Access to Tax Justice:

How Costs Influence Dispute Resolution Choices*

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EXECUTIVE SUMMARY

Tax dispute resolution is an indispensable component of the operation of modern tax systems around the world. Taxpayers’ accessibility to an independent, impartial tax dispute resolution process is critically important for two main reasons. First, access to tax justice may improve taxpayer compliance in view of the link between procedural justice and tax morale. Second, access to tax justice is an indispensable component of the principle of social justice, which demands that everyone is treated equally by the law. While an elaborate system of tax dispute resolution exists in Australia, it may become ineffective if, for a number of reasons, taxpayers cannot easily access it in practice.

This study explores how costs to taxpayers influence tax dispute resolution routes in the Australian context. This interim report focuses on the resolution of individual taxpayers’ applications to the Administrative Appeals Tribunal (AAT) for the review of the Australian Taxation Office (ATO)’s decisions. As background, the report briefly reviews the literature on the link between tax compliance, the morale and procedural justice, as well as relevant previous studies. The report then considers the current process of tax dispute resolution in Australia with particular emphasis on the AAT and the Small Taxation Claims Tribunal (STCT). Summary statistics of recent tax cases lodged at the AAT are also presented. These statistics indicate that (i) the number of tax dispute cases has been stable in recent years, (ii) a vast majority of cases have involved individual taxpayers or income tax, (iii) tax dispute cases normally take a long
time to be finalised, and (v) the probability of taxpayers’ applications to the STCT being successful tends to be low.

A simple model is formulated under the assumption of short-term cost minimisation to explain which route the taxpayer wishes to take for resolving tax dispute: ATO internal review, AAT review without professional assistance or AAT review with professional assistance. The decision rule involves three parameters: the amount of tax in dispute, the costs of tax dispute resolution to the taxpayer and his/her subjective probability of being successful at the AAT. Hypothetical costs based on well-informed sources are then constructed for two scenarios: with and without professional assistance. In the former case, the professional assistance fee is a main cost component while the opportunity cost of time loss represents the bulk of the costs in the latter. The costs are substantial, especially if professional assistance is engaged.

An examination of the data reveals that (i) the proportion of taxpayers in dispute taking the external review route is less than 5%, and (ii) the STCT has been playing a declining role over time. These findings support the claim that personal costs represent a considerable barrier to access tax justice. This may pose a challenge to the tax authorities in setting court fees and other assistance to taxpayers at an ‘equilibrium’ level which discourages frivolous disputes but not genuine tax grievances. It is recommended that (i) the STCT’s $5,000 tax threshold should be raised to $10,000; and/or (ii) costs be awarded to the taxpayer if his/her application to the AAT is successful but not to the ATO if the taxpayer’s application is unsuccessful.
1. INTRODUCTION

1.1 Background and Motives of the Study

The separation of powers and independence of the judiciary are fundamental, indeed indispensable, features of modern, democratic societies such as Australia. Social justice demands that every person is treated equally by the law. There are institutions, mechanisms and processes set up to ensure that Australian citizens can obtain legal justice in resolving conflicts or disputes with other individuals or organisations. Yet the elaborate system of administrative tribunals or courts can be ineffective if, for a variety of reasons, individuals are discouraged or deterred from using those forums for dispute resolution.

While effective accessibility to the legal system remains a general problem, it is particularly true in the case of taxation in Australia. The functioning of any modern tax system involves five broad types of activities: policy design and planning, tax law drafting and enactment, administration and enforcement, compliance and dispute resolution. An independent, impartial dispute procedure accessible to all taxpayers is fundamental to the proper operation of any tax system. There is now a wealth of international evidence that links taxpayers’ morale (or voluntary compliance) to their perception of tax equity. Tax equity or tax fairness has two major aspects. The first aspect, frequently discussed in the public finance literature, is concerned with tax policy equity. It is based on

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1 A comprehensive list of such studies is provided in Andrew Maples, “Resolving Small Tax Disputes in New Zealand – Is There a Better Way?” (2011) 6(1) Journal of the Australasian Tax Teachers Association 96, 99.
the “capacity to pay” principle and often expressed in terms of the horizontal and vertical equity principles. The second aspect deals with tax administrative (or procedural) equity. This concerns the fairness of the procedures involved in tax audits and disputes, and the perceived treatment the taxpayer receives from the tax authority.2

Tax disputes in many cases can be characterised by the asymmetry between the individual taxpayer and the Australian Taxation Office (ATO) in terms of resources and power. Further, resolving tax disputes outside the ATO is a very risky and costly process to individual taxpayers. In most cases, the implicit costs (loss of time) and explicit costs (monetary expenses) involved may be of sufficient magnitude to deter taxpayers from seeking independent tax dispute resolution. Thus, while an impartial tax dispute process does exist in Australia (as elaborated in Section 3 of the Report); it can become ineffective in terms of actual accessibility.

Individuals’ inaccessibility to the tribunals and courts for resolving their tax disputes with the ATO, where it exists and persists, is an undesirable state of affairs from many different perspectives. Most directly, it may negatively impact on taxpayers’ perceptions of tax procedural justice. This may in turn lower their tax morale and ultimately their voluntary tax compliance, which is universally regarded as a fundamental requirement for the successful operation of any modern tax systems. It is therefore important to study, in a systematic fashion, the extent of the problem in Australia and how this can be alleviated.

The present study, conducted by two independent academics at the University of New South Wales, is motivated by the above considerations. It is financially supported by a research grant from the Australasian Institute of Judicial Administrators (AIJA), which has a natural interest in the individual’s ability to access the legal system. In conducting their study, the authors have benefited from comments by a number of legal colleagues, but the authors are alone responsible for any shortcomings of the Report.

### 1.2 Aims and Focus of the Study

As suggested above, the principal aim of this study is to conduct a systematic investigation of the role of costs in accessing procedural justice in tax disputes in Australia. More specifically, it seeks to

- review the available information about the process of tax dispute resolution in Australia,
- estimate the full costs of tax disputes from the taxpayer’s perspective, and
- determine to what extent costs act as a barrier to access to tax justice.

However, it is important to note, from the outset, the tax focus of the study does not restrict its applicability. In fact, while this study solely focuses on tax disputes, its theoretical reasoning, arguments and analysis are generally applicable to any disputes that have to be resolved through administrative or judicial arbitration processes. Similarly, while the policy recommendations are tax specific, they can also be adapted to other areas of disputes as well.
1.3 Scope of the Study and Interim Report

In view of the limited time and resources available to the authors, it is necessary to restrict the scope of the study to a reasonable level. First, the study is confined primarily to tax dispute resolution outside the ATO although the ATO’s internal review process will also be briefly discussed. Second, the study focuses on individual taxpayers, including sole traders and partners, for whom the question of access to tax justice is most relevant. Third, while the study encompasses both the tribunals and courts, this interim report will focus on tax dispute applications lodged at the Administrative Appeals Tribunal (AAT). Further, special attention will also be paid to the Small Taxation Claims Tribunal (STCT), which is an integral part of the AAT. The costs of tax litigation and access to the courts for resolving tax disputes will be examined in the final report to the AIJA.

1.4 Research Approach

The study adopts a mixed research approach, which includes both qualitative and quantitative analyses. The qualitative approach is employed in reviewing the literature and previous Australian studies, and in examining the current process of tax dispute resolution in Australia. Simple statistical methods are then utilised to analyse empirical data. Basic algebraic operations are also employed with microeconomic reasoning to construct a simple decision rule regarding taxpayers’ choice of how to resolve their tax disputes. In terms of data, the study is essentially an archival/document analysis that draws data from published
sources, primarily annual reports of the AAT. Hypothetical data based on well-informed sources are also employed. Finally, note that while the empirical analysis is based on Australia data, the research methodology is applicable to other countries with comparable tax systems such as New Zealand and the UK.

