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EDITORS' NOTE

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Tax Disputes System Design

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1. INTRODUCTION

Seminal dispute resolution theorists Ury, Brett and Goldberg said that: '[D]isputes are inevitable when people with different interests deal with each other regularly.'[1] Echoing this, the current Australian Commissioner of Taxation (the Commissioner), has recently said: '[I]n relation to the application of tax law to complex facts, some level of disputation is inevitable.'[2]

This paper considers the effectiveness of tax dispute resolution processes from a dispute systems design theoretical perspective. Specifically, this paper is divided into three parts. By way of background and in order to provide a context within which to analyse and evaluate, the first part summarises the goals and theoretical framework for dispute systems design, including the fundamental principles for 'best practice' in dispute systems design. The second part outlines the range of current processes

2. DISPUTE SYSTEMS DESIGN THEORETICAL FRAMEWORK

Dispute systems design involves the design and implementation of a dispute resolution system, which is most commonly conceptualised as a series of procedures for dealing with the stream of disputes connected to an organisation or institution, rather than for an individual dispute or an individual procedure.[4]

A number of goals for dispute systems design are apparent from the literature. As Wolski[5] summarises, the central goal is to reduce the costs associated with dispute resolution, where costs are measured by reference to four broad criteria: transaction costs (i.e. money, time and emotional energy expended in disputing), satisfaction with procedures and outcomes, long-term effect of the procedures on the parties' relationship and recurrence of disputes. Dispute systems design also aims to prevent disputes by improving the parties' capability to negotiate differences at a 'pre-dispute' level, that is, before differences escalate into disputes.

Three inter-related theoretical propositions are said to underpin dispute systems design.[6] The first proposition is that dispute resolution procedures can be characterised according to whether they are primarily interests-based, rights-based or power-based in approach. Interests-based approaches focus on the underlying interests or needs of the parties with the aim of producing solutions that satisfy as many of those interests as possible. Rights-based approaches involve a determination of which party is correct according to some independent and objective standard. Power-based approaches are characterised by the use of power, that is, the ability to coerce a party to do something he or she would not otherwise do.[7] Coming back to the underpinning theoretical propositions, the second proposition is that interest-based procedures have the potential to be more cost-effective than rights-based procedures, which in turn may be more cost-effective than power-based procedures. Accordingly, the third proposition is that the costs of disputing may be reduced by creating systems that are 'interests-oriented', that is systems which emphasise interests-based procedures, however recognise that rights-based and power-based procedures are necessary and desirable components.[8]

A number of principles have been put forward for 'best practice' in effective dispute systems design. This paper focuses on the six fundamental dispute system design principles put forward by the seminal theorists Ury, Brett and Goldberg in *Getting*

Principle 1 - Create ways for reconciling the interests of those in dispute

By this, Ury, Brett and Goldberg mean:

> Establish clear negotiation procedures that are easy to follow and bring about negotiation as early as possible;
>
> Design multiple steps in the negotiation procedure, so that the progression to a ‘full-fledged’ dispute is slowed;
>
> Motivate use of the system by creating multiple points of entry, providing negotiators with necessary authority to implement a resolution and preventing retaliation against disputants;
>
> Ensure that there are people that disputants can turn to for help in respect of the negotiation procedures, including a mediator, and make certain that these people are adequately trained in the appropriate skills.[10]

Principle 2 - Build in “loop-backs” that encourage disputants to return to negotiation

By this, Ury, Brett and Goldberg mean:

> Where interests-based procedures do no resolve the dispute and it becomes a rights-based or power-based dispute, design loop-back procedures that allow the disputants time-out to re-assess their position before it becomes too entrenched;
>
> Examples in a rights-based dispute are information procedures in respect of outcomes of previously resolved cases, advisory arbitration or mini-trials;
>
> Examples in a power-based dispute are cooling-off periods or third-party intervention.L@D1ŽL5’%ôvÎvN“&!g-ÀRWv[$ã“ õ“ C¢

Principle 4 - Prevent unnecessary conflict through notification, consultation and feedback

By this, Ury, Brett and Goldberg mean:

> A party taking action likely to affect others should notify and consult them beforehand, so that points of difference can be identified and dealt with early and to prevent disputes;
>
> Allow for analysis and feedback after disputes to overcome systemic problems and to prevent disputes. This may occur at the organisational-level or through establishing a forum for discussion with parties, or by ombudsman or other external monitoring agencies.[13]

