and in a process as important as this to tax administration we believe the Inland Revenue should be expected to produce Notices of Proposed Adjustment or Notices of Response of a clear, coherent nature. This would, we believe, resolve many of the issues which practitioners from both the Society and NZICA have faced when working with these procedures.

3.4 Practitioners have also found that issues raised by Inland Revenue in Notices of Proposed Adjustment or Notices of Response issued by Inland Revenue are often abandoned if the matter proceeds further through the disputes resolution procedures. Practitioners from the Society and NZICA have commented that this most often arises because those issues had no substance in the first place, and were raised by Inland Revenue officials without experience and without oversight from more experienced officials. There is also anecdotal evidence of Inland Revenue officers not being prepared to omit or exclude issues because of the risk that at a later stage a different part of Inland Revenue will take an alternative view. This is frustrating for taxpayers and their advisers. We are also concerned that taxpayers feel intimidated by issues raised which actually have no substance or upon which Inland Revenue will not ultimately rely.

3.5 The Richardson Committee highlighted in its report the need for the disputes resolution process to "*encourage the Commissioner to apply the appropriate resources to getting the assessment right in the first place*", "*[to ensure] adequate legal analysis is applied to the points at issue to ensure that the law has been correctly interpreted*", and that "*steps should be taken to ensure that, .. appropriate legal and other expertise is applied, and generally there is adequate internal review*" (paragraph 10.3, Appendix E paragraphs 6, 7 and 9). The Society and NZICA believe that this is a requirement for the disputes resolution procedures to be operating well, and that if the early documents in the disputes resolution procedures do have that appropriate expertise applied, this could lead to more effective resolution of disputes and administration by Inland Revenue. We believe some changes are necessary to meet what was intended by the Richardson Committee.

Independent review

3.6 The Society and NZICA believe that a Standard Practice Statement requiring particular levels of independent Inland Revenue internal review of the early documents in the disputes resolution procedures (ie the Notice of Proposed Adjustment or Notice of Response) *prior to* their issue to taxpayers would materially assist the process. By this we mean an independent review from an Inland Revenue officer *outside* the office from which the document is issued. The Richardson Committee also focused on *independent review* at an early stage being a vital part of the procedures (Appendix E, paragraph 7).

3.7 The experience of the Society and NZICA is that a review by the office's own internal legal team does not always provide the necessary separation and objectivity needed for these early significant documents in the disputes resolution procedures. An alternative office may well lead to it being easier for a less entrenched view to be taken. In some cases, depending upon the nature of the issues involved, or the amount of the tax in dispute, an independent review of the type we refer may well require a review by National Office personnel of a Notice of Proposed Adjustment or Notice of Response which is to be issued by an office outside Wellington. The Society and NZICA understand that an independent internal review of this type does happen most regularly at Statement of Position stage using the Litigation Management Unit, but our experience is that it is actually at the earlier stages of the procedures that such a review would assist to narrow the issues to the substantive ones, to make the documents clear and coherent, and potentially this could lead to a more effective resolution at an earlier stage.

Word limits

3.8 Another aspect that such a Standard Practice Statement should contain is a word limit for Inland Revenue issued documents. We believe this would also materially assist the ease of application of the procedures and would also potentially assist the understanding of taxpayers. The experience of practitioners is that these documents are often extremely long, for no discernable purpose and often include lengthy quotes of a general nature in a particular issue. This is especially problematic in a document intended, at least in part, for non-specialist consumption.

Reducing the likelihood of disputes arising by encouraging open and full communication

3.9 Section 89A(1)(b) of the TAA provides that a purpose of the procedures is to reduce the likelihood of disputes arising by encouraging full and open communication between the Inland Revenue and taxpayers. The Society and NZICA have stated above the concerns about the nature of the Notices of Proposed Adjustment and Notices of Response which are an early part of the process, and we have made suggestions for change. We believe those suggestions would also assist to meet the purpose of encouraging full communication of the basis of Inland Revenue's decisions.

The conference and the use of money interest regime

3.10 We note that one of the purposes outlined in section 89A(1)(b) is to encourage open and full communication by taxpayers to the Inland Revenue so that all information necessary is received by the Inland Revenue. This in turn has the purpose of ensuring that the Inland Revenue makes accurate decisions. The Society and NZICA note that the Inland Revenue has extensive information gathering powers in other

parts of the TAA which can be utilised to obtain information from taxpayers. We accept that incentives to provide that information to the Inland Revenue should be an inherent part of the disputes resolution procedures. However, the Society and NZICA believe that the disputes resolution procedures are not in their current form encouraging taxpayers to narrow the matters at issue, and they are not encouraging either party to operate in the spirit of full disclosure.

3.11 The conference (where taxpayers and the Inland Revenue meet to discuss the dispute) is an important aspect of the procedures which is not currently compulsory, and the Society and NZICA believe that if it was compulsory it would encourage better communication between Inland Revenue and taxpayers. The experience of NZICA and Society practitioners is that the conference more often than not is not held, or not given significance by Inland Revenue officials, despite Inland Revenue's Standard Practice Statements 08/01 and 08/02 emphasising that the conference is considered an important part of the process from an administrative perspective.

3.12 We note that there is a suggestion in Standard Practice Statements 08/01 and 08/02 that the conference will be tape recorded.[1] The Society and NZICA believe that the conference should be focused on resolution; not Inland Revenue evidence gathering. The conference is based on materials already available, so there should be no new primary evidence being presented, consequently there should be no need to tape record the conference. We think that this shows that the Inland Revenue is approaching the conference as an opportunity to gather evidence, as opposed to dispute resolution which was the goal of the Richardson Committee.

3.13 Given that promoting the prompt and efficient resolution of a dispute is another purpose of the procedures (section 89A(1)(d) of the TAA), a conference which is a required legislative part of the procedures would in our view be providing the necessary emphasis that the procedures are focused upon resolution. We note that the Richardson Committee also considered the conference to have *"the intention of identifying and resolving issues, particularly factual ones"* (Appendix E, paragraph 10). We believe this should be a legislated part of the process for that purpose. We believe that details such as the location of the conference, cost, and the manner in which a conference is held (eg by teleconference or on a face to face basis) can be dealt with by way of Inland Revenue Standard Practice Statement and will depend upon the particular circumstances of the case.

3.14 Our suggestions follow:

(a) Part IVA should be amended to provide that at least one conference is a statutorily required part of the disputes resolution procedures in Part IVA, with an independent mediator, or personnel from the Litigation Management unit or the Office of the Chief Tax Counsel, being available to attend. We believe the presence of an independent party would provide taxpayers with the confidence that a resolution is possible. It may not always be necessary for such a person, but the Society and NZICA believe the potential involvement of an independent mediator would be a useful incentive for some taxpayers to engage in the process.

(b) A compulsory meeting should be held within two months of the receipt of the Notice of Response. A time frame is needed and should be set out by statute. Currently, in our experience, the lack of time frames on the Inland Revenue side leads to significant time delay.

[1] Paragraphs 175-176

(c) If the conference procedure is working and the parties agree by notice to have further meetings, there should be the ability for the parties to agree to suspend the operation of the statutory time bar indefinitely until the conference is completed, or until one party by notice withdraws its agreement to further meetings. We note that the Richardson Committee also suggested such a waiver of the time bar (Appendix E paragraph 10) and we believe flexibility as to the extent of such a waiver should be considered (as the current rule in section 108B of the TAA provides only for limited time bar extensions and is not flexible enough).

(d) The use of money interest regime is a significant factor in tax disputes. The Society and NZICA believe that while a use of money interest regime is inevitable in terms of the design of an efficient tax disputes system, that the current regime (which involves taxpayers paying 14.24% for underpaid tax, with the Inland Revenue paying 6.66% for overpaid tax) involves too wide a differential. If there is a substantive dispute as to whether tax is due in the first place, and the taxpayer is unable to fund a voluntary payment of tax to stop the interest accruing, the use of money interest regime gives rise to very serious financial risk for taxpayers (which must be reported in their accounts). In addition, the disputes resolution procedures are controlled to a significant degree in terms of timing by the Inland Revenue (as discussed below). This is the case whether the Inland Revenue has initiated the disputes resolution procedures or whether the taxpayer has. The Inland Revenue can be less than efficient (even tardy), and taxpayers can do nothing about that. It is taxpayers who are penalised for Inland Revenue's inefficiency by way of an imposition of use of money interest on underpaid tax at a very high rate.

The Society and NZICA believe that the use of money interest regime is a factor in taxpayers deciding not to pursue disputable matters. We believe the rate differential between the Inland Revenue's paying rate and the taxpayer's paying rate is far too wide and needs to be reviewed. The use of money interest regime has become a penalty on taxpayers and requires reconsideration. In terms of considering use of money interest in the context of a reform of the disputes resolution procedures some options should be considered in relation to use of money interest:

(i) As an incentive for taxpayers to continue to liaise with the Inland Revenue in an attempt resolve the dispute, use of interest money interest could be suspended while the conference process continues;

(ii) Alternatively, use of money interest could be imposed at a lesser rate (for instance the Commissioner's paying rate, or a different rate approximating for instance bank deposit rates) during the disputes resolution process as a whole. We note also that the actual rate on underpaid tax faced by taxpayers is more like 11% thanks to the activity of Tax Management NZ. Accordingly, it seems inappropriate for the statute to impose at a higher rate;

(iii) Alternatively, to ensure that use of money interest is not being imposed where there is time delay which is not the fault of the taxpayer, use of money interest could be suspended if the Inland Revenue fails to meet particular timeframes for response built into the disputes resolution procedures.

(e) If the parties do not agree by notice to have further meetings, the matter is not resolved, and the disputes resolution procedures are proceeding, the statute should provide that the Inland Revenue must issue a Disclosure Notice within two months following the end of the conference. If the conference fails, we believe the procedures should commence again without delay. Currently, in our experience, the lack of time frame for Inland Revenue to issue a Disclosure Notice leads to significant delay, and, even where the taxpayer initiated the disputes resolution procedures the taxpayer is unable to take any further steps to progress the dispute. This is for instance especially problematic with the accrual of use of money interest against the taxpayer at relatively high rates as discussed above. An alternative option to setting a specific time frame for Inland Revenue to issue a Disclosure Notice, is to allow the taxpayer to issue a Disclosure Notice generally, or in particular circumstances - for instance where the taxpayer has initiated the disputes resolution procedures.

The evidence exclusion rule

3.15 Another aspect to the issue of communication is the evidence exclusion rule. The evidence exclusion rule in section 138G of the TAA applies following the issue of a Disclosure Notice, and limits both taxpayers and the Inland Revenue to the facts and evidence, and issues arising from them, and the propositions of law disclosed in their respective Statements of Position. This rule was intended by the Richardson Committee to "*provide an appropriate incentive for disclosure of the factual basis of the arguments of both the taxpayer and Commissioner*" (Appendix E paragraph 10). The evidence exclusion rule was therefore intended to promote the purpose of encouraging open and full communication.

3.16 There are a number of problems which have arisen in practice in relation to this rule. Rather than incentivising full communication, it is leading to a "kitchen sink" approach to facts, issues and evidence in the Statement of Position with every possible issue, piece of evidence, and thought included in the Statement of Position. This is because it is only in very narrow circumstances that a Court will allow any further facts, evidence or issues to be raised (section 138G(2)). This generates a perverse incentive not to narrow the issues to the critical ones, but in fact to outline all possible matters, no matter how relevant or substantive.

3.17 In addition, because of the evidence exclusion rule focusing on *facts* and *evidence*, and the Court discretion to allow further matters to be raised focusing on what the applicant could have discovered with *due diligence* (section 138G(2)(a)), the evidence exclusion rule is leading to a huge amount of work being done prior to the issue of a Statement of Position. This is leading to the disputes resolution process being very costly indeed, and the Society and NZICA believe that the effect of the evidence exclusion rule is simply pricing some taxpayers out of pursuing the disputes resolution procedures. In addition, even though the rule is leading to high cost in the preparation of a Statement of Position, there is also a potential double up of costs if the matter reaches proceedings, as discovery processes must also be completed. This is an even greater disincentive to proceed with a dispute. We are also aware that at least one Taxation Review Authority Judge is of the view that the evidence exclusion rule may be contrary to the Taxation Review Authority's function as a commission of inquiry (as outlined in section 15 of the Taxation Review Authorities Act 1994).

3.18 We believe the evidence exclusion rule which was intended to promote communication is instead becoming unwieldy and is leading to a lack of clarity in communication. We note that in its 2003 Discussion Document *Resolving Disputes: A Legislative Review* the Government noted that the number of audited cases being

disputed was decreasing. We believe this is because the evidence exclusion rule (amongst other factors) is causing disputes to be too expensive. Our experience is that unfortunately it is not necessarily due to the Inland Revenue's decisions being any more accurate. In our experience, the disputes resolution procedures have detrimental costs effects for business. In our experience, some businesses give up legitimate disputes because the process will consume too much time and cost. The approach of Inland Revenue of leaving numerous issues alive until the last moment also unduly increases the costs. The overall effect is a reduced willingness of businesses to engage in the tax disputes process.

3.19 We finally note that it is also not a requirement that the Inland Revenue issue a Statement of Position; it can issue an amended assessment after simply considering the taxpayer's Statement of Position (section 89N(2) of the TAA). This means that the application of the evidence exclusion rule can be one sided – only applying to taxpayers. This seems unintended, and certainly the Richardson Committee's focus was on both parties – taxpayers *and* the Inland Revenue. Practitioners in the Society and NZICA have experience of the rule being one-sided in application.

3.20 If the conference was a statutory part of a process which is clearly designed to achieve a resolution (as we suggest), both the taxpayer and the Inland Revenue are incentivised to put their best case on the table at the conference and there is no need for the evidence exclusion rule. Instead taxpayers and the Inland Revenue would focus on ensuring that the early documents in the procedures clearly outlined their respective positions prior to the conference.

3.21 We suggest the evidence rule is amended, and that it focuses on limiting a taxpayer and the Inland Revenue to the *propositions of law* raised in the respective Statements of Position in a subsequent challenge before the Court (subject to Court discretion otherwise and subject also to the comments in paragraph 3.37 and following below). The Society and NZICA recognise that for the challenge procedures to operate fairly, they must operate from the premise that the parties are limited to positions previously taken. This was also the position in the former objection procedures, and has been the position because of long standing case law. However, our view is that the scope of the evidence exclusion rule is too wide, and it is not meeting its intended purpose in any event. If the evidence exclusion rule remains in its current form, in the alternative consideration needs to be given to ensuring that discovery obligations are amended to ensure that double cost does not arise if the matter reaches Court proceedings.

Early identification of the basis for a dispute

3.22 Section 89A(1)(c) of the TAA provides that the disputes resolution procedures are intended to promote the early identification of the basis for a dispute. The Society and NZICA have made suggestions above as to internal Inland Revenue policy changes to ensure that Notices of Proposed Adjustment and Notices of Response issued by Inland Revenue are more accurate and coherent. We have also made suggestions above as to statutory changes to ensure that the conference is a required part of the process, to incentivise the parties to communicate with one another and to promote resolution. The Society and NZICA believe that the exchange of documents that is the hallmark of the disputes resolution process, while cumbersome, does lead to a better identification of the basis for the dispute, and this would be improved as the quality of the documents produced improves.