1.5 Structure of the Interim Report

The remainder of the interim report is organised as follows. Section 2 provides a brief review of the literature on the relationship between tax morale and procedural justice, and on previous studies of the role of costs of access to tax dispute resolution. Section 3 then presents an overview of the current process of tax dispute resolution in Australia. In Section 4, up-to-date statistics on the extent, types, outcomes and timeliness of tax dispute resolution at the AAT are presented. In Section 5 an attempt is made to examine the full costs of tax dispute resolution at the AAT level from the taxpayer’s perspective. It is demonstrated that the monetary risks of such an action are so significant that a typical individual taxpayer would be strongly discouraged to seek legal representation in administrative/judicial determination for resolving tax disputes. This hypothesis seems to be supported by examining relevant tax dispute statistics. Some summary remarks and policy recommendations are then given in the concluding section.
2. **BRIEF LITERATURE REVIEW**

2.1 **Link Between Procedural Justice, Tax Morale and Tax Compliance**

Tax compliance, voluntary or otherwise, is fundamental to the success of any modern tax system. Voluntary compliance is always valued as it would lower the operational costs of the tax system as a whole. Understanding why people pay taxes is therefore of great interest not only to tax academics but also to administrators and authorities. This is particularly true for tax jurisdictions that rely on self assessment such as those of Australia, Canada, Ireland, New Zealand, the US and the UK. Economists, psychologists, sociologists and political scientists have all contributed to constructing models of tax compliance (or non-compliance) behaviour. Since these models have been extensively reviewed in the literature,\(^3\) it is not useful to reproduce that discussion here. Suffice to say no single model is by itself capable of offering a complete and consistent explanation of the full range of tax compliance behaviours observed in practice.

The traditional economic approach to tax compliance, popularly known as the deterrence model, is based on the seminal work of income tax evasion by

Allingham and Sandmo,\textsuperscript{4} which can in turn be viewed as an application of the economic theory of crime championed by the Nobel-prize Laureate Gary Becker.\textsuperscript{5} Under this kind of approach, a rational taxpayer will evade income tax so long as the (marginal) benefit from evasion exceeds the expected (marginal) cost of being caught and punished. While economists have over the years richly expanded the basic Allingham-Sandmo model in many different ways,\textsuperscript{6} these extensions have nevertheless taken place in a framework in which individuals are self-interested tax minimisers and tax compliance is costless.\textsuperscript{7}

The deterrence model appears to be consistent with an adversarial tax culture in which individuals are perceived by tax administrators as being responsive primarily to economic incentives and punishment. The model thus provides tax administrators with a theoretical justification for the use of such deterrence measures as tax auditing and penalties for improving compliance. While it represents a useful stating point of analysis, the deterrence model not only tends to underestimate the observed level of compliance but also offers little insight into the behaviour of inherently honest taxpayers.


\textsuperscript{6} These extensions are comprehensive and systematically reviewed in James Andreoni, Brian Erard and Jonathan Feinstein, above note 3.

\textsuperscript{7} Notable exceptions are James Alm (“Compliance Costs and the Tax Avoidance–Tax Evasion Decision” (1988) 16(1), \textit{Public Finance Quarterly} 31) and Joel Slemrod (“The Return to Tax Simplification: An Econometric Analysis” (1989) 17(1) \textit{Public Finance Quarterly} 3) who explicitly incorporate the (computational) compliance costs of income tax into models of tax compliance behaviour.
The 1990s saw the rise of the ‘fiscal psychology’ model, developed by Schmölders\textsuperscript{8} over three decades earlier. There are some subtle differences between the early and later fiscal psychology models.\textsuperscript{9} Moving away from the rationality approach, fiscal psychologists, especially later ones, view individual taxpayers as by and large responsible citizens and taxpaying as a complex social process, and only one aspect of a multitude of interrelated decisions made by individuals. In particular, a number of key determinants of taxpayer behaviour have been recognised. They include perceived opportunity to evade, the role of tax advisers and the level of trust in the tax administration (and, more broadly, the government). In summary, the fiscal psychology model is consistent with a co-operative tax culture in which tax administrators can promote taxpayers’ positive attitude toward the tax system in order to improve tax compliance.

It is interesting to note that Becker’s analysis of altruistic behaviour appears to be not well known among tax researchers. In his Nobel Lecture on 9 December 1992 he said “… that individuals maximize welfare as they conceive it, whether they be selfish, altruistic, loyal, spiteful, or masochistic. Their behaviour is forward-looking, and it is also consistent over time”.\textsuperscript{10} An example of Becker’s early approach to altruism is his paper on social interaction in 1974.\textsuperscript{11} According to this way of thinking, taxpayers are not only economic but also social agents,

\textsuperscript{9} For a concise and authoritative assessment of early and later fiscal psychology model refer to Jeff Pope and Margaret McKerchar, above note 3 at 590.
who are capable of feeling altruistic when paying taxes. They know that tax revenue can be spent in a way which is beneficial to all, including themselves. Perhaps this motivation is not even altruistic but a kind of far-sighted selfishness. Altruistic, rational individuals are thus capable of being honest, responsible citizens.

In recent years, there has been an increasing emphasis on the concept of ‘tax morale’, which can be defined as the intrinsic motivation to pay taxes, i.e., the willingness to comply voluntarily. Tax morale, a term first introduced in 1969 by Strümpel, can be viewed as an integral component of the fiscal psychology model. A number of key determinants of tax morale have been identified in the literature. They include social norms, tax fairness, governance and trust, and taxpaying culture. Of particular interest is the influence of tax fairness on tax morale. This will be elaborated below, focusing on the excellent, recent paper by Pope and McKerchar.

As mentioned in the introductory section of this paper, there are two separate aspects of tax fairness: policy fairness and procedural fairness. Both of these are recognised in Figure 1 of the paper by Pope and McKerchar. However, it is interesting to note that Pope and McKerchar do not link “perception of fairness” and “attitude to government and tax authority” in their Figure 3. Other things

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13 See, for example, Benno Torgler, Tax Compliance and Tax Morale (Cheltenham, Edward Elgar, 2007) and Jeff Pope and Margaret McKerchar, above note 3 at 592.
14 In the Australian context, see note 2 at 562.
15 See note 9 at 596.
16 See note 9 at 598.
being equal, one would expect that the fairer the taxpayer’s perception of a tax system, the more positive attitude the taxpayer will have toward the tax authority. In other words, there should be perhaps an arrow going from perception of fairness to attitude to government and tax authority in Figure 3 of Pope and McKerchar.

As suggested by Tran-Nam, the recognition of procedural tax justice allows us to construct a more flexible, integrated model of tax compliance that allows for taxpayers switching between being honest and dishonest. In such a model, the welfare of a typical taxpayer depends on consumption, leisure and psychic satisfaction (representing the taxpayer’s attitude toward the tax system). While consumption and leisure can be defined in the usual way, more thoughts are required for modelling the individual’s psychic satisfaction. A seemingly plausible approach is to link the taxpayer’s attitude to compliance to how the taxpayer feels he/she is treated by tax administrators. The major limitation of such proposal is that, under self assessment, few individual taxpayers have experiences dealing face to face with the tax authority.

To sum up, the deterrence and fiscal psychology models provide tax administrators with theoretical justification for a range of policy measures to promote tax compliance. While the traditional deterrence approach emphasises on involuntary compliance through detection and punitive enforcement measures such as auditing, penalties and prosecution, the modern fiscal psychology model stresses voluntary compliance through preventive and education measures,

including real and perceived procedural fairness. This is illustrated in Figure 1 below.

*Figure 1: Summary Relationship between Procedural Justice, Tax Fairness, Tax Morale and Voluntary Tax Compliance*

2.2 Previous Studies on Costs of Tax Dispute Resolution in Australia

As suggested in the introductory section, procedural tax justice, including tax litigation, can only be effective if taxpayers can access it with relative ease. However, if the costs to the individual taxpayer of seeking independent dispute resolution are sufficiently high, he/she will be deterred from seeking this option. It is therefore necessary to determine whether these costs are indeed excessive and therefore act as a barrier to accessing tax justice.

While there is a reasonable number of papers dealing with tax dispute resolution in Australia from a legal perspective, there is a paucity of evidence on the costs of access to procedural justice in tax disputes in Australia. This is not surprising

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in view of the difficulties associated with conducting such empirical studies, which will be elaborated in Section 5 of this Report.

In fact, to the best of the authors’ knowledge, there are only two papers that explicitly discuss the role of costs in accessing procedural justice in tax disputes in Australia, and both of them are out of date. The first is a study by Chapple\textsuperscript{19} which cited information about the legal costs of tax disputes from a submission by the Australian Attorney-General to the Senate Standing Committee on Legal and Constitutional Affairs.\textsuperscript{20} While this information is already 20 year old, it nevertheless provides a reliable basis for checking new cost estimates. The second is an exploratory study by Tran-Nam and Blissenden conducted over than ten years ago.\textsuperscript{21} That study clearly needs to be refined and updated. However it is worthwhile to note that the work by Tran-Nam and Blissenden examines the costs of tax dispute resolution from the social perspective whereas the present study is solely concerned with individual taxpayer costs only.