Principle 5 - Arrangeand hciduTs 57 T TD.00012Tc.0008 Tw(ei an ow -to-hih nco)7.48(t)3(y shequncie

The ATO is a Federal Government statutory agency that operates under the *Public Service Act 1999* and the *Financial Management and Accountability Act 1997* and acts as the Federal Government's principal revenue collection agency. The Commissioner is the individual office responsible for the general administration of a wide range of tax laws (e.g. income tax, goods and services tax, fringe benefits tax) and is, effectively, the 'head' of the ATO.[16]

Taxpayers are entities (e.g. individuals, trusts, corporations) that have obligations, liabilities and entitlements under the tax laws administered by the ATO.

Tax disputes may arise at any stage after the ATO has provided a view to a taxpayer in respect of a tax liability or entitlement and related issues, and the taxpayer takes a contrary view. Given the self-assessment regime, tax disputes principally arise from the ATO's review and audit activities.[17] Tax disputes typically come within four categories:

a. Complaints;

b. Objections to private binding rulings given to taxpayers on tax-related issues by the ATO;

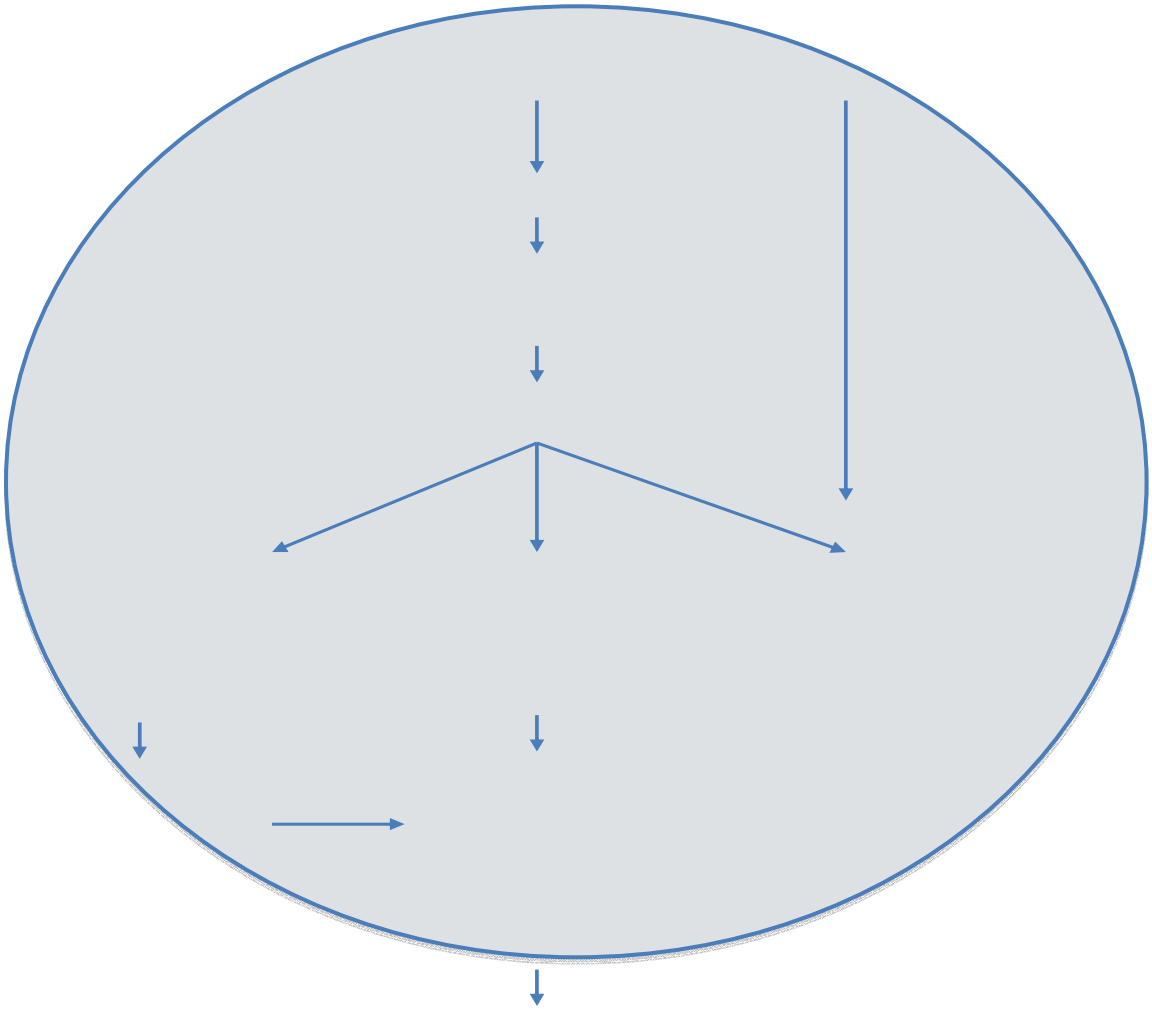
c. Disputes as to facts or the application of tax law by a taxpayer as matters are being assessed by the ATO; and