Promoting the prompt and efficient resolution of disputes

3.23 Section 89A(1)(d) of the TAA provides that the prompt and efficient resolution of disputes is a purpose of the disputes resolution procedures. The Richardson Committee focused on this aspect, stating that the procedures should "*encourage both the taxpayer and the Commissioner to avoid undue delay in resolving disputes that do occur*" (Appendix E, paragraph 7). In the 1994 Discussion Document *Resolving Tax Disputes: proposed procedures* the Government stated that a "*primary objective*" of the new procedures was "*to deal with any disputes over tax liability fairly, efficiently, and expeditiously*" (paragraph 3.2). The experience of the Society and NZICA is that this objective is not being met by the procedures.

Time frames and sanctions on Inland Revenue

3.24 There are a number of reasons why this objective is not being met. The first is that the time frames in the procedures are one-sided, applying only to taxpayers, and not to the Inland Revenue. This can mean very substantial time delays before any dispute progresses.

3.25 As an example, following the issue of a Notice of Response by a taxpayer to an Inland Revenue initiated Notice of Proposed Adjustment, there is no time frame in which a conference should be held, and there is no time frame for a Disclosure Notice to be issued by the Inland Revenue. Taxpayers do not have the ability to issue a Disclosure Notice and thereby ensure continuation of the dispute procedures. Taxpayers can do nothing to restart the process when it is stalled. In one case a Society practitioner waited over eight months for a Disclosure Notice to be issued. In the intervening period, the Inland Revenue officials did not continue to investigate the matter in dispute. There was no explanation for the delay. Use of money interest continued to be imposed during this period where the taxpayer was unable to do anything to restart the process. Practitioners have also said that in the case of taxpayer initiated disputes, Inland Revenue delays are commonplace (sometimes years), and that this is a very serious problem indeed (particularly because of the use of money interest regime).

3.26 The second reason the objective is not met is that there are effective sanctions on taxpayers for failing to meet time frames but only one effective sanction on Inland Revenue. If Inland Revenue fails to file a Notice of Response within two months of a taxpayer initiated Notice of Proposed Adjustment, it is deemed to accept the taxpayer's position (section 89H(2)). A taxpayer on the other hand is deemed to accept the Inland Revenue's position if it fails to issue a Notice of Proposed Adjustment within (generally) four months of the issue of an assessment or other disputable decision, or if it fails to respond to an Inland Revenue Notice of Proposed Adjustment or Inland Revenue Notice of Response (section 89H(1) and section 89H(3)), or to a Disclosure Notice by issuing a Statement of Position (section 89M(7)). If any of those events occur, the taxpayer is generally unable to file challenge proceedings (section 89I). In addition, Inland Revenue is entitled to apply to the Court for an order that the time for completion of the disputes resolution procedures is extended, or for the procedures not to be completed at all (section 89N(3)) and this can occur *at any time* during the four year statutory time bar period (section 89N(4)). The only time sanction on the Inland Revenue is the four year statutory time bar. Taxpayers have the right only to apply to the Court for further time to file a Statement of Position (section 89M(11)) only within the two month response period, and, in that event the "conduct of the parties in the dispute" is considered by the Court (section 89M(12)), while interestingly, no such consideration is required when the Inland Revenue applies to the Court under its mirroring ability in section 89M(10).

3.27 The lack of time sanctions on the Inland Revenue within the procedures means that Inland Revenue controls the time frame in which the disputes resolution procedures progress. In the case of taxpayer initiated disputes this is leading to significant time delays and a significant amount of use of money interest being accrued by taxpayers with genuine disputes. Inland Revenue's control of the process is leading to a slow resolution of matters. We suggest that time frames should be brought into the procedures for Inland Revenue as well to promote prompt and efficient dealing by Inland Revenue with the procedures.

3.28 As stated above, we believe a compulsory conference should be held within two months from the date of the Notice of Response. We also believe that a Disclosure Notice should be issued within two months following the end of the conference, or, in the alternative that the taxpayer be given the right to issue a Disclosure Notice in particular circumstances (for example if it is a taxpayer initiated dispute, or if the Inland Revenue fails to do so within a particular time frame). These time frames should be incorporated in Part IVA. We believe that to ensure that disputes are dealt with efficiently, fairly and expeditiously, incentives on the Inland Revenue to complete the procedures should be built into the procedures. We also suggest that if Inland Revenue fails to meet time frames, and in the absence of a Court order otherwise (which can only arise in "exceptional circumstances"), Inland Revenue should be deemed to have accepted the taxpayer's position. Alternatively, use of money interest should be suspended if Inland Revenue fails to meet particular time frames.

The definition of "exceptional circumstance"

3.29 The third reason that the objective is not being met is that the "exceptional circumstance" definition applying to taxpayers is narrower than that applying to Inland Revenue. This definition applies to provide the ability for late notices to be deemed to be received on time. Taxpayers must rely upon the Inland Revenue exercising discretion to accept a late notice, and this is only exercised if there is an "exceptional circumstance", namely an event outside the control of the taxpayer which provides a reasonable justification for not acting within the specific time frame (with additional even narrower rules applying in the case of failure by an agent of the taxpayer). The other way in which a taxpayer may have the discretion exercised in its favour is if the delay was 'minimal' (section 89K(3)). The Inland Revenue on the other hand can apply to the Court, and while an "exceptional circumstance" is something beyond the control of the Inland Revenue, included amongst its purview is a change in law, or a decision of a Court (section 89L(3)). The Inland Revenue also has the additional power in the absence of an exceptional circumstance to apply to the Court for a time extension or an order that the procedures do not need completion (section 89N(3)).

3.30 The Society and NZICA believe that the definition of "exceptional circumstance" applicable to both Inland Revenue and taxpayers should provide the Inland Revenue and the Court a clear discretion to allow a late filing of a document in circumstances where there is evidence of a clear intention to dispute, an error has been made, and where the time delay is not significant in the overall circumstances. We believe that taxpayer should also be entitled to seek the intervention of the Court (other than by way of expensive judicial review proceedings) if the Inland Revenue's discretion is not exercised in its favour. The taxpayer should have a similar ability to the Inland Revenue to apply to the Court for a general time extension (as is the case for Inland Revenue in section 89N(3)) – this could extend the statute bar by the period of extension as well.

3.31 The current definition of "exceptional circumstance" in section 89K(3) of the TAA is too narrow in our view, and the Inland Revenue is not exercising its discretion in section

89K(1) as a consequence. This is leading to matters that are genuinely disputed being deemed accepted and being unable to be challenged because of very minor errors by taxpayers. This is not meeting the purpose of prompt and efficient resolution, as it applies more narrowly to taxpayers than the Inland Revenue, and is not promoting the fair and accurate resolution of disputes as a consequence.

The processes in the Adjudication Unit

3.32 Finally, for the resolution of disputes to be "*efficient*" the Society and NZICA believe that administrative time frames are needed around the referral of a dispute to the Adjudication Unit. The Adjudication Unit is not a legislated part of the process, and it is fair to say that there are different views on the need for that amongst practitioners. Where practitioners all agree however, is that if it is to happen, referral to Adjudication should happen within a set time frame from the exchange of Statements of Position. We believe that should be within one month. We comment that while this is the Standard Practice Statements' suggestion of a time frame for referral to Adjudication (SPS 08/01, SPS 08/02), this standard is rarely met in our experience. We also note that those Standard Practice Statements downplay the significance of the Adjudication Unit providing that referral to that Unit is not essential and can be omitted.

3.33 The Society and NZICA also note that matters which are referred to Adjudication are taking an inordinate amount of time to go through the Adjudication process. The process for the Adjudication Unit needs to be reconsidered. One of the objectives of the disputes resolution procedures was to lead to more timely resolution than was the case with the objection procedures. That objective is not met by the Adjudication Unit which can in our experience take well over a year to respond with a report even on rather straight forward issues. We note that the Standard Practice Statements (SPS 08/01 and SPS 08/02) suggest that the Adjudication Unit will generally produce a report in a four month time frame. Practitioners do not have experience of that time frame, and instead our experience is a significantly longer period, sometimes years. Practitioners believe that the Adjudication Unit's current processes are unwieldy, and both the Society and NZICA believe that work needs to be put into making this part of the procedures much more cost and time efficient than it is at present.

3.34 At present the Adjudication Unit is unable to determine factual matters, and this can lead to Adjudication Unit refusing to issue a report, resulting in further delay in the disputes resolution process. The information provided to the Adjudication Unit is comprehensive, as the Adjudication Unit has access to each party's Statement of Position. It makes little sense for the Adjudication Unit to be unable to review those documents and make factual determinations. The Society and NZICA suggest giving the Adjudication Unit the ability to determine factual issues would lead to a more efficient process.

3.35 We also note that Inland Revenue is able to and does utilise Adjudication reports as precedent for future matters for internal staff, while taxpayers have no such access to those reports. Publication of basic summaries of Adjudication reports, or publication of Adjudication reports in redacted form where taxpayers cannot be identified should be released. There are currently used internally by Inland Revenue as legal guidance, and the release of these, in redacted form, would provide guidance as to Inland Revenue's views. This would promote voluntary compliance.

Other efficiencies

3.36 We also believe that other quite straight forward efficiencies could be considered in the regime. For instance, the design of the various parts of the Notice of Proposed

Adjustment, Notice of Response and Statement of Position could be reviewed so as to ensure that, if the matter proceeded to Court, preparing a Statement of Claim or Notice of Claim would simply be a task of cutting and pasting work already done. This would provide some cost efficiency if the matter proceeded to Court.

Other issues arising when the disputes resolution procedures do not operate appropriately

3.37 There are circumstances where the exchange of documents as prescribed by the disputes resolution procedures is not going to lead to prompt and efficient resolution of the dispute, or identification of issues, and simply serves no substantive purpose. In those situations forcing the Inland Revenue and taxpayers to proceed through the procedures simply is added cost – from a taxpayer perspective this is additional compliance cost for no benefit.

Test cases

3.38 An example of when the disputes resolution procedures are inappropriate is where there is a case before the Courts which deals with substantially similar issues to the disputed matter. Under the current procedures in this circumstance a taxpayer must seek the agreement of the Inland Revenue to suspend the disputes procedures (section 89O of the TAA) and this can only occur where the Inland Revenue has first exercised its sole discretion to designate the case before the Court a "test case" under section 138Q of the TAA. The Inland Revenue on the other hand is able to seek the exercise of the Court's discretion to suspend the disputes resolution procedures under section 89N(3), as a general matter, and in this context even where the taxpayer does not agree to a suspension of the disputes resolution procedures under section 89O.

3.39 The Society and NZICA suggest that this ability to suspend the disputes procedures be available to taxpayers by way of Court order, and not just in circumstances where the Inland Revenue has designated a case before the Courts as a "test case", but rather where a significant similarity exists between a case before the Courts and the taxpayer's dispute. Taxpayers should not be forced to judicially review the Inland Revenue's decision in this area to get a test case designation considered. They should have the right to apply for a Court order. We also suggest that where such an order is granted, that the statute bar in section 108 of the TAA be suspended, being reactivated again when the decision in the relevant case is issued. We suggest below in paragraphs 5.3 to 5.15 that a test case panel and Government funding of test cases should be considered. The test case panel could equally operate to assist in this context.

Ability to seek leave or to elect out of the disputes resolution procedures in particular circumstances

3.40 Another example where the procedures are inappropriate is where it is quite clear that the matter will not be resolved and that both parties will proceed to Court. For instance, this would arise in relation to a point upon which the Inland Revenue has assessed other taxpayers and is litigating, or in the case where a year subsequent to one which is already under dispute is being considered. Currently, unless the taxpayer has completed the disputes resolution procedures it cannot challenge the Inland Revenue's assessment (section 138B of the TAA).

3.41 Our suggestion for small claims in particular, is the cost of preparing documents for the disputes resolution procedures, would be better spent on a Notice of Claim and on having the Taxation Review Authority in its small claims jurisdiction finally determining

the matter. We believe that for small claims, taxpayers ought to be able to file a Notice of Claim and proceed directly to the small claims jurisdiction of the Taxation Review Authority without completing the disputes resolution procedures. In Australia, a model involving a compulsory pre-trial resolution conference between the Australian Tax Office, the taxpayer and a judge has been very successful. Consistently 70% to 80% of disputes are resolved without the need to proceed to a hearing. Approximately 70% of these consent orders were resolved wholly or partly in the taxpayer's favour.[2] We believe a similar approach could be adopted in New Zealand. Under current procedures, the costs of both the disputes procedures and proceeding to the Taxation Review Authority cause taxpayers with small claims not to proceed. We make further comments about small claims and our view that the disputes resolution procedures are failing in this area in Appendix A.

3.42 For other claims, we suggest that at minimum, as a general rule, following the exchange of a Notice of Proposed Adjustment and a Notice of Response, the matter should be able to be elected to go straight to Court by the taxpayer, or that the taxpayer has a mirroring right to the Inland Revenue to apply to the Court for such an order before the disputes resolution procedures commence. For the reasons outlined above at paragraph 3.21, if the taxpayer elects or seeks leave to go straight to the challenge procedures, and, absent the exercise of a discretion by the Court to allow otherwise, the taxpayer should be limited to the *propositions of law* raised in its Notice of Proposed Adjustment or Notice of Response (whichever is applicable) in the challenge before the Court.

3.43 In the event that a taxpayer was given the right to suspend the disputes resolution procedures and elect to go straight to the challenge procedures or the right to apply to the Court to do so, we would suggest that the Taxation Review Authority have the same or similar powers as the High Court in relation to the ability to take evidence in relation to a suspended dispute so as to create a contemporaneous record.

Grounds of assessment

3.44 It is currently possible for there to be no Statement of Position issued by the Inland Revenue before it issues an assessment. This is because the Inland Revenue is only required to consider a Statement of Position issued by the taxpayer before issuing an assessment, and also because the Inland Revenue has the ability to apply to the Court for the disputes resolution procedures not to be completed. In the event there is no Statement of Position from the Inland Revenue, no document establishes what the grounds of assessment are. In *C of IR v Zentrum Holdings Limited* (2006) 22 NZTC 19,912 the Court of Appeal held that in the absence of a Disclosure Notice no rule applied limiting the Inland Revenue to grounds issued in earlier documents in the disputes resolution process. It had for some time prior to *Zentrum* been the position that the Inland Revenue was limited to its grounds of assessment in subsequent Court proceedings (as a consequence of *C of IR* v *VH Farnsworth Ltd* [1984] 1 NZLR 428). The Court took the view in *Zentrum* that in the absence of section 138G of the TAA (the evidence exclusion rule) applying, nothing confined the taxpayer or the Inland Revenue to their pre-assessment positions.

3.45 In the case of a dispute where the Inland Revenue has issued an assessment, has considered a taxpayer's Statement of Position, but has not issued one of its own, this means that a taxpayer is confined to grounds in its pre assessment documentation, but the Inland Revenue is not. Presumably in this situation a taxpayer is forced to rely

[2] *Review of the Tax Office Management of Part IVC Litigation* Inspector General of Taxation (7 August 2006).

upon the discretion of the Court to allow it to adduce further evidence and legal arguments if the Inland Revenue raises a different ground of assessment.