It is interesting to note that an Atax research team was commissioned by the ATO to conduct two large scale surveys of Australian federal tax compliance costs in 1995–96.\textsuperscript{22} One such survey was concerned with Australian personal taxpayers. In the questionnaire, sent to about 2,000 personal taxpayers, there was a question about the time spent by taxpayers (and their unpaid helpers)

\textsuperscript{19} Suzette Chapple, above note 18 at 326.
\textsuperscript{20} Australian Attorney-General’s Department, “Submission to Senate Standing Committee on Legal and Constitutional Affairs”, Discussion Paper No. 6, The Courts and the Conduct of Litigation, March 1992, paras 2.32 and 2.36.
\textsuperscript{21} Binh Tran-Nam and Michael Blissenden, “Compliance Costs of Tax Dispute Resolution in Australia: An Exploratory Study” in Michael Walpole and Chris Evans (eds) Tax Administration and the 21\textsuperscript{st} Century (Sydney, Prospect, 2001) 287.
\textsuperscript{22} Chris Evans, Katherine Ritchie, Binh Tran-Nam and Michael Walpole, A Report into the Incremental Costs of Taxpayer Compliance (Canberra, ATO, 1996).
dealing with tax objections/appeals. Unfortunately, the effective sample of 936 respondents did not include any personal taxpayers who were involved in tax disputes. It is conceivable that in generating the sample of participants for the personal taxpayer survey the ATO deliberately excluded those individuals who were, at the time of selection, in dispute with the ATO. This would not have been unreasonable as an unbiased group of taxpayers was sought that would give accurate and normal data on their costs.

See note 22 at 59.
3. CURRENT PROCESS OF TAX DISPUTE RESOLUTION IN AUSTRALIA

3.1 What Are Tax Disputes?

Tax disputes are a common feature of modern tax systems around the world. They are said to occur when taxpayers disagree with the view provided by tax administrators in respect of the taxpayer’s tax liability or entitlements and related issues, and take some action regarding this disagreement. Tax disputes may arise at any stage after the disagreement between the tax administrators and taxpayers. In Australia they are classified into four broad categories:

(a) Complaints;
(b) Objections to reviewable rulings;
(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 (including self assessment and Commissioner adjustments).

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

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24 In view of procedural justice briefly discussed earlier, the formal definition of tax disputes here seems to be somewhat narrow. Perhaps it should be broadened to include complaints by taxpayers about how they are treated by tax administrators.

25 Commissioner of Taxation, In Search of Solutions (Speech to the Administrative Appeals Tribunal and the ACT Bar Association seminar, Canberra, 26 August 2009).
3.2 How Can Tax Disputes Be Resolved?

Tax disputes can be ultimately resolved via judicial determination, as recently affirmed by the Honourable Bill Shorten MP, Federal Assistant Treasurer:26

The ATO has sole responsibility for interpreting the taxation laws at first instance (for the purposes of administering those laws), while the Courts are the final arbiters.

The Federal Court of Australia (Federal Court) and ultimately the High Court of Australia (High Court) have jurisdiction to finalise substantive tax disputes. Although State courts do not have jurisdiction to hear substantive tax disputes, they have jurisdiction in tax debt recovery disputes. In addition, the Commonwealth Ombudsman and, to a much lesser extent, the Australian Human Rights Commissioner and the Australian Information Commissioner can examine how specific taxpayers have been treated by the ATO.

However, to avoid tax litigation before the courts, there has been emphasis on alternative dispute resolution (ADR), which “is an umbrella term for processes, other than judicial determination, in which an impartial person assists those in dispute to resolve the issues between them.”27 ADR often takes the form of

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26 Bill Shorten, Address to The Tax Forum (Speech, Canberra, 5 October 2011).
negotiation, mediation and arbitration. Each of these can be observed in the tax administration system. For example,

- Negotiation (no third party): tax audits often conclude with a negotiated settlement.  
- Meditation (with mediator): the process followed in the AAT or Commonwealth Ombudsman’s Office (via the Special Taxation Adviser).  
- Arbitration: The AAT provides an example of formal arbitration in the sense that it is not private and the outcome is binding on the parties “whereas much arbitration pursued by ADR practitioners in other disciplines tends to be more informal.”

The judicial and administrative route for resolving tax disputes is based on a variety of statutes:

- Pt IVC of the *Taxation Administration Act (TAA) 1953* (Cth): challenging the ATO decision in the Federal Court or the AAT;  
- *Administrative Appeals Tribunal Act (AATA) 1975* (Cth): appealing to the Federal Court from a decision of the AAT;  
- *Administrative Decisions (Judicial Review) Act 1977* (Cth): applying for an ATO decision to be reviewed by the Federal Court; and

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28 Duncan Bentley, above note 18 at 19–20.  
30 Duncan Bentley, above note 18 at 20.  
• *Judiciary Act 1903* (Cth) and State and Territory equivalent acts: seeking an injunction, declaration or some kind of relief - relatively rarely used.

Note that Pt IVC of the *TAA 1953* is linked with s 175A of the *Income Tax Assessment Act (ITAA) 1936* (Cth), which provides the principal legislative basis for a taxpayer wishing to object to an ATO assessment.

Since the process of tax dispute resolution in Australia has been extensively discussed elsewhere,\(^{32}\) it is sufficient to provide a brief description here. Figure 2 illustrates the avenues available to Australian taxpayers for resolving their tax disputes with the ATO. The remainder of this section briefly discusses each forum for resolving tax disputes.

\(^{32}\) See notes 18 and 21.
3.3 The Australian Taxation Office’s Internal Review Process

Under self assessment, the ATO would normally raise an assessment based on the information provided in the tax return. Disputes between the taxpayer and the ATO would typically commence at the point where the assessment is under review. Initially, an informal dispute may arise in the review period following self assessment. If this dispute cannot be resolved, then an amended assessment will be issued by the ATO, with the result of amended taxable income. At this point the taxpayer may formally lodge an ‘objection’ in accordance with Pt IVC of the TAA 1953 and s 175A of the ITAA 1936. When a valid objection has been
lodged, an internal review of the assessment will be conducted by ATO officers. Note that the internal review relates to matters raised in that objection and not in respect of the entire assessment. When the objection has been disallowed or only allowed in part, or has been deemed to be disallowed (no decision after 60 days), this serves as a trigger for further review opportunities for the taxpayer. In practice, the vast majority of objections are resolved by the ATO’s internal review.

Note that the Commissioner of Taxation uses the term ADR in a broader sense to include approaches that enable parties to manage their own disputes without outside assistance. According to the Attorney-General’s Legal Services Direction 2005, the ATO, as a “model litigant”, is required, where possible, to avoid, prevent and limit the scope of legal proceedings. This includes giving consideration in all cases to ADR before initiating legal proceedings and by participating in ADR where appropriate. Further, both the AAT and Federal Court may also direct the ATO to participate in certain ADR proceedings.

The Commissioner of Taxation has instructed ATO staff responsible for resolving tax disputes to consider participating in some form of ADR throughout the course of the dispute. The ATO’s focus on ADR in recent years has been

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33 See note 27.
35 s 34A AATA 1975 and s 53A Federal Court of Australia Act 1976.
“driven from the top” and is increasing.\textsuperscript{37} The most recent change in this respect is the introduction in 2011 of the \textit{Civil Dispute Resolution Act 2011} (Cth) which requires all parties coming to the Federal Court to demonstrate to the satisfaction of the judge that they have made genuine efforts to resolve their dispute before coming to court. The Federal Court rules have also been amended to give effect to this.

\section*{3.4 The Administrative Appeals Tribunal}

The taxpayer has a choice as to the appropriate external review body. The taxpayers may refer the objection decision to either the AAT or appeal to the Federal Court. In principle, it is the taxpayer’s choice and the ATO has no say in which review body is chosen. It is important to note that, as an administrative review body, the AAT is fundamentally and structurally different from the Federal Court, which is a judicial review body. These differences will be elaborated in subsection 3.6 of the Report.