d. Objections to assessments of liability to tax.[18]

Categories (b) and (d) generally refer to statutory rights, while categories (a) and (c) relate to administrative due process.[19]

5. ATO DISPUTE RESOLUTION MODEL

The current processes available for tax dispute resolution in Australia is comprehensive and essentially consists of



Finally, a taxpayer dissatisfied with assessments or certain types of other decisions[28] made by the ATO may also challenge the decision in accordance with the formal objection procedures in Part IVC of the *Taxation Administration Act 1953*. Again, the

hallmarks of when the ATO's par

Effectiveness against principle 2 - Build in "loop-back" procedures that encourage disputants to return to negotiation

The ATO dispute resolution model provides for loop-backs to negotiation in that the

from the taxpayer's perspective, it would be necessary to have their position worked out and require substantial input/costs to do this from the outset.[56]

Also, given the ATO's abovementioned settlement restrictions and that the taxpayer bears the burden of proof, depending on the type of tax dispute and the profile of the taxpayer, taxpayers will often move straight to the apparently higher-cost, rights-based procedures due to the belief that it would be necessary to do this in any case to reach a definitive outcome.

Again, depending on the type of dispute and profile of the taxpayer, taxpayers would most likely also engage a professional advisor from the outset given the complexity of the tax law. Professional advisor fees, if incurred, would represent the bulk of explicit costs to taxpayers.[57]

It is also noteworthy that it is well-recognised in the literature on tax compliance costs that the implicit costs (i.e. opportunity costs of time) and psychological costs (stress, frustration and anxiety) are also high at all levels.[58]

So, in short, the cost difference between the levels then essentially comes down to the type of dispute, the profile of the taxpayer, whether a professional advisor is engaged and, if recourse to the courts is available, the differences in application/filing costs between the AAT or Federal Court. For a small taxpayer, there may be a noticeable increase in costs at each level particularly if they do not engage a professional advisor and pursue informal procedures or recourse to the AAT. However, rather than increasing the pressure for a negotiated outcome at an early stage, this may rather form a deterrent for small taxpayers pursuing tax disputes at all and therefore a barrier to social justice.[59] For large taxpayers, whatever the minimal difference in costs to them between the levels is unlikely to increase the pressure for a negotiated outcome and deciding which recourse to pursue is most likely to be a strategic-based and commercial decision rather than costs-based.

Effectiveness against principle 4 - Prevent unnecessary conflict through notification, consultation and feedback

Notification is built into the ATO dispute resolution model. As the Taxpayers' Charter reflects, various conduct obligations require the ATO to clearly stipulate its decisions and what actions it is taking in relation to a taxpayer's affairs, and provide an explanation of its reasons, including the primary sources and factual information on which these are based. As mentioned above, the ATO informs the taxpayer of their compliance obligations in relation to decisions made, and must adhere to certain timeframes around notification.

[56] Bentley, n48 above, 40.
[57] B Tran-Nam and M Walpole, "Independent Tax Dispute Resolution and Social Justice in Australia", (2012), vol. 35, no.2 *UNSW Law Journal* 470, 488.
[58] Tran-Nam, n58 above, 487, 489-490.
[59] Tran-Nam, n58 above, 487–489, 491-492, 492-498.

Although not a feature of the ATO model per se, other ATO initiatives such as the Compliance Program (where the ATO details its 'target areas' and planned compliance activities for the forthcoming year) and Decision Impact Statements (where the ATO sets out its views and implications for taxpayers, in a broader sense, following discrete litigation outcomes) serve as a form of notification. The ATO's wider shift in focus to a 'risk differentiation framework' for classifying taxpayers and invitation for taxpayers to make voluntary disclosures in the course of ATO compliance activities[60] also allow identification of issues and points of difference in the pre-dispute stage.