3.46 This position was unintended and in the Society and NZICA's view it is inappropriate. In its 1994 Discussion Document *Resolving Tax Disputes: Proposed Procedures* the Government stated (paragraph 5.7 to paragraph 5.8):

> *[B]oth parties must know which points are at issue before they can accurately identify the relevant evidence. Introducing a new issue can make different evidence relevant. .. This intended outcome is broadly analogous with the position under the current procedures, in which taxpayers are limited to their grounds of objection, and, similarly, the Commissioner may not change the basis of an assessment to which an objection has been made. The judicial phase of the current procedure is technically an appeal from the Commissioner's decision. Under the new procedure, that substance will remain.*

3.47 The Society and NZICA believe that a greater focus should be placed upon the early stages of the disputes resolution procedures. We have already suggested that there is a need for a compulsory conference. We have also suggested that there is a need for greater overview within Inland Revenue of the Notice of Proposed Adjustment or Notice of Response issued by Inland Revenue. The Society and NZICA suggest that the legislation should prescribe where the grounds of assessment are. Our suggestion is that when issuing an assessment the Inland Revenue should be required to specify its grounds of assessment to the taxpayer in its Notice of Assessment, with the Inland Revenue being limited to those specific grounds in any subsequent matter before the Courts. It may be that the Inland Revenue simply refers in the normal course to its Statement of Position as containing those grounds, but, where there is no such document, and in the absence of it being otherwise specified in the Notice of Assessment itself, there should be a statutory presumption that those grounds are contained in the Notice of Proposed Adjustment or Notice of Response issued by the Inland Revenue (whichever is applicable). This would also incentivise Inland Revenue to ensure that those documents clearly communicate to taxpayers the basis for its view.

Settlement of disputes pre-assessment

3.48 Another area of concern is in relation to the Inland Revenue's ability to settle cases pre-assessment. Practitioners have consistently commented that Inland Revenue seems unable to reach sensible settlements (including for instance by not imposing penalties or use of money interest) in the course of the disputes resolution procedures. Practitioners say that there is inconsistency between Inland Revenue offices and Inland Revenue officers within an office, a lack of clarity about who the ultimate sign-off or decision maker is in a settlement, and a perception that Inland Revenue officers still believe that a settlement is impossible except where it reflects that correct tax outcome.

3.49 As is noted below in relation to settlements of challenge proceedings, it has been clear for some time and case law continues to reiterate that the Inland Revenue is able to reach settlements with taxpayers, including in the course of the tax disputes procedures. Guidance really needs to be given to Inland Revenue staff, and consistently applied. We discuss this issue further below at paragraph 5.16 and following. In the disputes resolution context we would suggest that guidance provide that settlement discussions need to involve an official other than the official who has

initiated the dispute, or who is dealing with a taxpayer initiated dispute. Practitioners have consistently commented how difficult it is to reach a settlement on a sensible basis during the disputes resolution procedures. An independent review is needed.

PART VIIIA OF THE TAX ADMINISTRATION ACT 1994 – THE CHALLENGE PROCEDURES

4. BACKGROUND

4.1 The challenge procedures were enacted alongside the disputes resolution procedures in 1996. The challenge procedures replaced what was the case stated process, under which, following the taxpayer specifying its objection in a Points of Objection Notice, the Commissioner filed proceedings by way of a case stated if an objection to a tax assessment was unresolved. The main difference in the challenge procedures is that under Part VIIIA it is the taxpayer which files a challenge by way of filing a statement of claim or notice of claim.

4.2 There is a very direct link between the challenge procedures and the disputes resolution procedures. Section 138B and section 138C of the TAA set out a number of requirements which must be satisfied before the taxpayer may file a challenge. Included amongst those requirements are the requirement that the assessment or disputable decision being challenged is first disputed and rejected under the disputes resolution procedures, and also that any challenge be filed within two months of the date of issue of the notice of assessment or, in the case of a disputable decision which is other than an assessment, within two months of the date of issue of the Notice of Response by the Commissioner. That two month period is subject to extension by the Court but only in an "exceptional circumstance" (section 138D of the TAA). In addition, further linkages with the disputes resolution procedures arise by way of section 138G of the TAA which imposes the evidence exclusion rule. The evidence exclusion rule provides that that the Commissioner and the taxpayer may raise in the challenge only the facts, evidence, issues and propositions of law disclosed in their respective Statements of Position.

4.3 Section 138E of the TAA sets out a number of decisions which cannot be the subject of a challenge, and which must instead be the subject of judicial review proceedings. Included amongst those decisions are discretions on the part of the Commissioner to extend the time for filing a notice or return (for example in the case of the disputes procedures, the Commissioner's discretion as to whether there is an exceptional circumstance justifying the late filing of a document, can only be subject to judicial review, not challenge).

4.4 For the reasons set out above at paragraph 3.40 and following, our view is that the challenge procedures should be able to be elected into, and the close linkage to the disputes resolution procedures is not always appropriate, and in practice leads to cost issues causing taxpayers not to pursue disputable matters. We have made suggestions relating to that issue above. Our other suggestions relating to the challenge procedures are as outlined below.

5. SPECIFIC ISSUES WITH THE CHALLENGE PROCEDURES IN PRACTICE AND SUGGESTIONS FOR CHANGE

Test cases

5.1 The current test case procedure under sections 89O, 138Q and 138R of the TAA allows the Commissioner to designate a challenge in the courts as a "test case". Under section 138Q of the TAA the Commissioner may designate a test case if the Commissioner considers that determination of a challenge is likely to be determinative of all or a substantive number of issues involved in one or more other challenges. If a case is designated a test case then the Commissioner may stay similar cases before

the courts or the Taxation Review Authority (section 138R) and may, with the agreement of the disputant, suspend the dispute resolution procedures for a "significantly similar" dispute (section 89O).

5.2 However, there are a number of problems with the current test case procedure. The current procedure seems to be rarely used and there is little guidance for taxpayers on when the procedure will in fact be used by the Commissioner. As well as being underused, the Commissioner can take far too long to determine whether a case should be treated as a test case. We are aware of one case where it took over 13 months before the Inland Revenue denied the taxpayer's suggestion for an identified challenge to be designated as a test case. Meanwhile the taxpayer was locked into a time barred dispute process without any way of knowing if the suspension of the disputes resolution procedures under section 89O of the TAA would be granted, with use of money interest continuing to accrue. In addition, the test case designation process is entirely in the hands of the Commissioner – the taxpayer really has little input into the process. Practitioners have also commented that precedential cases are not being heard, because taxpayers cannot afford to both complete the disputes resolution procedures and proceed with a challenge.

A test case panel and Government funded test cases

5.3 NZICA and the Society suggest that consideration be given to both a test case panel, and to a government funded test case programme similar to the Australian programme (details of which we have included as Appendix B). In so doing, the test case procedure can function to ensure that precedential cases are before the Courts when they might otherwise as a consequence of costs concerns never reach the litigation stage. The decision of whether to designate a matter a test case would be given more guidance and would involve members of the community including, but not solely limited to, the Commissioner. Such a system would provide for greater certainty for taxpayers as the way that the Commissioner deals with test cases would be comprehensively set out in the legislation.

5.4 Australia has had a test case litigation programme since 1995. The programme provides financial assistance to taxpayers involved in litigation that is regarded as important to the administration of the Australian tax system. The purpose of this programme is to clarify the operation of the laws administered by the Federal Commissioner of Taxation where:

(a) There is uncertainty or contention about the operation of areas of law;

(b) The issue is of significance to a substantial segment of the public or has significant commercial implications for an industry segment; and

(c) It is in the public interest for the issue to be litigated.

5.5 There are three types of funding arrangements that the Australian Tax Office (**ATO**) enters into under the program:

(a) A consent order under which the Federal Commissioner of Taxation pays the other party's costs;

(b) A written order to reimburse the other party's costs on specific terms; or

(c) A formal agreement to provide funding under a Test Case Deed. (The most common type of funding is under a Test Case Deed).

5.6 The programme is based upon a taxpayer applying for test case funding. Taxpayers are required to submit an application form and a submission detailing the case, the factual background and a full summary of the issues to be tested. The submission must also show how the issue in question relates to an area of tax law that needs clarification and how it affects a significant number of taxpayers. If it is known, the amount of revenue that will be affected by the case should also be included in the submission. Submissions may also be made by a professional or industry body to have a matter of significance tested. Typically, in these cases, an in-principle agreement is sought for the matter being tested and the case indentified for this purpose. Similarly the Federal Commissioner of Taxation may decide to test a matter and seek agreement from a taxpayer to proceed with the case. This may involve seeking the assistance of a professional or industry body to identify a suitable case. There are also cases where the Federal Commissioner of Taxation offers to meet the taxpayer's costs on an appeal in important cases, without an application for funding being provided.

5.7 If a submission is made by the taxpayer then it is considered by the Test Case Litigation Panel. The Panel consists of members of the accounting and legal professions, as well as senior tax officers from the ATO. The inclusion of representatives from outside of the ATO is to provide independent views and community input. The Panel convenes about four times a year and the submissions received in the previous quarter will be considered by the Panel when it convenes. The Panel then makes recommendations to the Panel's Chair who has the final say based upon the following criteria:

(a) Whether the case is likely to provide a precedent for a large number of taxpayer or a significant industry;

(b) Whether the case involves a challenge to a controversial public ruling or a contentious issue raised in either published public rulings or draft public rulings;

(c) Whether the case would pre-empt a draft public ruling (this is seen as a positive);

(d) The financial capacity of the taxpayer to pursue litigation, but without necessarily excluding applicants able to afford a tax case;

(e) Whether the taxpayer is prepared to co-operate to achieve an early hearing;

(f) Whether the issue in dispute concerns alleged tax avoidance or benefits allegedly not intended by the government.

5.8 Depending on the strength of the submission, a decision can be made without reference to the Panel. This happens when the submission is approved due to the importance of the issues that are raised or where there is some urgency. A decision can also be made to decline an application without reference to the Panel when a decision needs to be made urgently, such as when the case will go to hearing before the next Panel meeting.

5.9 If an application is successful, then funding is given on the terms set out in the Test Case Deed (unless it is one of the other, less common, types of funding arrangements outlined above). The Deed will provide for reimbursements to the taxpayer for solicitor fees, counsel fees and disbursements. There are limits to the amount of

reimbursement that a taxpayer receives but the intention is for that taxpayer to be adequately funded to pursue a precedential case.

5.10 Taxpayers are expected under the Test Case Deed to take the stage of their case funded to its conclusion. They are also expected to stick to the agreed issues and where possible an agreed statement of facts. If the case does not proceed on the agreed issues due to the taxpayer's actions then the funding will be discontinued and funding already paid may have to be reimbursed to the ATO.

5.11 Funding does not automatically roll over if the case is appealed by either side. A fresh application for funding needs to be made for each stage of proceedings. This enables the funding decision makers to take into account the nature of the issue being tested on appeal and the terms of the decision applicants are seeking to appeal.

5.12 The programme receives funding of $2 million annually which has on occasion been in excess of the actual cost of the programme. For the past two years that information is available, the cost of the programme has fallen well short of the $2 million provided for. In 2006-2007 there were 52 applications and 27 cases were funded at a cost of $1.2 million. In 2005-2006 there were 35 applications and 32 cases were funded at a cost of $519,606.

5.13 An example of the benefits of the Australian programme can be seen in some of the cases that have been funded by it. Examples include:

(a) *FC of T v McNeil* [2007] ATC 4223 where the High Court of Australia considered the character of sell-back rights in the hands of the taxpayer in relation to her shareholding in St. George Bank Limited. The amount of tax liability in question was less than $600, but the decision also affected the other 80,000 shareholders of St George who were offered sell-back rights. More generally, the decision had an effect on other public companies seeking to issue sell-back rights to their shareholders as a way of capital reduction.

(b) *FC of T v Stone* [2005] ATC 4234 which involved a professional sportsperson who received grants, prize money and appearance money from her sport. The High Court of Australia considered whether the money she received as a sportsperson was assessable income. Again, this case involved a relatively small amount of money ($136,448 of assessable income) but involved a question of law that was of wider significance to an industry (being the sports industry).

5.14 A programme comparable to that offered in Australia would ensure precedential decisions could be heard in New Zealand. A programme of this sort would assist to some degree to redress the disparity of resources and technical expertise that exists between the Inland Revenue and taxpayers. In addition, the presence of outside experts in the advisory panel would also bring an independent view to the application process for test cases in the first place, and, in the case of Government funded test cases would help to ensure that important cases are recognised and given funding. As the Australian system has shown, a larger taxpaying public than New Zealand can be served with a government funded test case programme for relatively little cost (less than $2 million a year).

5.15 NZICA and the Society are concerned that costs (including the impact of the use of money interest regime, and of completing the disputes resolution procedures) are such that taxpayers cannot financially pursue meritorious disputes. NZICA and the Society believe that a Government funded test case programme should have a

statutory or regulatory foundation. We believe this would promote confidence in the tax system. While the Inland Revenue may maintain it funds test cases on occasion, any such funding is extremely rare, there is no taxpayer or outside input into that decision, and given resourcing of Inland Revenue it does not necessarily set aside any funds for this purpose. We believe this area needs an overhaul.

Settlement

5.16 Another area of concern is in relation to the Inland Revenue's ability to settle cases. Practitioners have consistent comments in relation to both pre-assessment settlements and settlements of challenge proceedings. Those comments revolve around inconsistency between Inland Revenue offices and Inland Revenue officers within an office, a lack of clarity about who the ultimate sign-off or decision maker is in a settlement, a perception that Inland Revenue officers still believe that a settlement is impossible except where it reflects that correct tax outcome, and concern that Inland Revenue officers seem unwilling to consider settlements which involve (for example) the reduction or elimination of use of money interest and penalties.

5.17 Some practitioners have said that the involvement of the Litigation Management Unit at the stage of challenge procedures is helpful (and in comparison how difficult it is to reach settlements during the disputes resolution procedures), but other have commented that the Litigation Management Unit seems unable to reach settlements without deferring to the Crown Law Office, something which causes significant delay, and is administratively burdensome. The Society and NZICA make suggestions below (at paragraph 5.21 and following) about Model Litigant guidelines. As a part of that process, we believe Inland Revenue should *always* consider settlement.

5.18 In a number of cases before the Courts the Inland Revenue has been consistently told that the Commissioner has the ability to settle cases like any other litigant – see for instance the Court of Appeal in *C of IR* v *Auckland Gas Company Ltd* (1999) 19 NZTC 15,027 and more recently in *Accent Management Ltd v C of IR (No.2)* (2007) 23 NZTC 21,366. Those cases confirm that the Inland Revenue can reach commercial settlements, can take into account litigation risk, and can reach settlements where those settlements do not necessarily correspond to the Inland Revenue's view of the correct tax position. There is also no limitation on the Inland Revenue's ability to settle including by way of a reduction or elimination of use of money interest and penalties.

5.19 The Commissioner issued a draft Standard Practice Statement ED0007 in 1999 in relation to settlements. Nine years later this has still not been finalised. It provided little guidance in any event, providing that:

(a) Settlements must be based on the statutory criteria.

(b) Settlements must be consistent with treatment of other taxpayers in a similar position.

(c) Settlements must be consistent with the Commissioner's duty to collect, over time, the highest net revenue that is practicable within the law.

(d) Any settlement must be based on a genuine dispute over facts or law, rather than expediency.

5.20 The Society and NZICA believe it is high time that the Inland Revenue provided guidance for Inland Revenue officials in relation to settlements. We believe that there

should be clear guidelines providing that Inland Revenue has the ability and can exercise its ability to settle a dispute both pre-assessment, in the course of the disputes resolution procedures, and during challenge proceedings. This guidance can be given by way of Standard Practice Statement which taxpayers can also access. Any such guidance must be consistent with the case law, and should provide a clear sign-off for settlements (so taxpayers know who to write to). Any such guidance needs to be consistently applied. And, as noted above, we believe that Inland Revenue should *always* consider settlement. We discuss this further below.