The AAT, being an administrative body, is able to “stand in the shoes” of the Commissioner of Taxation and reexamines all powers and discretions available which are relevant to the objection decision. In its arbitration of tax disputes, the AAT may affirm, set aside, vary, remit or dismiss the objection decision while the Federal Court can confirm or vary the decision.\textsuperscript{38} The Tax Commissioner’s decision can be regarded as being upheld outright, at least practically, in the

\textsuperscript{37} ATO, National Tax Liaison Group Dispute Resolution Sub-Committee, \textit{Minutes June 2011}, 2011,  
\textsuperscript{38} s 14ZZP TAA 1953.
cases of decisions affirmed, dismissed and withdrawn. The taxpayer’s objection is upheld outright in the case of decisions set aside. If the AAT varies the decision, this means that the Tax Commissioner’s decision has been changed or altered in some way. In this grey situation, neither the Tax Commissioner nor the taxpayer can claim full success.

In terms of structural organisation, the taxation division of the AAT is divided into the Tax Appeals Division (TAD) and the STCT. These bodies differ substantially in terms of jurisdiction, application fee, confidentiality, conduct and timeliness. These differences are discussed in the next subsection.

3.5 The Small Tax Claims Tribunal

Given the focus of this study on administrative resolution of small tax disputes, it is important to elaborate on the STCT. The STCT is not a separate tribunal but a part of the AAT. If the amount of tax in dispute is less than $5,000 or if the ATO refuses the taxpayer’s request to be released from a tax debt (any amount), then the taxpayer may elect to have the matter dealt with by the STCT. A decision of the STCT is a decision of the AAT and thus can be appealed against in accordance with the AATA 1975.

There some key differences between the AAT and the AAT in its role as the STCT:

• The application fee: Standard application fee payable to the AAT is currently $777 per application (a reduced fee of $100 is available in certain circumstances) while it is $77 per application to the STCT. The application fee to the AAT is refundable in full if the decision is in favour to the taxpayer in any way while the application fee to the STCT is not refundable.

• Confidentiality of the application: It is the taxpayer’s prerogative to have the AAT hearing held in private\textsuperscript{40} while the STCT will be in public unless the taxpayer can successfully demonstrate to the Tribunal why the hearing should be in private.\textsuperscript{41}

• Conduct: The STCT tends to conduct its proceedings with less formality and more expedition than the AAT. Data indicate a clear preference for STCT matters to be dealt with at conferences and teleconferences rather than in a formal hearing.\textsuperscript{42}

• Internal time line: In principle the AAT gives the ATO more time to provide s 37 (AATA 1975) documents (35 days) compared with the STCT (14). However, in practice, the ATO has found it difficult to meet that deadline.\textsuperscript{43}

In short, the operation of the STCT can be characterised as follows:\textsuperscript{44}

\textsuperscript{40} Under the amended s 14ZZE of the TAA 1953, the taxpayer can request the AAT hearing to be held in private.

\textsuperscript{41} s 35 AATA 1975.

\textsuperscript{42} See note 21 at 296.

\textsuperscript{43} See note 21 at 297.

\textsuperscript{44} See also note 1, 126–128.
• Jurisdiction: The amount of tax in dispute is less than $5,000 or the ATO refuses the taxpayer’s request to be released from paying a tax debt;

• Application: The taxpayer files a two-page application form to the AAT seeking the review of the ATO decision;

• Application fee: Standard fee is $77 per application and this fee can neither be reduced nor refunded;

• Process: Pre-trial conference before members of the AAT to discuss facts and issues (a second conference or mediation may also be called) then proceeding to STCT hearing;

• Type of hearing: Informal hearings held in public unless the taxpayer can convince the STCT otherwise;

• Decision: Oral decision is made at the end of hearing but written reasons are available within two months of hearing either upon request or if the AAT member(s) wants more time after the hearing to think about the decision;

• Time frame: The STCT aims to finalise the case within 12 weeks of the taxpayer lodging an application for review of decision (rarely met);

• Appeal rights: It is possible to appeal on a point of law to the Federal Court;

• Award of costs: No award of costs; and

• Decision precedential or not: Non precedential.

### 3.6 The Courts
The taxpayer can appeal against the ATO’s decision or the AAT arbitration to the Federal Court. Unlike the AAT, the Federal Court is a judicial body and is not able to reexamine the discretions of the ATO. Its role is to examine the legality of the decision-making process to determine whether or not such discretions have been exercised in accordance with the law. Concepts such as relevant or irrelevant considerations are important in ascertaining whether the ATO has acted in an appropriate manner in exercising its discretions. The Federal Court can confirm or vary the decision,\(^{45}\) and its adjudication is precedential. The taxpayer or the Commissioner of Taxation can then appeal the Federal Court’s decision to the full Federal Court and, ultimately, the High Court of Australia.

In view of the scope of this particular report, the role of the courts for resolving tax disputes will not be discussed in the remainder of this report. However, two points deserve mention before proceeding further. First, in practice, tax disputes that are determined by the court are “the exception rather than the rule”.\(^{46}\) Second, unlike other types of disputes, if the taxpayer chooses to go to the court, the onus is upon her/him to demonstrate that the ATO decision is incorrect.

\(^{45}\) s 14ZZP TAA 1953.

\(^{46}\) Duncan Bentley, above note 18 at 18.
4. STATISTICAL SUMMARY OF TAX DISPUTE CASES AT THE AAT

Before trying to estimate the costs of tax dispute resolution to the taxpayer, it is necessary to briefly examine the number, types, timeliness and outcomes of tax dispute cases at the AAT level.

4.1 Number of Tax Dispute Cases

The number of tax disputes in Australia seems to be broadly stable in recent years. The number of tax disputes received at the AAT level over the last three years are summarised in Table 1.

Table 1: Number of Tax Dispute Applications to the AAT *

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Taxation Appeals Division</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lodged</td>
<td>1,110</td>
<td>994</td>
<td>1,103</td>
</tr>
<tr>
<td>Finalised</td>
<td>1,801</td>
<td>2,008</td>
<td>1,251</td>
</tr>
<tr>
<td>Outstanding at 30 June</td>
<td>2,545</td>
<td>1,571</td>
<td>1,429</td>
</tr>
<tr>
<td><strong>STCT</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lodged</td>
<td>97</td>
<td>59</td>
<td>73</td>
</tr>
<tr>
<td>Finalised</td>
<td>83</td>
<td>98</td>
<td>57</td>
</tr>
<tr>
<td>Outstanding at 30 June</td>
<td>68</td>
<td>31</td>
<td>50</td>
</tr>
</tbody>
</table>

* Applications regarding Family Tax Benefits fall under the jurisdiction of the Social Security Division of the AAT.
Table 1 indicates that the STCT has recently played a minor role in resolving tax disputes relative to the Taxation Appeals Division of the AAT. This was not the case a decade ago. The apparent declining role of the STCT will be further discussed in the next section.

4.2 Types of Tax Dispute Cases

What types of taxpayers are involved in tax dispute cases lodged at the AAT in recent years and what types of cases have these been? The answers to these questions are given in Tables 2 and 3, respectively.

Table 2: Tax Dispute Applications Lodged at the AAT by Taxpayer Type*

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Taxation Appeals Division</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individual</td>
<td>746</td>
<td>607</td>
<td>753</td>
</tr>
<tr>
<td>Corporation</td>
<td>370</td>
<td>374</td>
<td>347</td>
</tr>
<tr>
<td>Total</td>
<td>1,116</td>
<td>981</td>
<td>1,100</td>
</tr>
<tr>
<td><strong>STCT</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individual</td>
<td>89</td>
<td>54</td>
<td>64</td>
</tr>
<tr>
<td>Corporation</td>
<td>8</td>
<td>8</td>
<td>9</td>
</tr>
<tr>
<td>Total</td>
<td>97</td>
<td>62</td>
<td>73</td>
</tr>
</tbody>
</table>

Source: AAT Taxation Statistics provided by the AAT Principal Registrar.
* The total numbers in Tables 2 and 1 are very slightly inconsistent. The AAT states that the discrepancy is most probably due to data entry errors that would require a significant amount of resources to identify and remedy.