Consultation is implicit in the ATO model as most ATO interaction with taxpayers and/or their professional advisers in the lead-up to the making of a decision involves exchanges of information, views and often, informal discussion/meetings.[61] Consultation also occurs at a systemic level through consultative forums established by the ATO such as the National Tax Liaison Group, which recently established a Dispute Resolution sub-committee.

However, to point out some flaws, when dealing with internal reviews and complaints, there is usually no further consultation between the original ATO decision-maker and the taxpayer, but the original ATO decision-maker may stay involved with the taxpayer on an ongoing basis (rather than a new ATO officer being appointed to the taxpayer), which can contribute to conflict escalation rather than to the resolution of differences between the ATO and the taxpayer. [62]

An impediment to proper consultation (particularly for small taxpayers) may lie in the complexity of the tax law and the language used and that most tax disputes involve a range of issues of fact and law, including alternative positions. The negative perceptions and behavioural attitudes of taxpayers and their advisors (who are generally trained in adversarial and rights-based justice and present a 'third-party' problem) towards the ATO[63] is also problematic. It is suggested that in order to achieve this facet of the Ury, Brett and Goldberg model, these points need to be addressed via other strategies such as improved communication to ensure taxpayers understand the nature of the ATO's concerns and understanding of the facts and generally adopting and promoting a policy of open and informal information sharing 9525 -1.1475 T

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The Ombudsman through its annual reporting mechanism (which includes a separate section on the ATO) and Inspector-General of Taxation reviews[66] are also examples of systemic feedback and analysis.

However, what is significantly missing from the ATO model is a formal procedure for obtaining feedback from taxpayers as parties to tax disputes.[67] 'Micro-level' feedback of this kind would provide information on substantive issues (i.e. 'what is happening inside the room') and therefore allow better evaluation of the effectiveness of the ATO model and reform, in accordance with the accepted dispute resolution research protocol.[68]

Effectiveness against principle 6 - Provide the necessary motivation, skills and resources to allow the system to work

Mandatory processes are not feature of the ATO dispute resolution model, although the ATO is bound by the abovementioned model litigant obligations and genuine steps statement requirements. The ATO is also intending to update the Taxpayers' Charter to state that: 'the ATO will consider avenues for dispute resolution, including ADR, in appropriate circumstances.'[69]

The ATO's cultural commitment to, and focus on, dispute resolution is certainly evident from a variety of recent speeches,[70] publications[71] and initiatives - most notably, the abovementioned National Tax Liaison Group Dispute Resolution sub-committee, as well as the ATO's commitment to put in place a 'Dispute Management Plan' in accordance with recent National Alternative Dispute Resolution Advisory Council recommendations to all Federal Government agencies.[72]

However, there has been a lot of criticism levelled at the day-to-day ATO officers' capability to engage in meaningful and effective dispute resolution.[73] Positively, in response to this, the ATO has recently committed to enhancing the skills of personnel via specific dispute resolution training initiatives.[74]

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[66] The Inspector-General of Taxation is an independent statutory office responsible for identifying systemic tax administration issues and reports to the Commonwealth Treasury with recommendations for improvement. The Inspector-General is not concerned with individual taxpayers or matters. Relevantly, the Inspector-General just completed a review into the ATO's use of early and alternative dispute resolution; see IGT, n49 above.

[67] Bentley, n48 above, 38.

[68] National Alternative Dispute Resolution Advisory Council, *ADR Research: A resource paper*, 2004, 34-35.

[69] IGT, n49 above, 42.

[70] E.g. Commissioner, n2 above.

[71] E.g. ATO dispute resolution webpage.

[72] National Tax Liaison Group Dispute Resolution Sub-Committee, *Minutes May 2012 Meeting*, 2012; National Alternative Dispute Resolution Advisory Council, *Managing Disputes in Federal Government Agencies: Essential Elements of a Dispute Management Plan*, 2010.

[73] IGT n49 above, 45-47.

[74]

7. CONCLUSION

Overall, the ATO dispute resolution model supports its assertions that it's eager to seek to resol6(ode03 (v)-2Sy)eTncAIwith taxpayto7(v)rs. Csseainlytotha, thATOatitno6( )]TjTD.003

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