Model litigant procedures

5.21 The Society and NZICA have been concerned at some of the recent case law relating to procedural aspects of the disputes resolution procedures. In that recent case law the Inland Revenue's position has seemed unusual and potentially at odds with the purposes of the procedures. For instance:

(a) In *ANZ National Bank Ltd v C of IR (No. 2)* (2006) 22 NZTC 19,835 the Inland Revenue seemed to argue that its own Adjudication Unit did not have the technical capability to consider complex tax matters, notwithstanding that the Taxpayer Rulings unit within the same office (the Office of the Chief Tax Counsel) had previously given rulings on similar transactions;

(b) In *Case X6* (2005) 22 NZTC 12,079 at paragraph 49 the Taxation Review Authority noted the commonplace nature of very procedural arguments from the Inland Revenue:

> *Cases in this jurisdiction have become commonplace where taxpayers have been prevented from ever having the merits of their dispute determined by a hearing authority because of failure to comply with some procedural requirement.....In the former case, the taxpayer is thus far (pending a further appeal) prevented from defending an allegation of fraud because of a highly technical analysis of the relevant procedural steps. This case is a further such example.*

5.22 In Australia, all Government departments are required to act as "Model Litigants". We have included a copy of those requirements as Appendix C. In broad terms, these require that departments should:

(a) Not cause unnecessary delay in the handling of litigation.

(b) Act consistently.

(c) Endeavour to avoid, prevent and limit the scope of legal proceedings wherever possible, for example by the use of alternative dispute resolution processes.

(d) Keep the costs of any litigation to a minimum.

(e) Not take advantage of claimants who lack the resources to litigate a claim.

(f) Not rely on technical defences.

(g) Not pursue an appeal unless it believes that it has reasonable prospects for success or the appeal is otherwise justified in the public interest.

(h) Apologise where it is clear that it has acted wrongfully or improperly.

5.23 For these guidelines to be effective in Australia, each Government department is independently reviewed. In New Zealand, this would require an entity which is able to act independently of Crown Law, as Crown Law undertakes Inland Revenue's litigation. The State Services Commission could perhaps be considered in the New Zealand context.

5.24 As part of a Model Litigant model for New Zealand, we suggest that the Inland Revenue should formally consider a number of options before pursuing litigation:

(a) Proactive consideration of settlement (unfortunately in our experience this does not take place);

(b) Test cases;

(c) Mediation;

(d) Legislative change – and in this area there should be concession to the taxpayer if the legislation is drafted with a complete lack of clarity, and legislative amendment where necessary.

5.25 In many cases, ordinary legal proceedings will be the only option. However, the Inland Revenue should consider the other options, as these will have a place in many disputes. The size of the current Revenue Acts have mushroomed and the quality of the legislation and consultation has at times suffered. Increasingly of late, officials have relied on "base maintenance" amendments to correct drafting errors. As a result of this, the legislation becomes uncertain. Taxpayers should not be penalised for taking positions which are the result of uncertain or unclear legislation.

Appendix A

Appendix A: The costs of the procedures and the impact on tax litigation

As outlined in our paper, the Society and NZICA consider that a current tax dispute processes impose a high level of costs. This is reflected in the pattern of court usage and Inland Revenue's costs. The Richardson Committee noted in 1994, that in a six month sample period in 1991 the median amount of tax in dispute for a sample of cases over a six month period was $5,000 for objections, and $20,000 cases filed[3].

We are unable to compare this to any current statistics as the cost of the processes are so high, that taxpayers very rarely get to the stage that they take the matter to dispute unless there is a considerable amount is at stake. There are a large number of New Zealand businesses and individuals that are "small" in tax terms. In New Zealand, 89% of New Zealand enterprises employ five or fewer staff[4]. In the United States of America ("USA") these are regarded as "micro" businesses. In the USA, enterprises that have less than 100 employees are regarded as "small". In New Zealand 99.54% of New Zealand enterprises are "small" in USA terms. Similarly, there are a large number of individuals who are also "small" in tax terms.

It is not possible to produce statistics to show how many people are not willing to proceed due to the high costs involved. All that can be shown is the large decline in the number of people prepared to use the Courts. For example[5]:

Number of hearings through the Taxation Review Authority	
Inland Revenue Financial Year	**Total**
1/7/1995 – 30/6/1996	64
1/7/1996 – 30/6/1997	64
1/7/1997 – 30/6/1998	60
1/7/1998 – 30/6/1999	21
1/7/1999 – 30/6/2000	45
1/7/2000 – 30/6/2001	24
1/7/2001 – 30/6/2002	19
1/7/2002 – 30/6/2003	29
1/7/2003 – 30/6/2004	26
1/7/2004 – 30/6/2005	14
1/7/2005 – 30/6/2006	13

This now suggests that very few people are prepared to go to Court, particularly when then are small amounts in dispute. This does not mean that people no longer have disputes with Inland Revenue for small amounts of tax – it just means that there is no forum for those cases to be heard, where the tax dispute cannot be heard for less than the cost of the disputes process. This has been regarded as a victory[6] –

> *The current process would appear to a significant extent to be meeting its objectives because the number of audited cases that are disputed is decreasing and the cases that are being litigated are also decreasing.*

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[3] Refer *Organisational Review of the Inland Revenue Department* April 1994 at page 66.

[4] Refer to the Feb 2007 statistics - http://www.stats.govt.nz/NR/rdonlyres/8BE43774-521C-481E-A97F-933285CD7D88/22502/NZBDS2007alltabls.xls

[5] This information came from an OIA request to Litigation Management Unit of Inland Revenue

[6] Refer to the discussion document *Resolving Tax Disputes: A legislative review paragraphs 1.7 & 1.8.*

In 1997, the proportion of audited cases giving rise to a dispute was two percent of total cases. This figure dropped to 0.91 percent in 2002. The decrease suggests that the disputes process, combined with Inland Revenue's audit selection process, is reducing the number of disputed cases.

In our view, what is not shown by the decrease in the number of cases heard by the Taxation Review Authority, are the costs of bringing a dispute. We are not able to provide accurate statistical details that demonstrate the increase in taxpayer's costs to take a matter to court. However, the other side of those expenses are the costs incurred by the Litigation Management Unit of Inland Revenue. Those costs are lower than the costs incurred by taxpayers, as the preparation and management of the documents form the disputes resolution procedures are undertaken by other parts of the Inland Revenue. However Litigation Management does have a review role in relation to Statements of Position issued by Inland Revenue. Litigation Management's costs have also spiralled since the introduction of the disputes system in 1996.

Inland Revenue no longer provides the details of the cases under management and the cases it took to court in its Annual Report. For example, the cost of the Litigation Management Unit in 1999 was $5,449,000. This compares with a cost of $7,300,000 in 2006 when it took 26 cases to court.

In addition to the high costs of the current process, there is a considerable barrier in terms of the procedure involved. In the Society's and NZICA's view:

- The current disputes resolution system is an abject failure in how it handles small disputes.
- Based on the information supplied by the Richardson Committee, the vast majority of disputes are for small amounts.
- The costs involved in disputing a matter have now increased to such a stage that it is no longer financial viable for people to dispute small amounts with the Inland Revenue.
- Most taxpayers in New Zealand are "small" (or micro in USA terms) and the amounts in dispute are for small amounts.

The current disputes resolution procedures fail the majority of taxpayers.

	TRA			High Court			Court of Appeal			Privy Council/Supreme Court			Total Cases			Cost of Litigation Mgmt	IRD's Figures (per OIA)	Cost per Case Managed	Cost per Case Heard
	Started/ Managed	Total Disposed	Cases Heard	Started/ Managed	Total Disposed	Cases Heard	Started/ Managed	Total Disposed	Cases Heard	Started/ Managed	Total Disposed	Cases Heard	Started/ Managed	Total Disposed	Cases Heard				
1996*	93	160	44	54	65	37	0	5	5	0	1	1	147	231	87				
1997*	120	117	40	80	57	16	0	5	5	0	1	1	200	180	62		$3,416,334		
1998	49		58	27		26	0		8			1	76		93		$4,427,882		
1999	294		38	393		22	0		19	0			687		79	$5,449,000	$4,394,167	$7,931.59	$68,974.68
2000	228		31	205		17	0		4	0		0	433		52	$5,056,000	$4,650,530	$11,676.67	$97,230.77
2001	140		29	156		25	0		9				296		63	$4,723,000	$4,247,601	$15,956.08	$74,968.25
2002			15			16			4				321		35	$5,039,000		$15,697.82	$143,971.43
2003	225		16	266		8			13				491		37	$5,881,000		$11,977.60	$158,945.95
2004													569	109	52	$7,060,000		$12,407.73	$135,769.23
2005																$8,066,000			
2006															26	$7,300,000			$280,769.23
2007																$9,679,000			
2008																			

* Note that there is a different method of recording cases commenced in 1999, in 1996 & 1997 this was based on cases filed. This information is extracted from IRD's Annual Reports except for the second range of information on Litigation Management which was supplied as an OIA response. Note there is also a difference between the number of cases heard by the TRA in IRD's annual reports when compared to the OIA information received.

Appendix B

GENERAL	SOLICITORS AND LAWYERS	GUIDE	NAT 4556-04.2005
SEGMENT	AUDIENCE	FORMAT	PRODUCT ID

Australian Government
Australian Taxation Office

Test Case Litigation Program

How to apply for funding

For more information, go to our website at **www.ato.gov.au**

CONTENTS

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FOREWORD

The Australian Government and the community expect us to provide greater certainty about the laws we administer. Although we provide binding advice and extensive information about tax administration, ultimately the courts have the final say in determining what our laws mean.

Under the Test Case Litigation Program we provide financial assistance to taxpayers involved in litigation that we regard as being important to the administration of the revenue system.

The purpose of the program is to develop legal precedent, that is, legal decisions that provide guiding principles on how laws should be applied. This initiative has provided greater certainty to taxpayers since the start of the program in 1995.

Applications are considered by the Test Case Litigation Panel, which at various times has included solicitors, accountants and academics to ensure the integrity of the cases selected.

We have also simplified the criteria to be addressed and broadened the categories of cases we will be funding under the program, demonstrating our continued and increasing commitment to the Test Case Litigation Program.

Michael Carmody

Michael Carmody Commissioner of Taxation.

ABOUT THE TEST CASE LITIGATION PROGRAM

PURPOSE

The purpose of the Test Case Litigation Program is to clarify the operation of the laws administered by the Commissioner of Taxation where:

- there is uncertainty or contention about the operation of areas of law
- the issue is of significance to a substantial segment of the public or has significant commercial implications for an industry segment, and
- it is in the public interest for the issue to be litigated.

In applying these criteria:

- cases with issues involving questions of fact where there are established legal principles will not generally be funded
- the program will usually be directed to applications for cases being litigated through Part IVC of the *Taxation Administration Act 1953*. Part IVC allows for the review of a Commissioner's decision on an objection to an assessment or a private ruling, an appeal to the Administrative Appeals Tribunal (AAT) or a court from the Commissioner's decision on an objection, or a subsequent appeal from an AAT or court decision. Preference for the program is given to court cases rather than AAT cases. Cases outside of the Part IVC regime involving debt issues, applications for declaratory relief, and judicial review issues, will be considered for funding where an important law clarification issue arises
- consideration will be given to the degree to which the taxpayer is prepared to cooperate to achieve an early hearing
- the financial capacity of the taxpayer to pursue litigation will be taken into consideration, although applicants of financial substance will not necessarily be excluded, and
- cases involving tax avoidance schemes or attempts to gain a benefit clearly not intended by the law will not generally be funded. Cases will be considered for funding where they test the proper meaning of anti-avoidance provisions or where the circumstances are such that there is a strong public interest served.

FUNDING FURTHER APPEALS

Given the nature of the issues covered by the program, funding will generally extend to appeals against funded decisions, at least to the Full Federal Court. (Where cases are approved for funding in state or territory courts, funding will generally extend to the Court of Appeal or equivalent in the relevant Supreme Court). A fresh application for funding will need to be made at each stage of proceedings, to enable the funding decision to take into account the nature of the issue being tested and the terms of the decision applicants are seeking to appeal.

IDENTIFICATION OF CASES

Generally, cases will arise through applications for funding from taxpayers appealing a decision by the Commissioner of Taxation. These applications go to the Tax Office's Test Case Litigation Panel which makes recommendations about whether funding should be provided.

Submissions may also be made by, for example, a professional or industry body to have a matter of significance tested. Typically, in these cases, in principle agreement is sought to the matter being tested and a case being identified for this purpose (see 'Approval in principle to develop a case' on page 8). These applications also go to the Tax Office's Test Case Litigation Panel.

Similarly, the Commissioner of Taxation may decide to test a matter and seek agreement from a taxpayer to proceed with the case. This may involve seeking the assistance of a professional or industry body to identify a suitable case. There are also cases where the Commissioner offers to meet the taxpayer's costs on an appeal, in important cases, without an application for funding being provided. Although they are an important part of the Commissioner's Test Case Litigation Program, these cases do not usually go to the Tax Office's Test Case Litigation Panel, except for information.

DECISION MAKING PROCESS

You can apply for funding by completing the application form at the end of this guide and attaching it to a submission (see 'Prepare a submission' on page 10). You must prepare a submission in order to apply for test case funding.

You need to provide the details of the case, the factual background and a full summary of the issues to be tested. Your submission must show how the issue in question relates to an area of the tax law that needs clarification and how it affects a significant number of other taxpayers. The significance of the case should be clear from the submission, including the amount of revenue that will be affected by the case, if that is known.

It is intended that, over time, the program will help build a body of legal precedent that will serve as a rule for future similar cases. Therefore, cases that are brought before a court, rather than the AAT, are preferred. However, cases before the AAT or Small Taxation Claims Tribunal can still be considered for funding, particularly where the case is to be heard by a Presidential Member.

The submission and any supporting materials will normally be considered by the Test Case Litigation Panel (the panel) when it next convenes. The panel generally convenes about four times a year. Generally, a decision will be made within three months of your application being received.

If your application appears plainly deficient for any reason, we may contact you to give you the opportunity to provide more information before your application is submitted to the panel, so you can present your best case.

Once a fully supported application is received, comments will be sought from internal Tax Office sources, which may include the relevant business line, the Legal Services Branch and the Tax Counsel Network. Any written comments received will form part of the papers that will be forwarded to the panel.

The panel will consider whether or not your written application and the supporting documentation meet the specific criteria. A recommendation to approve or decline funding is then made to the Chair of the panel, who makes the final decision.

Decisions about test case funding can also be made by a number of senior staff in the Tax Office, including the Commissioner, a Second Commissioner, or a Deputy Chief Tax Counsel. The Senior Tax Counsel (Strategic Litigation) is the Chair of the panel, and is ordinarily the officer to make the final decision about funding.

Depending on the strength of the application, a decision can be made without reference to the panel. This will happen where your application is to be approved due to the important issues that are raised, or where there is some greater urgency. A decision may also be made to decline your application without reference to the panel where a decision needs to be made urgently, such as where the case will go to hearing before the next panel meeting.

You will then be advised in writing of the decision, with reasons. If your application is declined, funding will not be given. A decision to approve funding does not give rise to an automatic legal right to funding – an agreement about the terms of funding has to then be reached. You will be sent a draft Test Case Funding Agreement setting out the terms and conditions upon which funding is offered and you will need to consider that offer carefully before responding or accepting.

TEST CASE LITIGATION PANEL

The Test Case Litigation Panel consists of members of the accounting and legal professions, as well as senior tax officers.