As expected, while the majority of applications is by individual taxpayers, the ratio of individual taxpayers over corporate taxpayers is much higher in the STCT than in the Tax Appeals Division.
Table 3: Tax Dispute Applications Lodged at the AAT by Case Type*

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Taxation Appeals Division</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income tax (other than tax schemes)</td>
<td>812</td>
<td>700</td>
<td>820</td>
</tr>
<tr>
<td>Income tax (tax schemes)</td>
<td>73</td>
<td>34</td>
<td>0</td>
</tr>
<tr>
<td>Goods and Services Tax</td>
<td>97</td>
<td>99</td>
<td>97</td>
</tr>
<tr>
<td>Fringe Benefits Tax</td>
<td>6</td>
<td>19</td>
<td>18</td>
</tr>
<tr>
<td>Other</td>
<td>119</td>
<td>139</td>
<td>175</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,107*</td>
<td>981</td>
<td>1,100</td>
</tr>
<tr>
<td><strong>STCT</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income tax (other than tax schemes)</td>
<td>38</td>
<td>29</td>
<td>30</td>
</tr>
<tr>
<td>Income tax (tax schemes)</td>
<td>3</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Goods and Services Tax</td>
<td>4</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Refusal of extension of time to lodge objection</td>
<td>6</td>
<td>14</td>
<td>18</td>
</tr>
<tr>
<td>Release from tax liabilities</td>
<td>37</td>
<td>10</td>
<td>7</td>
</tr>
<tr>
<td>Other</td>
<td>9</td>
<td>7</td>
<td>15</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>97</td>
<td>62</td>
<td>73</td>
</tr>
</tbody>
</table>

Source: AAT Taxation Statistics provided by the AAT Principal Registrar.
* This total is slightly different from the corresponding total in Table 2.

Table 3 shows that a great majority of tax cases involves income tax (820 out of 1,100 application to the Taxation Appeals Division* and 30 out of 73 applications to the STCT in 2010–11).

4.3 Timeliness of Tax Dispute Cases

Timeliness is an important factor in determining the costs of tax dispute resolution to taxpayers. Table 4 below reveals that tax disputes at the AAT’s Taxation Appeals Division generally take a long time to be finalised.

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Note that in Table A3.1 on p 127 of *AAT Annual Report 2010–11* (Sydney, AAT, 2011) this total was stated as 1,103 although the individual numbers add up only to 1,100, which is consistent with the data provided by the Registrar of the AAT.
Table 4: Percentage of Applications Finalised Within 12 Months

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Appeals Division</td>
<td>75</td>
<td>29</td>
<td>26</td>
<td>36</td>
</tr>
<tr>
<td>All AAT Jurisdictions</td>
<td>–</td>
<td>62</td>
<td>63</td>
<td>72</td>
</tr>
</tbody>
</table>


While there was a marked improvement in the proportion of applications finalised within 12 months of lodgement in the Tax Appeals Division in 2010–11, the actual proportions have consistently fallen short of the target of 75%. It is also obvious that tax dispute cases take considerably longer than other dispute cases to be finalised by the AAT. In fact, only 54% of tax dispute applications were finalised by the Tax Appeals Division within 18 months in 2010–11.\(^{48}\) It was claimed by the AAT that the timeliness of general taxation matters dealt with by the Tax Appeals Division will improve as the bulk of the applications relating to tax schemes had already been finalised.\(^{49}\)

The proportions of tax dispute cases finalised by the STCT have also fallen short of its aim of 12 weeks as shown in Table 5.

Table 5: Percentage of Applications Finalised Within 12 Weeks

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>STCT</td>
<td>12 weeks</td>
<td>18</td>
<td>22</td>
<td>34</td>
</tr>
</tbody>
</table>


---

\(^{48}\) See note 47 at 24.

\(^{49}\) Since 1999 the ATT has received more than 12,000 applications for review of ATO decisions relating to about 120 tax schemes. Only a small number of these applications remain not yet finalised. See note 47 at 34.
Tax dispute cases in the STCT are, in principle, expected to take less time to be finalised than those in the Taxation Appeals Division. However, in reality, the AAT’s experience is that “applications dealt with by the Small Taxation Claims Tribunal cannot be necessarily completed faster than other types of taxation review.”

4.4 Outcomes of Tax Dispute Cases

It is interesting to note that the majority of all types of applications to the AAT tends to be resolved without a hearing. Further, tax dispute applications to the AAT have an above average percentage of being finalised without a hearing, as shown in Table 6 below.

Table 6: Percentage of Applications Finalised Without a Hearing*

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxation Appeals</td>
<td>89</td>
<td>92</td>
<td>85</td>
</tr>
<tr>
<td>Division</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>STCT</td>
<td>84</td>
<td>95</td>
<td>82</td>
</tr>
<tr>
<td>All AAT Jurisdictions</td>
<td>81</td>
<td>82</td>
<td></td>
</tr>
</tbody>
</table>


*Applications finalised by the Tribunal without it completing its review and giving a decision on the merits under s 43 of the *AATA 1975*. Includes applications finalised in accordance with terms of agreement lodged by both parties (ss 34D and 42C), applications withdrawn by the applicants (subs 42A(1A)) and applications dismissed by the Tribunal (ss 42A and 42 B).

Further statistics on court and AAT cases that did not proceed to hearing in 2010–11 are provided by the ATO.\(^51\)

\(^{50}\) See n 47 at 24.

\(^{51}\) *Commissioner of Taxation Annual Report 2010–11* (Canberra, ATO, 2011) Table 4.24 at 105.
The number of applications finalised by outcome in the Taxation Appeals Division and STCT of the AAT in 2010–11 are summarised in Table 7.

### Table 7: Applications Finalised by Outcome, 2010–11

<table>
<thead>
<tr>
<th></th>
<th>Taxation Appeals Division</th>
<th>STCT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>%</td>
</tr>
<tr>
<td><strong>By Consent or Withdrawn</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Decision affirmed</td>
<td>15</td>
<td>1</td>
</tr>
<tr>
<td>Decision varied</td>
<td>446</td>
<td>36</td>
</tr>
<tr>
<td>Decision set aside</td>
<td>232</td>
<td>19</td>
</tr>
<tr>
<td>Dismissed by consent</td>
<td>16</td>
<td>1</td>
</tr>
<tr>
<td>Dismissed by operation of law</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Withdrawn by applicants</td>
<td>276</td>
<td>22</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>985</td>
<td>79</td>
</tr>
<tr>
<td><strong>By Decision</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Decision affirmed</td>
<td>90</td>
<td>7</td>
</tr>
<tr>
<td>Decision varied</td>
<td>32</td>
<td>3</td>
</tr>
<tr>
<td>Decision set aside</td>
<td>68</td>
<td>5</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>190</td>
<td>15</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dismissed by Tribunal</td>
<td>62</td>
<td>8</td>
</tr>
<tr>
<td>No jurisdiction</td>
<td>1</td>
<td>&gt; 1</td>
</tr>
<tr>
<td>Extension of time refused</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>No application fee paid</td>
<td>10</td>
<td>&gt; 1</td>
</tr>
<tr>
<td>Other</td>
<td>3</td>
<td>&gt; 1</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>76</td>
<td>6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,251</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: *AAT Annual Report 2011–11*, Chapter 3, Table A3.5 at 133.

Thus, in 2010–11, The Tax Commissioner’s decision was upheld (decisions affirmed, dismissed, withdrawn and extension of time refused) in 459 out of 1,251 (37%) finalised cases in the Taxation Appeals Division and in 36 out of 57 (63%) finalised cases in the STCT. The difference in the two percentages appears to be quite significant. It is interesting to note that the data contained in Table 7 does not seem to support the Tax Commissioner’s assertion that in
2010–11 “we were successful or partly successful in … 91% of tribunal decisions.”

The *AAT Annual Report 2010–11* also provides some data on ADR processes, interlocutory hearings and hearings conducted by the AAT. However, since these statistics are not broken down by jurisdiction, it is not possible to make any deductions for the Taxation Appeals Division and STCT alone. Suffice to say that conferences are by far the most common form of ADR. Further statistics on settlements (a form of ADR) are also provided by the ATO.

Tables 8 and 9 summarise the number of appeals to the Federal Court from decisions of the AAT by division and by outcome, respectively.

**Table 8: Number of Appeals Against Decisions of the AAT**

<table>
<thead>
<tr>
<th>Division</th>
<th>2008–09</th>
<th>2009–10</th>
<th>2010–11</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Section 44*</td>
<td>Other**</td>
<td>Section 44*</td>
</tr>
<tr>
<td>Taxation Appeals Division</td>
<td>13</td>
<td>1</td>
<td>17</td>
</tr>
<tr>
<td>STCT</td>
<td>2</td>
<td>0</td>
<td>1</td>
</tr>
</tbody>
</table>


* Appeals lodged to the Federal Court under s 44 of the *AATA 1975*.

** Applications to judicial review under *Administrative Decisions (Judicial Review) Act 1977*, *Judiciary Act 1903* and State and Territory equivalent acts

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52 See note 51 at 107.
53 See note 47 at Chapter 3, Table A3.7 at 135.
54 See note 47, Table 4.25 at 16.
Table 9: Outcomes of Appeals From AAT Decisions

<table>
<thead>
<tr>
<th>Division</th>
<th>2008–09</th>
<th>2009–10</th>
<th>2010–11</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Section 44</td>
<td>Other</td>
<td>Section 44</td>
</tr>
<tr>
<td>Taxation Appeals Division</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Allowed/Remitted</td>
<td>2</td>
<td>0</td>
<td>7</td>
</tr>
<tr>
<td>Dismissed</td>
<td>7</td>
<td>1</td>
<td>9</td>
</tr>
<tr>
<td>Discontinued</td>
<td>2</td>
<td>0</td>
<td>4</td>
</tr>
<tr>
<td>Subtotal</td>
<td>11</td>
<td>1</td>
<td>20</td>
</tr>
<tr>
<td>STCT</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Allowed/Remitted</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Discontinued</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Discontinued</td>
<td>0</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Subtotal</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>12</strong></td>
<td><strong>1</strong></td>
<td><strong>21</strong></td>
</tr>
</tbody>
</table>

Source: AAT Annual Report 2010–11, Chapter 3, Table A3.10 at 137.

The data presented in Tables 8 and 9 can be supplemented by the information provided by the ATO. During 2010–11, the ATO was involved in tax litigation in the High Court, Federal Court and state courts of appeal. The verdicts of the courts were favourable to the ATO in 75% of cases (60 out of 79), while 9% of cases (7 out of 79) were decided in favour of the taxpayer, and the remaining 15% of cases (12 out of 79) were favourable, in part, to each party.55

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55 See n 51 at 107.
5. PERSONAL COSTS OF TAX DISPUTE RESOLUTION AT THE AAT

5.1 Overview

It is necessary to limit the scope of the study to a reasonable level. First, while generating some benefits (such as clarity or certainty of tax laws) the process of tax dispute resolution is costly to the whole society. For example, the ATO, AAT and courts also incur costs in the process of tax dispute resolution but these costs are not relevant to the current study, which is confined to the costs to taxpayers. In particular, the study focuses on individual taxpayers to whom the question of access to tax justice is probably most meaningful. Second, a taxpayer who is in dispute with the ATO may incur costs at different stages of dispute resolution, which in principle can encompass both ADR and judicial adjudication. This interim report focuses on the taxpayer’s costs incurred specifically at the AAT level, i.e., costs incurred at other stages such as internal ATO review or courts are ignored.

Third, the costs (excluding the tax debt) considered in this study are economic, not accounting, costs. They include both explicit costs (monetary expenses) and implicit costs (value of time expended by the taxpayers and unpaid helpers in dealing with the resolution process). In the literature on tax compliance costs, researchers also recognise psychological costs, which in this case refer to the stresses and anxiety that the taxpayer typically suffers as a result of disputing the
ATO decision.\textsuperscript{56} To avoid difficulties associated with valuation, psychological costs are excluded in this study despite their theoretical relevance. Note also that monetary expenses incurred by the taxpayer in resolving tax disputes with the ATO are recognised as legitimate income tax deductions, so these expenses should be expressed in terms of after-tax costs.

Having defined the scope of the study, it is now necessary to ascertain how the costs (excluding the tax debt) to individual taxpayers at the AAT level can be estimated. Ideally, the information required for such estimation should be derived from a large-scale survey or in-depth interviews of taxpayers whose applications to the AAT for review of ATO decisions were finalised. Such a study is in general not possible for a number of reasons, primarily because of the confidentiality of the tax dispute resolution process (so that it is not possible to identify a random sample of suitable participants). Further, a carefully designed survey or case studies on this scale would not be feasible in view of the time and resource constraints available to the authors.

Theoretically, an alternative approach is to update costs estimates derived from past studies. As discussed in subsection 2.2, there are little reliable quantitative data available on the costs of tax disputes in Australia. The two past studies discussed in subsection 2.2 are both dated and insufficiently systematic for the purposes of the current study.

\textsuperscript{56} See, for example, Robin Woellner, Cynthia Coleman, Margaret McKerchar, Michael Walpole and Julie Zetler, ‘Can Simplified Legal Drafting Reduce the Psychological Costs of Tax Compliance? An Australian Perspective’ (2007) \textit{6 British Tax Review} 717.
In the absence of large-scale actual data, the authors adopt the following approach. Given the well-known knowledge of the costs of legal representation, two hypothetical scenarios will be considered. In the first scenario, the taxpayer represents himself/herself at the AAT. In the second scenario, the taxpayer employs professional assistance (of a lawyer or an accountant) to represent his/her case at the AAT. In each scenario, the estimation of costs of a typical case is based on anecdotal evidence and opinion of legal experts, especially those who have been working with the AAT. The construction of these hypothetical cost scenarios has to be obviously consistent with the data presented in Section 4.

Clearly, the costs of tax disputes to personal taxpayers vary widely depending primarily on the nature of the disputes. It seems plausible, however, to assume that the costs are ‘regressive’ in the amount of tax in dispute. That is, the costs expressed as a percentage of the taxes in dispute will decline as the amount of tax in dispute increases.

### 5.2 A Simple Decision Rule

Before proceeding to cost estimation it seems useful to conceptualise the decision facing the taxpayer who is in dispute with the ATO. Using a microeconomic approach, this can be achieved by examining the taxpayer’s motive (preferences), options available and financial consequences of these various options. It is conceivable that the taxpayer has a number of possible motives for resolving tax dispute with the ATO and some of them are consistent while others are not. These include:
• Short-term financial optimisation: to minimise total personal payments arising from the tax dispute;
• Long-term financial optimisation: taxpayers seek clarity of the tax laws so that they can continue to engage in tax planning or make deduction claims in the future;
• The psychological satisfaction of proving the ATO wrong; or
• The desire to exercise inherent legal rights in a civic and democratic society.

If the taxpayer’s motive is purely short-term financial optimisation (i.e., to minimise one-off total personal payment) then it is possible to employ the traditional economic cost–benefit analysis to derive a decision rule for tax dispute behavior. A short-term maximising taxpayer who is in dispute with the ATO has three courses of options available: (i) to settle within the ATO, (ii) to seek AAT review without professional assistance, and (iii) to seek AAT review with professional assistance. What are the financial consequences of these various options?

Let $T$ be the tax debt that the taxpayer has to pay now if he/she chooses to settle using the ATO’s internal review. If the taxpayer risks external review then under the “50/50” arrangement” he/she is required to pay at least 50% of the disputed tax now and the balance plus general interest charge within 14 days after an external decision in favour of the Commissioner of Taxation has been handed
Assuming that there are no administrative penalties, if the taxpayer’s application to the AAT is unsuccessful then the present value of his/her payment to the ATO is \( 0.5T + (1+i)^n 0.5T/(1+p)^n \) where \( i \) stands for the ATO’s annual interest rate, \( p \) stands for the annual inflation rate and \( n \) is the number of years required to finalise the case. Since \( i \) and \( p \) are normally close, it can be seen that 
\[
0.5T + (1+i)^n 0.5T/(1+p)^n = 0.5T + 0.5T = T,
\]
i.e., the present value of tax debt payment to the ATO by the taxpayer is still \( T \).

Now let \( C_2 \) and \( C_1 \) stand for the after-tax costs of tax dispute to the taxpayer with and without professional assistance, respectively. It is obvious that \( C_2 \) is greater than \( C_1 \). Let \( p_2 \) and \( p_1 \) be the taxpayer’s subjective probabilities that his/her objection application is successful with and without professional assistance, respectively. These (exogenously given) probabilities represent the taxpayer’s perception based on his/her personal belief, advice received or long-term statistics on outcomes of tax disputes at the AAT. Given the technical nature of taxation laws, it seems plausible to assume that \( p_2 \) is greater than \( p_1 \). Note also that there is of course a third possibility that the taxpayer’s objection is partly successful (the decision is varied) but this case is ignored for simplicity.

If the taxpayer risks AAT review without professional assistance then he/she pays nothing now and there are two possibilities:

- The taxpayer’s objection is successful: in this case his/her payment is the after-tax cost \( C_1 \) since there is no award of costs.

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• The taxpayer’s objection is unsuccessful: in this case his/her payment is the after-tax cost \( C_1 \) plus the tax debt \( T \).

Similarly, if the taxpayer risks AAT review with professional assistance then his/her payment is either \( C_2 \) (successful application) or \( C_2 + T \) (unsuccessful application).