The panel considers the applications according to the program's criteria, and recommends to the Chair of the panel – the Senior Tax Counsel (Strategic Litigation) – whether or not funding is appropriate.

The panel considers applications with respect to both actual cases and issues where no case has yet been identified.

The panel was formed with the intention of providing community input. Representatives from the accounting and legal professions provide independent views on the merits of cases and on the significance of issues to the community.

FUNDING ARRANGEMENTS

Following your acceptance of the offer setting out the terms and conditions upon which funding will be provided, we will let you know the name of the test case funding contact officer allocated to your case. This officer will not be involved in the conduct of the actual case on behalf of the Commissioner – a different officer will be allocated to that role.

Funding is available to taxpayers who:

- have successfully applied and been approved for funding under the program for a case that is in a court or tribunal, or
- have successfully applied and been approved for funding in principle under the program for a case to be located and/or developed for court (see 'Approval in principle to develop a case' on page 8).

TYPES OF FUNDING

There are broadly three kinds of funding arrangements that the Tax Office enters into under the program:

1 a consent order under which the Commissioner pays the other party's costs
2 a written offer to reimburse the other party's costs on specific terms, or
3 a formal agreement to providing funding under a Test Case Deed.

The most common type of funding is under a Test Case Deed.

1 **Cost orders:** When the Federal Court, for example, makes an order as to costs, the costs are generally read as a reference to party/party costs (unless it specifies otherwise). The Commissioner's liability for costs awarded against him will follow the ordinary court process, including taxation of costs where necessary.
Similarly, in other courts, the Commissioner will be liable for costs on the basis assessed by the courts under their own processes. Generally, the costs can be met on the basis of an itemised account submitted to the Commissioner's solicitor, or they may be settled by agreement between the parties. Nonetheless, as this category of funding is entirely within the domain of the relevant court process, it will not be further discussed in this guide. You should seek the advice of your solicitor or counsel if you need more information.
2 **Written offers:** Offers of funding by way of a letter offering to reimburse specific costs have been less frequently used in recent times. However, it may still be used in a situation where, for example, the Commissioner provides funding retrospectively following an internal review process (see 'What happens if my application is declined?' on page 7).
3 **Test Case Deed:** Generally speaking, under the Commissioner's Test Case Deed, when a case goes to hearing and a decision is provided by the court, it is agreed that the parties will request orders that costs be paid in accordance with the deed. The taxpayer's costs will be assessed having regard to the terms of the deed rather than the usual rules of the court. This is usually dealt with directly between our funding contact officer and the taxpayer's solicitor. In the event of a dispute or doubt, the Commissioner may seek the guidance of an independent cost consultant. If costs cannot be agreed, costs may be taxed under the process provided by the particular court.

WHAT DOES THE TEST CASE DEED COVER?

When you receive written advice that your application has been approved, an offer of funding will usually be provided at the same time, in the form of a deed.

You should consider the deed fully and carefully. You should not rely on this guide to understand the particular deed that has been sent to you – you should obtain independent legal advice about the content of the deed.

The deed provided to you will specify rates at which we will reimburse your costs for the members of your legal team. It will also detail the basis for reimbursing the cost of disbursements.

The deed generally offers funding of reasonable costs incurred at the approved stage of litigation on a solicitor/client basis, subject to certain limits. The Commissioner will only provide funding for reasonably sized teams, having regard to the relative complexity of the matter.

The basis for calculating costs under the deed generally results in a higher amount of costs being paid to the taxpayer than would be the case if the costs were taxed on a party/party basis by the Federal Court of Australia. However, there are limits on the monetary rates paid to solicitors and counsel. Your legal team may not be entitled to the full commercial rates they may wish to be paid, notwithstanding that the case is test-case-funded. Reimbursement is limited to the amounts specified under the deed, which means you may need to pay the balance of your legal advisers' costs.

Subject to the terms and conditions of the deed, funded taxpayers will receive reimbursements for:

- solicitor fees
- counsel fees, and
- disbursements.

Solicitor fees

The deed will only reimburse solicitor fees up to a certain rate. These rates are provided by the Tax Office and are determined by reference to the rates the Commissioner pays for legal services.

Counsel fees

Under the program, the Tax Office will fund no more than the same number and seniority of counsel that the Tax Office itself will engage to conduct the test case. For example, if we brief one junior counsel, we will only reimburse you for the cost of engaging one junior counsel to represent you.

We will reimburse you for counsel fees according to the general Australian Government rate, as determined pursuant to the Legal Services Directions issued by the Attorney General's Department. Where your counsel has been approved by the Attorney General's Department for a specific Australian Government rate, they will receive that rate.

Disbursements

Normal disbursements (such as photocopying, facsimiles and telephone costs) are limited to $500.

Disbursements such as filing fees, witnesses' expenses and other such disbursements covered by the deed will be reimbursed separately and are not covered by the $500 limit.

> **NOTE**
>
> Funding under the program may not cover all your expenses in running the case.

WHAT COSTS ARE NOT COVERED BY TEST CASE FUNDING?

Some of the items the program will not cover include fees and disbursements that:

- are unreasonable in amount or unreasonably incurred
- are above the set rates provided in the deed
- are not directly related to the test case
- relate to your application for funding
- are incurred after the decision is handed down for the test case
- relate to some travel costs
- are for the litigation of issues not agreed upon, or
- relate to the preparation of bills of costs.

WHAT ABOUT NON-LEGAL COSTS?

Generally, test case funding is limited to legal costs: that is, the costs of preparing and conducting a case for litigation. However, when funding has been approved to find and develop a case for litigation, the Commissioner will consider approving the costs of preparing objections and private binding rulings. This preparation may require the assistance of your accountant or tax agent.

If you seek this type of funding, you should support your application with a proposal of the types of costs you anticipate will be incurred and the estimated costs of the total work to be done. This material should accompany your submission. Any costs that are agreed will be set out in the Test Case Deed that will be sent to you with the offer of funding.

FUNDING REVIEW AND TERMINATION

The Tax Office may review and terminate funding at any time if you breach any condition of the funding offer as set out in the deed.

DO I HAVE TO RE-APPLY IF I WANT TO APPEAL THE COURT'S DECISION OF MY TEST CASE?

Yes. The Test Case Deed applies to a single stage only. However, if you have been funded at one stage, your application for funding for an appeal will generally be favourably considered, at least to the Full Federal Court (or where cases are approved in state or territory courts, to the relevant Court of Appeal in the relevant Supreme Court).

For example, if your case in the Federal Court is funded and the decision is not in your favour, you will need to make a further application for funding should you decide to appeal to the Full Federal Court. If funding is approved to the next stage, a new deed will be offered that will update the agreed rates for solicitors and counsel (if necessary) and will also review the key issues that are to be considered by the court on appeal.

WHAT TYPES OF CONDITIONS ARE THERE ON FUNDING?

There are many conditions and obligations set out in the Test Case Deed that you need to carefully consider before agreeing to the deed. A number of key issues that you will probably notice in the terms of the deed include the following:

- You are expected to take the particular stage of the case to its conclusion. This may require you to supplement the cost of litigation with your own funds, to the extent that the funding provided does not fully indemnify you for your costs.
- If the case does not proceed on the agreed issues outlined in the deed, due to actions by you or your legal representatives, funding will not be provided in relation to the preparation for – and conduct of – the test case proceedings, and we may ask you to refund money that has already been paid to you.

- Any funding that is paid to you or your representatives must only be spent on the legal expenses related to the conduct of your case.
- If you are successful in the test case, you will not seek costs orders against the Tax Office, other than orders in the form set out in the deed.

HOW DO I CLAIM A REIMBURSEMENT FOR MY TEST CASE COSTS?

The terms of the deed specify how and when claims can be made.

Generally, once funding has been agreed, claims can be made every six months, or immediately after each significant court or tribunal appearance. Alternative payment arrangements may also be considered, and should be discussed with the test case contact officer when an offer for funding is made.

Accounts should be sent to:

Test Case Program
Senior Tax Counsel (Strategic Litigation)
Legal Services Branch
Office of the Chief Tax Counsel
Australian Taxation Office
GPO Box 9990
Sydney NSW 2001

Your legal adviser's account must detail each item of work and the hourly or daily rate charged. All expended moneys must be itemised clearly, as would be done with a bill of costs submitted in taxable form.

You can only claim expenses associated with the conduct of the case. For example, public relations costs will not be reimbursed.

> **NOTE**
>
> Invoices submitted to the Tax Office may be subject to a review by a cost consultant. To ensure there are no delays with payment of invoices, we ask that all invoices submitted are in taxable form: that is, in the form required by court rules for costs assessment.

TAX CONSEQUENCES

There may be tax consequences if you claim a tax deduction for legal costs incurred in objecting or appealing against an assessment or determination of the Commissioner. Any money received to recoup deductible expenditure under the program is assessable.

WHAT HAPPENS IF MY APPLICATION IS DECLINED?

If your application for funding is declined, you will be advised in writing with reasons.

If you think that your application has not been properly considered or if there have been further developments in your case since you first lodged your application, you can request (in writing) a review of the decision to decline funding.

The review is undertaken by a senior officer of the Tax Office. This process normally takes about one month and you will be advised in writing of the review decision.

OTHER CASES WE MAY FUND

This guide generally covers the situation where a taxpayer has a case in the Federal Court or the AAT and seeks test case funding in the ordinary way. However, there are other situations where we fund cases for law clarification.

COMMISSIONER'S APPEAL AGAINST AAT CASES

When the Commissioner appeals against a decision of the AAT or the Small Taxation Claims Tribunal, the Commissioner will generally consider funding the taxpayer's reasonable costs of the appeal. Funding under this category is offered at the Commissioner's own volition without reference to the Test Case Litigation Panel. The purpose of this is to ensure that taxpayers can avail themselves of the low cost environment of the AAT without suffering the risk of litigation in the court system. Funding of this kind will be provided, depending on the merits of the case. Generally, we will have regard to the size of the issue and the capacity of the taxpayer to meet legal costs.

Funding is generally not available in cases involving tax avoidance schemes or attempts to gain a benefit clearly not intended by the law.

The costs that will be funded will be subject to the terms and conditions set out in a deed that will be provided to you. As long as the Commissioner continues to appeal subsequent decisions, the offer of paying reasonable costs will continue, subject to agreement at each appeal stage about the terms of funding.

If the taxpayer appeals the decision of the AAT or any subsequent decision of the court, we will not ordinarily fund those proceedings under this type of funding. If you are seeking funding, you will need to submit an application for test case funding in the usual way and it will be dealt with by the Test Case Litigation Panel process.

HIGH COURT CASES

When the Commissioner seeks special leave to appeal to the High Court, and the particular issues in a case justify it, the Commissioner may, of his own volition, offer to meet the taxpayer's costs of special leave and the costs of the appeal in the event that leave is granted by the High Court. This is done without reference to the Test Case Litigation Panel.

These types of cases are usually funded by consenting to orders as to costs against the Commissioner. Those costs provided under this category are the usual reasonable party/party costs that are calculated in accordance with the High Court's rules.

A taxpayer can apply for funding under the program in the usual way to receive the benefit of the costs that are paid under the deed. Such an application should be made well before the case is brought on for hearing of special leave.

APPROVAL IN PRINCIPLE TO DEVELOP A CASE

This category refers to the situation where a case has been identified that has the potential to test an important issue but further work is needed before it can be litigated.

On some occasions, funding may be provided for the costs (including non-legal costs) associated with developing the case, such as preparing the objection or private binding ruling request.

You need to make an application for approval in principle before you incur the expenses involved in developing the case for litigation.

Once a case has been identified, you need to lodge a submission for approval in principle to fund a case. The submission needs to include the following details:

- the name and address of the applicant taxpayer, organisation or group
- a description of the issue, and
- details of how the case is intended to be developed for the purposes of bringing it before a court or the AAT.

If you are seeking funding for preparing the objection or private binding ruling request, the application would need to establish that there are special circumstances. For example, there might be a situation where the value of the issue to the community would be high, but the cost to an individual of running a case would greatly exceed their potential gain if the case was won.

Before funding in principle will be granted, you will need to provide details of a proposed work plan and budget for developing the case.

The work plan needs to describe each item of work, who is to perform the work and their qualifications, and the proposed timeframe for this work to be completed. The budget should show the number of hours or days expected to be spent on each item in the work plan. The work plan would also need to show the hourly and daily rates to be charged.

APPROVAL IN PRINCIPLE TO FIND A CASE ON AN ISSUE

If, for instance, an association has a tax issue of importance to its members, the association may seek approval in principle for the issue to be funded. This may occur before the association actually incurs the expenses in finding a case that will test the issue.

You should send your application to the Tax Office, together with a submission setting out the required information (see 'Prepare a submission' on page 10). As this submission will be prepared before an actual case can be considered by the Test Case Litigation Panel, it is particularly important to explain the legal principles that will be tested. Cases where the issues will ultimately be determined on the facts of the case, rather than test legal principles, will not generally be funded.

You will be advised in writing if your application is supported. If you are granted an approval in principle to fund a case, you will be allocated a Tax Office contact officer to help you with your case.

Once the case is ready for litigation, you need to make a request in writing to the Senior Tax Counsel (Strategic Litigation) to confirm funding. Your request should detail the case and refer to the approval-in-principle decision to fund.

You will be sent a letter of offer and a Test Case Deed once a suitable vehicle for testing the issue is found. If you are seeking funding for the costs involved in finding a case, you need to:

- establish that special circumstances exist, including that the costs associated with finding a case are relatively significant, and
- provide details of a proposed work plan and budget for finding the case.

HOW TO APPLY FOR TEST CASE FUNDING

COMPLETE AN APPLICATION FORM

Taxpayers who want to apply for test case funding must provide – as a minimum – the information requested on the application form. This form is included at the end of this guide and is available electronically on our website at **www.ato.gov.au**

The application form must be attached to the front page of your submission (see 'Prepare a submission' below). If there is not enough space on the application form, the detail should be provided in the body of your submission.

PREPARE A SUBMISSION

You need to prepare a submission in order to apply for test case funding. Your submission will be considered by the Test Case Litigation Panel, and is the supporting document to your application for funding your case.

In line with the purpose of the Test Case Litigation Program, as explained at the beginning of this guide, your submission should address the following points:

1 **How does the issue to be tested relate to an area of the tax law where there is uncertainty or contention?**
In dealing with this question, it is important to explain the legal principles to be tested. Issues involving questions of fact where there are established legal principles will not generally be funded.

2 **How do you propose to bring this issue forward for testing?**
Preference is generally given to cases brought before courts rather than the AAT, due to the aim of building a body of legal precedent with relatively limited public funding.
In addition, the program would usually be directed to applications for cases being litigated through Part IVC of the *Taxation Administration Act 1953*. Part IVC allows for the review of a Commissioner's decision on an objection to an assessment or a private ruling, an appeal to a court from an objection decision, or a subsequent appeal from the AAT or Federal Court. Cases outside the Part IVC regime will also be considered where an important law clarification issue arises. Such cases may include debt issues, applications for declaratory relief, and judicial review issues.

3 **To what extent is the issue of significance to a substantial segment of the public, or does it have significant commercial implications for an industry segment?**

4 **Why is it in the public interest for the issue to be litigated?**
Cases involving tax avoidance schemes or attempts to gain a benefit clearly not intended by the law will not generally be funded. Cases will be considered for funding where they test the proper meaning of anti-avoidance provisions or where the circumstances are such that there is a strong public interest served.

5 **To what degree are you prepared to cooperate to achieve an early hearing?**

6 **What is your financial capacity to pursue litigation without the benefit of test case funding?**

Please note that applicants of financial substance will not necessarily be excluded.