The taxpayer’s decision is arrived at by comparing the ‘expected’ (i.e., average) total payment under three possible options:

• ATO’s internal review: \( T \);
• AAT review without professional assistance: \( p_1C_1 + (1−p_1)(C_1+T) = C_1 + (1−p_1)T \)
• AAT review with professional assistance: \( p_2C_2 + (1−p_2)(C_2+T) = C_2 + (1−p_2)T \)

The interpretation of the expected total payment is straightforward. If the taxpayer seeks external review, his/her total payment will be the sum of the after-tax costs and the tax debt multiplied by the probability that the Tax Commissioner’s decision is upheld.

The ranking of \( T, C_1 + (1−p_1)T \) and \( C_2 + (1−p_2)T \) gives rise to many possibilities which can be grouped into the following main cases:

• \( T < C_1 + (1−p_1)T \) and \( T < C_2 + (1−p_2)T \), i.e., \( T < C_1/p_1 \) and \( T < C_2/p_2 \): The taxpayer prefers the ATO internal review.
• \( C_1 + (1−p_1)T < T \) and \( C_1 + (1−p_1)T < C_2 + (1−p_2)T \), i.e., \( C_1/p_1 < T < (C_2−C_1)/(p_2−p_1) \): The taxpayer prefers AAT review without professional assistance; and
• \( C_2 + (1-p_2)T < T \) and \( C_2 + (1-p_2)T < C_1 + (1-p_2)T \), i.e., \( C_2/p_2 < T \) and \( (C_2-C_1)/(p_2-p_1) < T \): The taxpayer prefers AAT review with professional assistance.

The much less likely cases in which the taxpayer is indifferent between ATO internal review and AAT external review with or without professional assistance are disregarded.

A few numerical examples will illustrate this simple decision rule:

• \( T = $8,000, \ C_2 = $1,500, \ p_2 = 0.1, \ C_2 = $5,000 \) and \( p_2 = 0.5 \): since \( 8,000 < 1,500/0.1 \) and \( 8,000 < 5,000/0.5 \), the taxpayer is financially better off with ATO internal review.

• \( T = $12,000, \ C_2 = $1,500, \ p_2 = 0.1, \ C_2 = $7,000 \) and \( p_2 = 0.5 \): since \( 1,500/0.1 < 12,000 \) and \( (7,000-1,500)/(0.5-0.1) = 5,500/0.4 > 12,000 \), the taxpayer is financially better off applying for AAT review without professional assistance.

• \( T = $12,000, \ C_2 = $1,500, \ p_2 = 0.1, \ C_2 = $5,000 \) and \( p_2 = 0.5 \): since \( 5,000/0.5 < 12,000 \) and \( (5,000-1,500)/(0.5-0.1) = 3,500/0.4 < 12,000 \), the taxpayer is financially better off applying for AAT review with professional assistance.

Note that the simple model developed above provides some quick rules for predicting the decision choice of a rational short-term maximizing taxpayer. If the taxpayer’s actual behaviour is not consistent with the model’s prediction, it
simply means that the taxpayer has objectives other than one-off minimisation of total personal payment.

5.3 Hypothetical Cost Scenarios

The costs of tax disputes (excluding the tax debt) at the AAT level to a typical personal taxpayer can be very substantial as demonstrated below.

Explicit Costs (Out of Pocket Expenses)

- Application fee;
- Professional assistance fee (if any); and
- Personal expenses (transport, telephone, mailing, etc).

Implicit Costs (Opportunity Costs of Time Losses)

- Time losses of applicants; and
- Time losses of unpaid helpers (if any).

Each of the above components is briefly discussed in turn below.

Application Fee\(^{58}\)

The full application fee to the Taxation Appeals Division of the AAT is currently $770 and refundable if the application is successful. This fee can be reduced to $100 in certain circumstances but the reduced fee cannot be refunded regardless

of the outcome of the application. The application fee to the STCT is $77. This fee can neither be reduced nor refunded. Note that the application fees have over time increased at more or less the same rate as CPI inflation: from $639 in 2006–07 to $777 in 2010–11 in the Tax Appeals Division and from $64 in 2006–07 to $77 in 2010–11.59

Professional assistance fee

Since professional assistance costs, if incurred, would represent the bulk of the costs to taxpayers, it is worthwhile to discuss this single item in detail. Legal representation at the AAT is completely optional. In fact the STCT is designed for taxpayers to represent themselves. The fact that the vast majority of tax dispute cases do not proceed to hearing at the AAT suggests that by and large taxpayers who are in dispute with the ATO would choose to represent themselves at the AAT conference.

Nevertheless, given the technical nature of taxation, it seems very unwise for the taxpayer (who is serious about his/her dispute with the ATO) to proceed to a conference or hearing without the paid assistance of a qualified lawyer or accountant. Even at earlier stages of the process, it seems sensible for the taxpayer to employ the service of such an expert.60 This is consistent with the fact that currently more than 70% of Australian individual taxpayers rely on the

59 According to information provided by the AAT Registrar.
60 In 1996, taxpayers were represented in 66 out of 76 Tribunal reported cases. See Suzette Chapple, above note 18 at 326.
services of tax agents for the completion and lodgement of their tax income tax returns.\textsuperscript{61}

The market for tax professional services, especially tax lawyers, is somewhat specialised. Not all lawyers or accounts can advise on tax matters. Substantial delays in obtaining a conference, mediation or hearings will increase professional assistance costs. Based on the current market for legal and accounting services, it is estimated that a tax lawyer (tax accountant) would normally charge at least $2,000 ($1,500) per day or $300 ($250) per hour for their professional assistance to the taxpayer. Note that these estimates are based on normal conditions and it is possible for taxpayers to obtain qualified advice at a lower cost.

It is conservatively estimated that a taxpayer who choose to employ a lawyer or an accountant to attend a STCT tax dispute case would require about two days of professional assistance (including discussion, preparation, conference and hearing).\textsuperscript{62} This would cost the taxpayer between $3,000 and $4,000. For a typical Taxation Appeals Division case, it is suggested that the taxpayer would require three days of professional assistance, amounting to a sum that varies between $4,500 and $6,000.

\textsuperscript{61} According to ATO, \textit{Taxation Statistics 2007–08} (Canberra, ATO, 2010) 9, 72.1\% of Australian individual taxpayers in 2007–08 used tax agents to assist with their income tax returns.

\textsuperscript{62} This estimate has been obtained after interviewing Professor John Glover of RMIT University, who has been working as a barrister for both the ATO and taxpayers at the AAT and Federal Court.
Personal expenses

Personal expenses relating to the application are roughly estimated at $200 to cover transportation, telephone calls, postal stamps, etc, arising from the tax dispute resolution process. This estimate does not include accommodation costs that may be incurred by taxpayers who do not reside in capital cities.

Time costs

The taxpayer (and unpaid helpers, if any) must spend time to learn about the process, file the application, prepare documents, search for professional assistance (if any), discuss with his/her legal/accounting advisor, travel and appear before the Tribunal. No distinction is made between those taxpayers who employ professional assistance and those who do not. This is because while those who use a lawyer/accountant spend more time with their advisers, those who do not, spend more time preparing for the case and learning about the process.

Based on anecdotal evidence provided to the authors, it is likely that the taxpayer and unpaid helpers will have to spend an average of 48 hours filing applications, preparing documents, searching and discussing with their legal/accounting advisor and travelling. It is also estimated the taxpayer will have to spend, on average, 24 hours to appear before the STCT or the Taxation
Appeals Division.\textsuperscript{63} Consistent with the AAT’s experience cited previously, no distinction is made between STCT and the Taxation Appeals Division in terms of the taxpayer’s time expended. This means an applicant to the STCT (or the Taxation Appeals Division) will have to spend, on average, about 72 hours on his/her application. Using an average after-tax earning of $25 an hour, this is equivalent to $1,800.

Tables 10 and 11 summarise the estimated personal costs to the taxpayer under different assumptions about use of professional assistance. In both tables, a personal marginal income tax rate of 30\% is assumed.

\textit{Table 10: Hypothetical Costs ($) to the Taxpayer Who Do Not Engage Professional Assistance}

\begin{center}
\begin{tabular}{|l|c|c|c|c|}
\hline
 & Application fee & Personal expenses & Value of time losses & After-Tax total* \\
\hline
Tax Appeals Division & 770 & 200 & 1,800 & 2,479 \\
STCT & 77 & 200 & 1,800 & 1,994 \\
\hline
\end{tabular}
\end{center}

\textsuperscript{*} Application fee and personal expenses are assumed to be tax deductible at 30\% marginal income tax rate. Loss of time is already valued at the after-tax rate.

\textit{Table 11: Hypothetical Costs ($) to the Taxpayer Who Engage Professional Assistance}

\begin{center}
\begin{tabular}{|l|c|c|c|c|}
\hline
 & Application fee & Professional assistance fee & Personal expenses & Value of time losses & After-tax total \\
\hline
Tax Appeals Division & 770 & 4,500–6,000 & 200 & 1,800 & 4,794–6,679 \\
STCT & 77 & 3,000–4,000 & 200 & 1,800 & 4,094–5,629 \\
\hline
\end{tabular}
\end{center}

It is interesting to note that the estimated average personal costs to the taxpayer for resolving a tax dispute at the STCT is roughly the same as the maximum

\textsuperscript{63} The figures for those time losses were based on an informal discussion with David Schabe who used to work for the AAT in Brisbane.
amount of tax in dispute (currently less than $5,000). If the taxpayer chooses to represent himself/herself then his/her personal costs will be more affordable, but his/her chance of being successful will be negatively impacted.

5.4 Impact of Costs on Accessibility to Tax Justice

The hypothetical cost scenarios in the previous subsection confirm that costs of tax dispute resolution, even at the STCT, can be substantial to the taxpayer, especially if he/she chooses to engage professional assistance. At a theoretical level it is plausible to argue that high costs deter taxpayers from seeking external review of the ATO decisions. In fact, the simple decision rule discussed above indicates that, for any given amount of tax in dispute and a taxpayer’s subjective probability of successful objection application, there exists a cost threshold above which the taxpayer will not proceed to external review. Is there any concrete empirical evidence to support this kind of theoretical reasoning?

To obtain a direct answer to the above question a researcher needs to survey those taxpayers who were in dispute with the ATO. As discussed previously, such a survey is not easily undertaken primarily because of the confidential nature of tax disputes. More specifically, without the ATO assistance, it would not be possible to obtain a random sample of such individuals. In the absence of such survey results, the only alternative approach is to examine aggregate statistics published by the ATO and the AAT to infer from these the possible impact of costs on actual accessibility. A quick examination of these statistics
seems to suggest that high costs to taxpayers serve as an effective barrier to access to the legal system for resolving tax disputes.

An official Australian taxation data source indicates that 24,513 tax disputes were resolved by the ATO in 2010–11,\(^64\) not counting tax disputes initiated or not yet finalised within the ATO, and tax disputes considered outside the ATO. During the same period only 1,308 tax dispute cases were finalised by the AAT, including both the Taxation Appeals Division and the STCT.\(^65\) This means that, in terms of finalised cases, approximately 5\% \(= 1,308/(1,308+24,513)\) of taxpayers chose to seek AAT review of ATO decisions. This percentage seems very low and does not seem to reflect taxpayers’ true preferences. Surely a much higher percentage of taxpayers in dispute with the ATO would like to resolve the matters by external review. A primary reason for this low percentage of applications to AAT review must therefore be attributable to the high costs (and long duration) discussed earlier.

Four points deserve mention. First, the above 5\% includes both corporate and personal taxpayers. However, it seems reasonable to presume that corporate taxpayers are more likely to seek external review of the ATO decision than personal taxpayers. Under this assumption, if we exclude corporate taxpayers, then the percentage of individual taxpayers seeking external review would be definitely lower than 5\%. Second, as argued previously, many taxpayers choose to proceed to external review of ATO decisions for motives other than short-term financial gains. If we exclude these taxpayers from our consideration then the

\(^{64}\) See note 51, Table 4.16.

\(^{65}\) See Table 1 of this paper.
impact of costs on access to procedural justice would be even more pronounced. Third, it would be more accurate to compare the numbers of new dispute cases lodged at the ATO and the AAT. However, the ATO does not seem to publicly provide data on the number of new tax dispute cases lodged at the ATO. Fourth, the above examination excludes tax disputes finalised by the courts. However, this does not really matter as there are very few tax dispute cases finalised by the courts.

As a final piece of evidence, we will consider the role of the STCT within the AAT over time. According to Table 1, the STCT currently plays a minor role relative to the Tax Appeals Division. For example, in 2010–11, only about 6% \(=73/(73+1,103)\) of all tax dispute applications lodged at the AAT went to the STCT. This was not the case more than a decade ago. For example, in 1997–98 and 1998–99, almost 25% \(= 311/311+949\) and more than 31% \(= 357/(357+768)\) of tax dispute cases of the AAT went to the STCT respectively.\(^{66}\) The remarkable declining role of the STCT, both in absolute and relative terms, is attributable to a variety of factors. These include:

- Because of the cumulative effect of inflation, the upper eligibility limit of $5,000 has in real terms become smaller and smaller over the years.
- Taxpayers have had a low chance of success in the STCT.
- The high costs of small tax disputes.

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In fact, the decline of the STCT is not surprising in view of the simple decision rule developed in the previous subsection. Whatever the reasons, the declining role of the STC indicates a gradual decline of effective accessibility to procedural justice for resolving small tax disputes.

6. SUMMARY CONCLUSION AND POLICY RECOMMENDATIONS

This study examined the role of costs in accessing procedural justice in tax disputes in Australia. As a background, it first presented a brief overview of the literature on tax compliance, tax morale and procedural justice. It then discussed the current process of tax dispute resolution in Australia and presented current statistics relating to tax disputes at the AAT level. Under a number of seemingly plausible assumptions, the study attempted to provide some quantitative estimates of the taxpayer’s full costs in applying to review the ATO decision at the AAT’s Tax Appeals Division and STCT. A simple decision rule regarding the taxpayer’s choice of where to resolve his/her tax dispute with the ATO decision was also derived.

The quantification of the hypothetical costs incurred by the taxpayer in seeking external review confirmed the existing knowledge that costs can be a considerable barrier to access to the legal system, especially if professional assistance is employed. This is perhaps more severe in the case of tax disputes for a number of reasons. First, tax disputes tend to take longer to finalise than other types of dispute. Second, tax law is a specialised area and it can be costly to employ the services of a suitably qualified tax lawyer or accountant. Third, if
the taxpayer chooses to go to the court, the onus is upon her/him to show that the ATO decision is incorrect. Thus, substantial costs to taxpayers, especially relative to the amounts of tax in dispute, have deterred them from seeking external review or resolving tax disputes.

If the taxpayer decides to represent himself/herself, then the costs to the taxpayer are more affordable and mainly take the form of implicit costs (value of loss of time). However, given the technical nature of tax laws, the taxpayer has, other things being equal, lower chance of success than if he/she employed professional assistance of a lawyer or an accountant. In this case, inadequate representation also acts as an effective barrier to tax justice just as the costs of professional assistance do.

This theoretical argument is borne out by empirical data which indicate that only a very small fraction (about 5%) of taxpayers (including corporate taxpayers) who are in dispute with the ATO choose to seek external review. This has also been accompanied by the marked declining role of the STCT within the AAT during the last 12 years. These findings in turn imply that the review system, despite being operational, is not readily accessible. The lack of effective accessibility to external resolution of tax disputes may negatively impact taxpayers’ perception of procedural justice and potentially their level of voluntary tax compliance.

The findings of the paper may pose a challenge to the tax authority in particular and the government in general. On the one hand, it is desirable that frivolous or
vexatious tax disputes do not proceed to external review. On the other hand, genuine tax grievances should be heard by the tribunal and courts. It is an immensely difficult task to find an “equilibrium” level of application fees and assistance to the taxpayer that discourages frivolous but not genuine objection applications.

A couple of immediate solutions seem to be within the control of the government. It is apparent that that maximum threshold of the amount the tax in dispute falling under the jurisdiction of the STCT is too low. This threshold has remained at $5,000 for two decades despite continuous inflation as well as growth of income and taxation revenue in the Australia economy during the same period. Thus, a simple and more modest proposal is to raise this threshold to, say, $10,000. Such an increase, if implemented, may reverse the declining role of the STCT within the AAT.

A substantially more radical proposal is to consider the asymmetry of resources between the ATO and the individual taxpayer. Given this asymmetry, a case can be made for a new procedure which awards explicit costs (including in particular legal costs) to the taxpayer if his/her application is successful but not to the ATO if the taxpayer’s application is unsuccessful. Perhaps this proposal would contribute in some way to improving taxpayers’ accessibility to external review and making the legal system more effective, but at a cost to the government.