> **NOTE**
> Your application will be considered on its merits. You should consider how best to present your application so that the Test Case Litigation Panel can fully appreciate the strength of your application against the criteria for funding.

Australian Government
Australian Taxation Office

Test case litigation program application form

Complete this form if you are applying for test case funding. You need to attach this form to the front of your submission to the Test Case Litigation Panel. If there is not enough space on this form you can provide additional detail in your submission.

WHEN COMPLETING THE FORM

- initial the form where directed
- print neatly in BLOCK LETTERS, using a BLACK pen only, and
- place ✗ in all relevant boxes.

AFTER COMPLETING THE FORM

- sign the declaration
- keep a copy for your records, and
- mail your completed form to the address shown on this form.

You can download an electronic version of this form from **www.ato.gov.au**

MORE INFORMATION

If you need help completing this form, you can:

- refer to the attached guide
- phone the Secretariat of the Test Case Litigation Panel on (02) 9374 2986 between 8.00am and 5.00pm, Monday to Friday, or
- visit **www.ato.gov.au**

How to lodge your completed application

Send your completed application and accompanying submission to:

Test Case Program
Senior Tax Counsel (Strategic Litigation)
Legal Services Branch
Office of the Chief Tax Counsel
Australian Taxation Office
GPO Box 9990
Sydney NSW 2001

Section A: Applicant information

1 Taxpayer's name

Include the name of the taxpayer or, if you are seeking funding for a particular issue and if no case has been identified, name the issue at question.

Title (Mr, Mrs, Miss, Ms or other title)

Family name

Given names

2 Person and/or organisation lodging application

Provide details of the legal representative, association or organisation proposing the test case.

Organisation:

Contact person details: The contact person must be appropriately authorised and instructed to act on behalf of a named taxpayer.

Name

Address

Suburb/town | State/Territory | Postcode

Business telephone number | Mobile | Fax

Email address (Please use BLOCK LETTERS)

Section B: **Test case funding details**

3 Provide a brief summary of the issue(s) for which you are seeking funding.
Do not forget to add to this application a more comprehensive submission addressing the criteria as set out at page 10 of the guide.

4 Revenue:
Case: This relates to the amount of tax at issue in the particular case (if known).

Industry: This relates to the amount of tax at issue in the industry (if known).

5 Summary of case history
For example, the matter was heard before the AAT and decided in favour of the Tax Office. The taxpayer has appealed to the Federal Court'. Also include the history of the case in relation to the Test Case Litigation Program, if relevant. For example, the history should specify whether this is the first application for funding for this case or whether a previous stage of proceedings has already been funded.

Section C: **Declaration**

I declare that the information given in this application and its attachments is true and correct.

Name of signatory

Signature

Date Day / Month / Year

Penalties may be imposed for giving false or misleading information

MORE INFORMATION

For further information on this topic:

- visit our website at **www.ato.gov.au**
- phone us on **(02) 9374 2986**, or
- write to:

  Test Case Program
  Senior Tax Counsel (Strategic Litigation)
  Legal Services Branch
  Office of the Chief Tax Counsel
  Australian Taxation Office
  GPO Box 9990
  Sydney NSW 2001

If you do not speak English well and want to talk to a tax officer, phone the Translating and Interpreting Service on **13 14 50** for help with your call.

If you have a hearing or speech impairment and have access to appropriate TTY or modem equipment, phone **13 36 77**. If you do not have access to TTY or modem equipment, phone the Speech to Speech Relay Service on **1300 555 727**.

FEEDBACK

To provide comments on the Test Case Litigation Program, you can:

- email **testcasefeedback@ato.gov.au**, or
- write to:

  Test Case Program
  Senior Tax Counsel (Strategic Litigation)
  Legal Services Branch
  Office of the Chief Tax Counsel
  Australian Taxation Office
  GPO Box 9990
  Sydney NSW 2001

Appendix C

Review of Tax Office Management of Part IVC litigation

Appendix 5: Commonwealth's obligation to act as a model litigant — old and new versions

A.5.1 This appendix contains copies of the old and new versions of the model litigant rules.

A.5.2 The old (pre 1 March 2006) version of these rules is as follows:

Directions on the Commonwealth's obligation to act as a model litigant — Pre 1 March 2006 Version[164]

1. Consistently with the Attorney-General's responsibility for the maintenance of proper standards in litigation, the Commonwealth and its agencies must behave as a model litigant in the conduct of litigation.

Nature of the obligation

2. The obligation requires that the Commonwealth and its agencies act honestly and fairly in handling claims and litigation brought by or against the Commonwealth or an agency by:

(a) dealing with claims promptly and not causing unnecessary delay in the handling of claims and litigation,

(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 litigation, wherever possible,

(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, and

(ii) not contesting liability if the Commonwealth or the agency knows that the dispute is really about quantum,

(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.

Notes:

1. The obligation applies to litigation (including before courts, tribunals, inquiries, and in arbitration and other alternative dispute resolution processes) involving Commonwealth Departments and agencies, as well as Ministers and officers where the Commonwealth provides a full indemnity in respect of an action for damages brought against them personally. Ensuring compliance with the obligation is primarily the responsibility of the agency which has responsibility for the litigation. In addition, lawyers engaged in such litigation, whether Australian Government Solicitor, in-house or private, will need to act in accordance with the obligation and to assist their client agency to do so.

2. In essence, being a model litigant requires that the Commonwealth and its agencies, as parties to litigation, act with complete propriety, fairly and in accordance with the highest professional standards. The expectation that the Commonwealth and its agencies will act as a model litigant has been recognised by the Courts. See, for example, *Melbourne Steamship Limited v Moorhead (1912)* 15 CLR 133 at 342; *Kenny v State of South Australia (1987)* 46 SASR 268 at 273; *Yong Jun Qin v The Minister for Immigration and Ethnic Affairs* (1997) 75 FCR 155.

3. The obligation to act as a model litigant may require more than merely acting honestly and in accordance with the law and court rules. It also goes beyond the requirement for lawyers to act in accordance with their ethical obligations.

4. The obligation does not prevent the Commonwealth and its agencies from acting firmly and properly to protect their interests. It does not therefore preclude all legitimate steps being taken to pursue claims by the

where it is necessary to avoid prejudice to the interests of the Commonwealth or an agency pending the receipt or proper consideration of legal advice, provided that a decision whether to continue the appeal is made as soon as practicable. In certain circumstances, it will be appropriate for the Commonwealth to pay costs (for example, for a test case in the public interest.)

NOTE 5. The obligation does not prevent the Commonwealth from enforcing costs orders or seeking to recover its costs.

Merits review proceedings

3. The obligation to act as a model litigant extends to agencies involved in merits review proceedings.

4. An agency should use its best endeavours to assist the tribunal to make its decision.

NOTE. The term 'litigation' is defined in paragraph 15 of these Directions in terms that encompass merits review before tribunals. There are particular obligations in relation to assisting a tribunal engaged in merits review to arrive at a decision. Agencies should pay close attention to the legislation under which a tribunal is established, and any practice directions issued by the tribunal. In the case of the Administrative Appeals Tribunal see in particular subsection 33(1AA) of the *Administrative Appeals Tribunal Act 1975* and the explanatory memorandum to the Administrative Appeals Tribunal Amendment Bill 2005.

Alternative dispute resolution

5. When participating in alternative dispute resolution, the Commonwealth and its agencies are to:

(a) participate fully and effectively, and

(b) wherever practicable, ensure that their representatives have authority to settle the matter, or at least clear instructions on the possible terms of settlement that would be acceptable to the Commonwealth, so as to facilitate appropriate and timely resolution of a dispute.

NOTE 1. When participating in alternative dispute resolution processes, regard is still to be had to the requirements for settling major claims under paragraph 4.4 and Appendix C. In practical terms, this may mean that a representative attending an alternative dispute resolution process may not be able to be given authority to settle a matter to finality. This is to be made clear to the other party when discussing the use of this process.

NOTE 2. Agencies are encouraged to develop dispute management plans addressing the place of litigation and alternative strategies in addressing disputes.

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[164] Attorney-General, Legal Services Directions, Appendix B, issued pursuant to section 55ZF of the Judiciary Act 1903, with effect from 1 September 1999. The directions are available on the Attorney-General's web site at www.ag.gov.au.

[165] Attorney-General, *Legal Services Directions*, Appendix B, issued pursuant to section 55ZF of the *Judiciary Act 1903*, with effect from 1 March 2006.

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Commonwealth and its agencies and testing or defending claims against them. The commencement of an appeal may be justified in the public interest where it is necessary to avoid prejudice to the interests of the Commonwealth or an agency pending the receipt or proper consideration of legal advice, provided that a decision whether to continue the appeal is made as soon as practicable.

5. The obligation does not prevent the Commonwealth from enforcing costs orders or seeking to recover its costs.

A.5.3 The new post 1 March 2006 version of the model litigant rules is as follows.

Directions on the Commonwealth's obligation to act as a model litigant — Post 1 March 2006 Version[165]

The obligation

1. Consistently with the Attorney-General's responsibility for the maintenance of proper standards in litigation, the Commonwealth and its agencies are to behave as model litigants in the conduct of litigation.

Nature of the obligation

2. The obligation to act as a model litigant requires that the Commonwealth and its agencies act honestly and fairly in handling claims and litigation brought by or against the Commonwealth or an agency by:

> (a) dealing with claims promptly and not causing unnecessary delay in the handling of claims and litigation
>
> (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, and

(ii) not contesting liability if the Commonwealth or the agency knows that the dispute is really about quantum

(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.

NOTE 1. The obligation applies to litigation (including before courts, tribunals, inquiries, and in arbitration and other alternative dispute resolution processes) involving Commonwealth Departments and agencies, as well as Ministers and officers where the Commonwealth provides a full indemnity in respect of an action for damages brought against them personally. Ensuring compliance with the obligation is primarily the responsibility of the agency which has responsibility for the litigation. In addition, lawyers engaged in such litigation, whether Australian Government Solicitor, in-house or private, will need to act in accordance with the obligation and to assist their client agency to do so.

NOTE 2. In essence, being a model litigant requires that the Commonwealth and its agencies, as parties to litigation, act with complete propriety, fairly and in accordance with the highest professional standards. The expectation that the Commonwealth and its agencies will act as a model litigant has been recognised by the Courts. See, for example, *Melbourne Steamship Limited v Moorhead* (1912) 15 CLR 133 at 342; *Kenny v State of South Australia* (1987) 46 SASR 268 at 273; *Yong Jun Qin v The Minister for Immigration and Ethnic Affairs* (1997) 75 FCR 155.

NOTE 3. The obligation to act as a model litigant may require more than merely acting honestly and in accordance with the law and court rules. It also goes beyond the requirement for lawyers to act in accordance with their ethical obligations.

NOTE 4. The obligation does not prevent the Commonwealth and its agencies from acting firmly and properly to protect their interests. It does not therefore preclude all legitimate steps being taken to pursue claims by the Commonwealth and its agencies and testing or defending claims against them. It does not preclude pursuing litigation in order to clarify a significant point of law even if the other party wishes to settle the dispute. The commencement of an appeal may be justified in the public interest

Australian Government
Australian Taxation Office

Practice Statement Law Administration

PS LA 2007/12

SUBJECT: **Conduct of Tax Office Litigation in Courts and Tribunals[1]**

PURPOSE: **To advise of policies and guidelines to be followed in the conduct of ATO Litigation**

Refer to end of document for amendment history. Prior versions can be obtained from the PTI & Public Rulings Branch if required.

FOI status: may be released

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This practice statement is issued under the authority of the Commissioner of Taxation and must be read in conjunction with Law Administration Practice Statement PS LA 1998/1. It must be followed by Tax Office staff unless doing so creates unintended consequences or is considered incorrect. Where this occurs Tax office staff must follow their business line's escalation process.

STATEMENT

Tax Office approach and philosophy to litigation

1. The Tax Office conducts and manages its litigation in accordance with its obligations under the law, the Attorney-General's *Legal Services Directions 2005* (in particular the Model Litigant Obligation), relevant Court and Tribunal rules and directions, and other relevant internal and external policies and guidelines. The Tax Office strives to have all disputes brought to finality in a fair, timely and equitable manner consistent with the law. In taxation disputes, the Tax Office argues its cases consistently with its published view of the tax law. The Tax Office recognises that recourse to the Courts and Tribunals not only provides final, fair and independent resolution of disputes, it will in some cases, achieve law clarification benefits for Government and the community.

2. This practice statement should be read in conjunction with the following:

- PS LA 2005/22 Litigation and priority technical issues
- PS LA 2007/2 Management of Decisions of Courts and Tribunals
- PS LA 2007/15 Briefing Counsel
- PS LA 2007/16 Risk Management in litigation
- PS LA 2007/17 Tax technical litigation in the Administrative Appeals Tribunal
- PS LA 2007/18 Tax technical litigation in Federal Court matters
- PS LA 2007/19 Tax technical litigation in High Court matters, and
- PS LA 2007/12 Alternative Disputes Resolution in Tax Office disputes and litigation.

Litigation to which this practice statement applies

3. This practice statement applies to all civil litigation in which the Commissioner is a party.

Principles that guide our conduct

4. In conducting litigation the Tax Office is guided by the following principles:

(i) the Commissioner in his statutory functions under the executive arm of government has a role to administer various laws enacted by Parliament, such as those related to taxation and superannuation. Consistent with this, the Tax Office will conduct and manage its litigation as a model litigant in accordance with its obligations under the law, the Attorney-General's *Legal Services Directions 2005* (in particular the model litigant obligation), relevant court and tribunal rules and directions, and other relevant internal and external policies and guidelines

(ii) the model litigant obligation does not prevent the Commissioner from acting firmly

and properly to protect its interests

(iii) the litigation function of the Tax Office will have as its strategic focus the desire to obtain law clarification in a timely way providing greater certainty for the community

(iv) the Tax Office has as an underlying value in its administration, respect for the rule of law. It follows that this value applies in the conduct of litigation, the resolution of disputes and in managing the outcome of judicial decisions

(v) the Tax Office seeks to promote an environment

- where people have a reasonable understanding of their rights and obligations or can readily obtain adequate guidance
- where in practice the law can be complied with voluntarily
- where the law is applied and enforced fairly; and where disputes about the law's operation can be resolved expeditiously.[2]

In keeping with this, the Tax Office respects and supports the rights of taxpayers to access appropriate review processes to achieve final, fair and independent resolution of disputes

(vi) the Tax Office has a continuing commitment to a public interest Test Case Litigation Program through which taxpayers can be provided with financial support in appropriate circumstances to achieve law clarification

(vii) an objective of the Tax Office litigation function is to assist decision makers in making well reasoned and supportable decisions so as to avoid unnecessary litigation

(viii) the Tax Office will argue its cases consistently with Tax Office published views of the law

(ix) in determining the Tax Office view of the law the Tax Office adopts a 'purposive' approach to statutory construction, consistent with the statutory requirement[3] and guidance of the High Court[4]. For practical purposes this means that where the words of the Act and their statutory context allow, a view of the law that reflects the underlying policy is preferred.

(x) the Tax Office will risk assess litigation cases to ensure that cases are appropriately managed. All cases will have appropriately capable teams marshalled to conduct litigation. In particular, cases that will examine 'priority technical issues' will be identified and escalated in accordance with corporate practice guidelines

(xi) the Tax Office will be consistent, yet vigorous, firm and efficient in the conduct of litigation. Where possible and appropriate, emphasis will be placed on resolving disputes through consultation, negotiation, mediation and formal alternative dispute resolution process available through tribunals and courts to avoid unnecessary litigation

(xii) the Tax Office aims to resolve disputes in a fair and timely manner, consistent with the law

(xiii) consistent with the model litigant obligation, the Tax Office aims to handle its cases efficiently and effectively in accordance with its responsibility to the community to deal responsibly with public revenue and also to fulfil their responsibilities to other litigants and the justice system

(xiv) the Tax Office will not adopt an unnecessarily adversarial approach particularly in

tribunal matters where the taxpayer is unrepresented

(xv) the Tax Office will show appropriate deference to the decisions of Courts and quasi-judicial decisions, but reserves the right to exercise appeal rights and review and clarify the law through litigation consistently with the model litigant obligation

(xvi) the Tax Office will foster effective relationships with the courts, tribunals and other parts of the legal system

(xvii) the Tax Office will foster a close working relationship with the Attorney-General's department

(xviii) the Tax Office will seek to gain value for money from the provision of external legal services, and

(xix) Tax Office staff will have the range of skills and competencies appropriate to support its litigation strategy.

EXPLANATION

External rules, policies and guidelines

Court and Tribunal rules

5. All Tax Officers must follow the various rules and practice directions of the relevant Court or Tribunal in which the proceedings are held.

6. Rules and practice directions of the various Courts and Tribunals are set out on their web sites and must be reviewed and understood by the litigation team, particularly the Legal Services Branch (LSB) officers. These include:

- Practice Directions of the Administrative Appeals Tribunal
- Rules of the various State Courts
- Rules of the Australian Industrial Relations Commission
- Rules and Practice Directions of the Federal Court, and
- Rules of the High Court.

7. Of particular importance is the requirement under subsection 33(1AA) of the *Administrative Appeals Tribunal Act 1975* which requires decision-makers to use their *best endeavours* to assist the Tribunal to make the 'correct and preferable' decision according to law in the proceedings. The object of the requirement is to allow the Tribunal to conduct its reviews as efficiently as possible.

Legal Services Directions

8. The *Financial Management and Accountability Act 1997* (FMA Act) provides a framework for the proper management of public money and public property. As a Commonwealth agency, the Commissioner has a responsibility under section 44 of the FMA Act to promote efficient, effective and ethical use of Commonwealth resources. This includes a responsibility to properly manage the spending of public money on legal services.

9. The Attorney-General has issued (under section 55ZF of the *Judiciary Act 1903*) the *Legal Services Directions 2005* (the Legal Services Directions) which are legally binding on agencies, including the Tax Office, subject to the FMA Act (called FMA Agencies) on a number of issues, including:

- Tied Areas of Commonwealth Legal Work
- The Commonwealth's Obligation to Act as a Model Litigant
- Handling Monetary Claims
- The Engagement of Counsel, and
- Assistance to Employees for Legal Proceedings.

The Legal Services Directions and information about the Directions can be accessed from www.ag.gov.au/olsc.

10. The Directions help to ensure that Commonwealth agencies receive consistent and well coordinated legal services that are of a high standard, that uphold the public interest and that are sensitive to their context of Commonwealth interests which are broader than any one agency.

11. LSB officers must have a detailed understanding of the Legal Services Directions and ensure that they are followed by all members of the litigation team including all tax officers and any external legal providers.

Obligation to act as a model litigant

12. The Attorney-General, as First Law Officer, is responsible for the maintenance of proper standards in Commonwealth litigation and accordingly requires that the Commonwealth behave as a model litigant in the conduct of its litigation. The requirement for Government litigants to act as model litigants is set out in Appendix B to the Legal Services Directions. The Directions largely restate duties and codes of behaviour that have always been expected of government and its agencies by the courts.[5]

13. In essence, being a model litigant requires that the Commonwealth, as a party to litigation, acts with propriety, fairness and in accordance with the highest professional standards. The obligation applies to the handling of civil claims and litigation before the Courts, Tribunals, Inquiries and in Alternative Dispute Resolution processes. The model litigant obligation requires Commonwealth litigants to handle their cases efficiently and effectively in accordance with their responsibility to the community to deal responsibly with public revenue and also to fulfil their responsibilities to other litigants and the justice system.

14. The obligation to act as a model litigant does not prevent the Commonwealth from acting properly to protect the Commonwealth's interests. It does not therefore preclude the Commonwealth from taking all legitimate steps in pursuing claims by it and testing or defending claims against it.[6] The obligation not to pursue an appeal without reasonable prospects of success is not intended to prevent the Commonwealth from lodging notice of appeal to assess whether or not to pursue the matter. It does not preclude pursuing litigation in order to clarify a significant point of law even if the other party wishes to settle the dispute. The commencement of an appeal may be justified in the public interest where it is necessary to avoid prejudice to the interests of the Commonwealth or an agency pending the receipt or proper consideration of legal advice, provided that a decision whether to continue the appeal is made as soon as practicable.[7]

15. The model litigant obligation is to be drawn to the attention of counsel acting on behalf of the Commonwealth so that they understand the standards required of them.

Counsel to comply with their taxation obligations

16. All counsel briefed directly by the Tax Office or on its behalf, must understand that they are required to comply with their taxation obligations. Any issues which arise out of this obligation must be discussed between Counsel and the LSB officer prior to the acceptance of the brief.

17. As of 1 March 2006, the new clause 4A of Appendix D of the Legal Services Directions mandates that:

A brief issued to counsel is to contain a condition that, in accepting the brief, counsel is taken to warrant that he or she has not, at any time, been declared bankrupt, unless counsel advises of any such bankruptcy.

18. Thus, all direct briefs and all briefs delivered by an external legal provider on behalf of the Tax Office must contain the following paragraphs: *The Attorney-General has made it clear to all Commonwealth Departments and Agencies that it is expected that the Commonwealth will not engage counsel who use insolvency as a means of avoiding tax. In accordance with paragraph 4A of Appendix D of the Legal Services Directions 2005, counsel is taken to warrant, unless he or she advises to the contrary, that he or she has not, at any time, been declared bankrupt. Additionally, the Commissioner of Taxation does not wish to engage Counsel who are not complying with their taxation obligations. If you have any concerns about these requirements or wish to discuss any aspect of them please do not hesitate to contact your instructor.*

Breach of the Legal Services Directions

19. The Office of Legal Services Co-Ordination (OLSC) is part of the Attorney-General's Department, and is responsible for monitoring possible breaches of the Legal Services Directions, including the model litigant obligation. They do this in a number of ways, including:

- by monitoring reports of case law and tribunal decisions
- by receiving reports from agencies and legal service providers
- from courts and tribunals, and
- by receiving complaints from other parties to litigation involving the Commonwealth.

20. Paragraph 11.1(d) of the Legal Services Directions provides that the Chief Executive of an FMA agency is responsible for ensuring that 'the agency gives reports as soon as practicable to the Attorney-General or OLSC about any possible or apparent breaches of the Directions by the agency, or allegations of breaches by the agency of which the agency is aware, and about any corrective steps that have been taken or are proposed to be taken, by the agency'. The Chief Executive of an FMA agency is responsible for giving to OLSC, within 60 days after the end of each financial year, a certificate setting out the extent to which the Chief Executive believes there has been compliance by the agency with the Directions.

21. Guidance Note 3 of 2006 (guidance on reporting breaches of the Directions) and Guidance Note 4 of 2006 (guidance about the investigation of breaches) issued by OLSC[8] can be found on the Attorney-General's website at www.ag.gov.au/olsc.

Internal escalation process for breaches of the Legal Services Directions

22. The Commissioner reports breaches of the Legal Services Directions to OLSC via the ATO General Counsel.

23. A complaint received about our conduct or any instance where a Tax Officer is aware of a breach or an allegation of a breach by the Commissioner of the Legal Service Directions, should be reported to the ATO General Counsel. The ATO General Counsel will ensure that the allegation is investigated, and where appropriate provide a report to OLSC.

APS Values and the Code of Conduct

24. Sections 10 and 13 of the *Public Service Act 1999* set out the Australian Public Service (APS) Values and Code of Conduct. They are supported by the Public Service Commissioner's Directions. All APS employees are required to uphold the APS Values and comply with the Code of Conduct, with sanctions available for breaches of the Code. Agency Heads and members of the Senior Executive Service are required to promote and uphold the APS Values.

25. The APS Values and Code of Conduct cover all APS employees and Agency Heads. The principles set out give guidance on personal behaviour as well as on relationships and behaviours between:

- APS employees and the Government and the Parliament

- APS employees and the public, and
- APS employees and colleagues in the workplace

26. A publication of the Australian Public Service Commission *APS Values and Code of Conduct in practice* assists APS employees to understand the practical application of the APS Values and Code of Conduct in both common and unusual circumstances. The publication is a guide not a rulebook. It provides a useful summary of important legal requirements across the APS, although it does not attempt to be comprehensive.

Internal policies and guidelines

27. There are a number of internal Tax Office policies and guidelines which are relevant to the conduct of litigation. All tax officers should be aware of and consider the application of these policies and guidelines to the litigation. These policies and guidelines include:

- Panel firm or AGS/ATO Memorandum of Understanding
- Legal Services Branch Bulletins
- Corporate Management and Law Administration Practice Statements
- Taxpayers' Charter
- Code of Settlement Practice
- Access and Information Gathering Manual, and
- Public Rulings, Determinations and Bulletins.

Exceptions to the usual rules and complaints

28. These policies and guidelines are to be followed by those representing the Commissioner in litigation at all times. However, where following these policies and guidelines produce an anomalous or unintended result (and it is expected that such occasions will be rare), approval must be sought from the relevant LSB Stream Leader or a member of the LSB Executive.

29. Complaints, other than those related to the Attorney General's Legal Services Directions referred to at paragraphs 19 to 21, received from taxpayers or their representatives that our conduct in litigation has fallen short of acceptable standards, should be considered by a senior officer, usually the relevant LSB Stream Leader or a member of the LSB Executive.

Litigation in the Tax Office

30. LSB has corporate responsibility for legal services in the Tax Office. Access to any legal services must go through LSB. As LSB is the central point of reference in respect of all legal work where the Tax Office is using external legal providers (other than prosecutions work), all requests seeking the services of external legal providers must go to LSB.

Working as a team

31. Litigation is handled by several people working together as a team. The team may vary from time to time, but an LSB officer and a business line officer will always be a part of each team. Depending on the case, the litigation team might also include a Tax Counsel Network officer, a business line officer, an officer from the relevant Centre of Expertise (CoE), and an external legal service provider. Presently, the range of external legal service providers available to the Tax Office consists of the Australian Government Solicitor (AGS), legal service providers on any Tax Office panel (such as the Debt Litigation panel, General Law panel and Tax Technical Litigation and Tax Legal Advice panel), and counsel.

32. The following is a general outline of the individual roles of each member of the litigation team. It is meant to provide guidelines rather than be prescriptive. The team must work collaboratively to ensure that the litigation team works together to achieve the best possible outcome.

The role of LSB in tax litigation

33. 'Tax litigation' includes all litigation undertaken under Part IVC of the *Taxation Administration Act 1953* (TAA), declaratory proceedings brought in any court that will directly affect the taxation liability of a taxpayer, and judicial review under the *Administrative Decisions (Judicial Review) Act 1977* or section 39B of the *Judiciary Act 1903* in relation to any decision made under the Income Tax Assessment Acts, or the TAA. It does not include, for example, employment related litigation or commercial litigation.

34. LSB manages the Tax Office's litigation program. It provides legal and strategic advice through in-house teams of LSB officers. It manages access to external legal service providers, and is primarily responsible for managing legal risks to the Commissioner.

35. LSB is responsible for all appearance work and related advice on legal process and risks, all matters under Part IVC of the TAA, debt matters requiring legal representation, administrative law matters, employment law, commercial law, compensation, other related legal advice and appearance work (except prosecutions), and managing the Test Case Litigation Program.

36. LSB is the central point of reference for all legal work undertaken for the Tax Office by external legal providers. LSB is the conduit for the exchange of any information between the Tax Office and the external legal service provider. LSB provides a single point of contact so that conflicting Tax Office messages are not given.

37. LSB is the central liaison point for the litigation team. Contact with the external legal service provider other than through LSB should be avoided as much as possible. If contact without LSB is unavoidable then the LSB officer and other litigation team members are to be informed and provided with copies of all relevant documents without delay.

38. The LSB officer must ensure that where Tax Counsel is involved, that Tax Counsel is kept fully informed of all important actions arising in the course of litigation. Tax Counsel will be involved where the matter is a strategic litigation matter, or if the matter relates to an existing priority technical issue.[9]

39. The LSB officer will ensure that Tax Counsel is informed of the specific technical issues arising during the course of litigation and provide ample opportunity for Tax Counsel to comment on the technical arguments in the case. Tax Counsel will be the final decision maker on the technical arguments to be run.

40. Where Tax Counsel is not involved in litigation, LSB will be the final decision maker on all issues arising in the course of the litigation, including the technical argument and issues relating to the conduct of the litigation, such as the litigation strategy or issues concerning Court or Tribunal processes. Although the business line officer will be consulted, the decision will ultimately rest with LSB. If members of the litigation team cannot resolve an issue, it must be escalated to the relevant Senior Tax Counsel (Strategic Litigation) [10] or an Assistant Commissioner, Litigation. Depending on the significance of the issue, it may need to be escalated to the Chief Tax Counsel or the Deputy Chief Tax Counsel.

41. Generally, the LSB officer will:

- provide legal and litigation support
- provide advice on the admissibility and the extent of the factual evidence available to support the Tax Office view
- identify any technical or procedural issues that require further discussion and development by or with Tax Counsel
- ensure that any matters requiring the advice of Tax Counsel are supported with sufficient information and documentation to enable an informed decision to be made

- ensure that Tax Counsel is invited to any conference with counsel that is directed towards technical arguments or important directions of the case
- provide assistance to Tax Counsel on the refinement and presentation of the Tax Office view
- ensure that Tax Office policies and procedures are followed, for example that we do not argue inconsistently with views expressed in public rulings or taxation determinations, and
- ensure that the Tax Office operates as a model litigant.

42. During the conduct of a matter, there will be mutual feedback on any performance or resource issues that arise, and issues should be escalated appropriately.

Strategic litigation

43. The strategic litigation program represents those cases regarded by the Tax Office as being of the greatest importance in terms of law clarification. There are three Senior Tax Counsel providing leadership in strategic litigation, two with responsibility for income tax issues and one with responsibility for indirect tax issues. Strategic litigation may arise from any of the streams in the LSB. The relevant Senior Tax Counsel may either directly undertake the conduct of, or closely monitor, strategic litigation cases, with or without other Tax Counsel involvement.

44. Issues identified for strategic litigation will ordinarily be identified through various risk management actions (see PS LA 2007/16 Risk Management in litigation) or through the Priority Technical Issue process (see PS LA 2005/22 Litigation and priority technical issues). The escalation processes set out in the practice statements will ensure that strategic litigation is referred to one of the relevant Senior Tax Counsel (Strategic Litigation). The Senior Tax Counsel (Strategic Litigation) will be required to report to PTIC on the progress of strategic litigation. Relationship management is a key aspect of strategic litigation.

45. A Strategic Litigation team located in LSB provides support to the Senior Tax Counsel (Strategic Litigation) to ensure that the highest priority litigation is identified, reported and managed corporately. The primary responsibility of the relevant Senior Tax Counsel (Strategic Litigation) is technical leadership and management of strategic litigation.

The role of LSB in non-tax litigation

Debt

46. The Debt Stream within LSB is responsible for litigation relating to the Tax Office collection of tax revenue and insolvency matters, under the laws administered by the Commissioner or other relevant legislation such as the *Corporations Act 2001* and the *Bankruptcy Act 1966* . This includes representing the Commissioner in Court, briefing counsel, and negotiating and settling matters such as company wind ups (and substitutions), creditors petitions, defended debt matters, and voidable preference claims.

Commercial law

47. The ATO General Counsel in LSB is responsible for the provision of expert advice and litigation services in respect of commercial law issues affecting the Tax Office. The commercial law group within LSB deals with issues arising out of contracts (for Information Technology services and goods procurements), tendering and procurement processes and associated administrative law issues, intellectual property rights and real property. The group also provides advice on procurement related corporate management practice statements and other corporate guidelines.

48. External legal advice on commercial law issues must be obtained through the commercial law team. The commercial law team leader is the LSB relationship manager between LSB and Corporate Procurement and Facilities (including Comcover).

Employment law

49. The employment law group deals with issues arising form the Tax Office's relationship with its employees. These issues include litigation relating to termination of employment, industrial disputes and litigation arising from discrimination claims against the Tax Office. Litigation is usually conducted in the Australian Industrial Relations Commission (AIRC), Federal Court, Human Rights and Equal Opportunity Commission and other courts of appeal. The employment law group also provides advice on all aspects of employment, industrial and discrimination law issues as they affect the Tax Office.

The role of tax counsel in litigation

50. Tax Counsel Network (TCN) is a national network of highly skilled tax technical officers. The role of TCN is to provide technical leadership for the Tax Office. TCN works with the business lines and CoE (where appropriate) to resolve the Tax Office's key significant issues. The responsibility for formulating the ATO view on these significant issues rests with TCN. This can involve TCN working on strategic litigation, especially where the Tax Office view on a priority technical issue (PTI) is under challenge.

51. Once a litigation matter has been risk assessed and it is decided that it warrants being a PTI (or is related to an existing PTI), Tax Counsel will have the final say as to the Tax Office view and the preparation of arguments. Usually, once a Tax Counsel becomes involved, they will have an on-going role throughout the litigation process. The level of involvement of Tax Counsel may vary from case to case and from milestone to milestone (for example when the Appeal Statement is being drafted, or when submissions are being settled). This will ultimately be at the discretion of Tax Counsel, who should work collaboratively with other members of the team, and ensure that the skills and expertise of the other members are fully utilised.

52. Tax Counsel has an important role in strategic litigation matters. They will ensure that:

- the coherent fabric of the law is maintained and an interpretation of the law will not be pursued where it is not consistent with this principle, and
- cases are prepared and presented in a way that best enables the Tax Office view to be presented to court.

53. Tax Counsel will have the final say in technical arguments arising in litigation. Tax Counsel will also contribute to the management of the wider risk associated with the PTI.

54. Written instructions to external counsel should always be signed off by Tax Counsel, especially where:

- the instruction is to make arguments not previously contemplated *by the Tax Office*
- action is being taken that is contrary to the advice of counsel, or
- there is disagreement between senior officers of the Tax Office regarding the arguments or the strategy put before counsel.

Any such directions provided by Tax Counsel to the LSB officer should be forwarded immediately to the external legal service provider (where they are involved) for the instruction of counsel.

55. Tax Counsel will consult with the CoE on the level of assistance required from the CoE in the conduct of the litigation, having regard to the assistance already available from the business line, LSB and the external solicitor.

The role of the Chief Tax Counsel and Deputy Chief Tax Counsels in litigation

56. The Chief Tax Counsel, the various Deputy Chief Tax Counsels, and ultimately the Second Commissioner (Law) have the final say in all tax technical issues argued in litigation. Special Leave applications to appeal to the High Court will be decided by the Chief Tax Counsel. The decision whether or not to appeal an adverse decision will usually be made by the relevant Deputy Chief Tax Counsel or if necessary, the Second Commissioner (Law) on the recommendation of one of the relevant Senior Tax Counsel (Strategic Litigation), Tax Counsel allocated to cases act on the authority of the Deputy Chief Tax Counsels.

The role of the business lines in litigation

57. Generally, throughout the litigation process, the business line will be responsible for managing the risk associated with the case and dependent cases.

58. The business line has the responsibility of providing a complete and comprehensive statement of facts which cross-references to supporting evidence. This will assist LSB, Tax Counsel or the CoE to ensure that the Tax Office view has been correctly applied.

59. Tax Counsel or LSB are responsible for determining the Tax Office view. It is not determined by the business line.

60. The business line has a continuous role throughout the course of litigation. Where the business line has collected the facts at the audit and objection stage, it will have an expertise in the knowledge of the location of documents and the underlying facts. The business line will support the litigation process with that knowledge. The business line is responsible for issuing assessments and amended assessments, and will harness the corporate expertise to ensure the accuracy of assessments issued before and after the litigation process has commenced.

61. The business line will have an integral role in identifying whether or not an issue arising from litigation is a PTI. The business line will make an assessment of the risks posed to the Commissioner which arise from the litigation. This necessarily requires an understanding of not only the 'legal' or 'technical' issue but also of the business context in which it arises, its impact in terms of numbers of taxpayers affected, the revenue at risk and the implications for government and the community as a whole. The business line is responsible for managing this risk.

62. At the commencement of the litigation process, the business line must assess (or review) the risk in relation to the litigation and the underlying technical issue (with input from LSB in relation to the legal risks which could arise). If it is determined that the case and/or underlying issue warrants a PTI, the business line must prepare a PTI proposal and escalate it in accordance with its normal PTI procedures to the relevant Deputy Chief Tax Counsel.

63. If the business line requires assistance to decide whether the underlying technical issue of a case should be classified as a PTI, the business line can ask the relevant Deputy Chief Tax Counsel to have Tax Counsel allocated to assist in determining whether or not a PTI is warranted.

64. The business line (with the assistance of other members of the litigation team where required) will be responsible for developing a strategy to explain and manage the implications of the Court decision, and the associated compliance impact. See PS LA 2007/2 for details on the corporate approach to dealing with the risks to the Commissioner arising from Court and Tribunal decisions.[11]

The role of external solicitors in litigation

65. Legal services may be provided by external solicitors on the relevant Tax Office panel in the conduct of litigation to which the Commissioner is a party. Solicitors acting for the Commissioner are expected to assist the Commissioner in the conduct of litigation to achieve a timely and appropriate resolution of the particular dispute. This may result in law clarification which provides greater certainty for the community about the law. A solicitor acting for the Commissioner will provide legal services in the conduct of litigation consistent with the professional and ethical standards expected of a solicitor practising in the relevant State or Territory.

66. As the solicitor will have direct dealings with taxpayers or their representatives it is expected that the solicitor will also conduct him or herself consistently with the standards of conduct expected of a tax officer. In particular the solicitor must:

- comply with the Legal Services Directions made by the Attorney-General for the conduct of litigation by Commonwealth Departments and Agencies
- if the solicitor becomes aware of, or suspects, a breach of the Attorney-General's Legal Services Directions, notify the LSB officer immediately of that breach or suspected breach and advise on any possible actions that would minimise the

impact of that breach

- comply with the tax law secrecy provisions, and
- avoid conflicts of interest and where one arises, advise the Tax Office immediately.

67. The solicitor will provide general legal services, including advice on the selection of external counsel, drafting and filing Court and Tribunal documents, advise on the adequacy and admissibility of evidence, advise on court requirements and procedures, and undertake advocacy where appropriate.

68. The solicitor needs to clearly understand the requirements of the Commissioner in the conduct of the case, and to relay those requirements to counsel. Thus, it is vital that clear and specific instructions are provided from the LSB officer to the solicitor. In turn, the solicitor is expected to advise the Tax Office of views provided by counsel on the case and any developments in the court timetable.

69. There is a category of legal work which cannot be undertaken by any other external legal service provider but tied legal services providers.[12] This relates to 'tied work' which must be briefed directly to AGS outside of its membership of any panel of external legal service providers. 'Tied work' as defined by the Legal Services Directions comprises areas of government legal work relating to:

Category	**Tied provider**
Constitutional issues	AGS
National security issues	AGS
Legal advice to be considered by Cabinet or relied on in preparing a Cabinet submission or memorandum	AGS
Legal advice on a legislative proposal to be considered for adoption by government or on draft legislation for introduction into Parliament	AGS
Public international law work **(a)** International litigation and arbitration (Government to Government) **(b)** Advice involving Australia's or another country's obligations under international law **(c)** Advice on treaty implementation **(d)** Advice on implementing a treaty (including bilateral agreements) **(e)** Domestic litigation involving a significant public international law issue	**(a)** AGS, AGD[13], DFAT[14] **(b)** AGS, AGD, DFAT **(c)** AGS, AGD, DFAT **(d)** AGS, AGD, DFAT **(e)** AGS, AGD
Drafting work	

(a) Drafting government Bills and parliamentary amendments of Bills **(b)** Drafting of regulations, ordinances and regulations of non-self-governing territories and other legislative instruments made or approved by the Governor-General, or published in the Statutory Rules series	**(a)** Office of Parliamentary Counsel **(b)** Office of Legislative Drafting and Publishing in the Attorney-General's Department

The role of the Strategic Internal Litigation Committee

70. A Strategic Internal Litigation Committee (SILC) is to be convened for every litigation matter, and meetings should be convened at all critical stages of litigation. Each SILC meeting has a particular purpose in managing the litigation matter to ensure that the litigation strategy is appropriate and in place:

- Document Preparation SILC
- Instruction SILC
- Pre-hearing SILC
- Post-hearing SILC
- Pre-decision SILC
- Decision SILC
- Post-decision SILC
- Appeal SILC[15]

However, it is recognised that due to the timeframes set by the Courts or Tribunals in particular cases, it is not always possible to convene every SILC for each litigation matter. Good judgment and consultation between the litigation team members is required to ensure continual good management of the case and that key decisions are made collaboratively. The actual SILC can vary depending on the significance of the matter, but will always include an LSB officer and a business line officer. Depending on the particular case, it may also include Tax Counsel and Centre of Expertise officers.

SILC Plan

71. Every litigation matter must have a SILC Plan. A SILC Plan is a document setting out the details and status of a litigation matter, including the litigation strategy and any milestones. The Plan includes amongst other things, a summary of the issues, the Tax Office view and the significance of the matter. The BSL officer is to initially prepare the SILC Plan and provide the document electronically to the LSB officer.

72. The SILC Plan is to be updated by the LSB officer throughout the litigation process, particularly after each SILC meeting. Updated versions of the SILC Plan must be provided to all internal members of the litigation team.

Governance - litigation

73. A corporate level committee (the Priority Technical Issues Committee) chaired by the Chief Tax Counsel provides guidance and direction, and monitors the management of PTIs within the established corporate framework. Litigation forms a part of that framework. LSB also reports to the Law Sub-plan Executive across all litigation work types, including volume trends, resource costs and the amount of revenue at risk. Strategic litigation reports, involving PTI litigation are provided to the Priority Technical Issues Committee.

74. Monthly reports on significant litigation matters are provided to senior management, including the ATO Executive.

75. LSB officers provide monthly assurances on their conduct in litigation on matters including whether the Legal Services Directions have been complied with and whether court time-frames have been met. These monthly assurances are used in the corporate assurance process provided to the Commissioner in the form of a twice yearly Certificate of Assurance.

Date of Issue: 21 June 2007

Date of Effect: 21 June 2007

[1]
Includes reference to Administrative Appeals Tribunal, Small Taxation Claims Tribunal and Australian Industrial Relations Commission.

[2]
C Saunders and K Le Roy, "Perspectives on the Rule of Law", in C. Saunders and K. Le Roy (eds), The Rule of Law (Federation Press, Melbourne, 2003), 5.

[3]
Acts Interpretation Act 1901 (Cth), section 15AA;

[4]
CIC Insurance Ltd v Bankstown Football Club Ltd (1997) 187 CLR 384; Cooper Brookes (Wollongong) Pty Ltd v Commissioner of Taxation (1980) 147 CLR 297 Kirby J in Austin v The Commonwealth (2003) 51 ATR 654, 723-724 said, "That in the case of federal legislation, the purposive principle is supported by the Acts Interpretation Act 1901 (Cth)

[5]
See for example, *Melbourne Steamship v. Moorhead* (1912) 15 CLR 333 at 342, *Kenny v. State of South Australia* (1987) 46 SASR 268 at 273 and *Yon v. The Minister for Immigration and Ethnic Affairs* (1996) 75 FCR 155 at 166.

[6]
See for example *Wodrow v. Commonwealth of Australia* (2003) FCA 403 at paragraph 42.

[7]
Legal Services Directions 2005, Appendix B, Paragraph 2, Note 4

[8]
OLSC issues Guidance Notes in order to assist Australian Government Departments and Agencies to comply with the Legal Services Directions, procure legal services, and deal with legal issues in an efficient and effective manner.

[9]
'Strategic litigation' is defined in paragraph 6 of PS LA 2005/22 Litigation and priority technical issues.

[10]
There are three Senior Tax Counsel involved in strategic litigation, two with responsibility for income tax issues and one with responsibility for indirect tax issues.

[11]
The business line officer will have a role in drafting the Decision Impact Statement and other documents as discussed in PS LA 2007/2.

[12]
Typically AGS, but a full list of tied providers is in Appendix A of the Legal Services Directions.

[13]
Attorney General's Department.

[14]
Department of Foreign Affairs and Trade.

[15]
Details of what is required for each of the SILC's should be outlined in the SILC Plan (see paragraphs 71 and 72 of this practice statement).

Subject References:
Litigation

Legislative References:
AAT Act 1975 33(1AA)
AD(JR) Act 1977
Bankruptcy Act 1966
Corporations Act 2001
FMA Act 1997
FMA Act 1997 44
Judiciary Act 1903 39B
Judiciary Act 1903 55ZF
Public Service Act 1999 10
Public Service Act 1999 13
TAA 1953 Pt IVC
Federal Court Rules Order 52 Rule 4

Related Practice Statements:
PS LA 1998/1
PS LA 2005/22
PS LA 2007/2
PS LA 2007/15
PS LA 2007/16
PS LA 2007/17
PS LA 2007/18
PS LA 2007/19
PS LA 2007/23

Other References
APS Values and Code of Conduct in practice
Legal Services Directions 2005

www.ag.gov.au/olsc

Case References:
Kenny v. State of South Australia
(1987) 46 SASR 268

Melbourne Steamship v. Moorhead
(1912) 15 CLR 333
(1912) 18 ALR 533

Wodrow v. Commonwealth of Australia
[2003] FCA 403

Yon v. The Minister for Immigration and Ethnic Affairs
(1996) 75 FCR 155

ATO references:
File 07/2541

Authorised by:
Bruce Quigley
Second Commissioner (Law)

Other Business Lines Consulted	**All - Ongoing**
Amendment history	**30 January 2008** References to Model Litigant "Guidelines" changed to "Obligation". Relevant practice statements that were subsequently issued included. Paragraph 4 amended to provide clearer articulation of the Tax Office's role in litigation (as distinct from the role of Parliament), include the Tax Office's commitment to resolve disputes consistently with the Rule of Law, and include an explanation of the Tax Office's purposive approach to interpreting the law. References to the new Tax Technical Litigation and Tax Legal Advice panel now available to the Tax Office included. Changes made to remove reference to Strategic Litigation team, and articulate how strategic issues are identified through the risk management strategies and the PTI process.