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Tax disputes, litigation costs and access to tax justice

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Abstract

Tax dispute resolution is an integral part of the operation in any modern tax system. The availability of a fair, impartial and independent mechanism for resolving tax disputes between taxpayers and the central collection agency can be viewed as an indicator of how well-developed or advanced is the tax system under study. In Australia, in addition to the Australian Taxation Office (ATO)'s internal review, there exists a comprehensive system of external tax dispute resolution involving the Administrative Appeals Tribunal (AAT) and the courts, and, to a lesser extent, a variety of governmental bodies. At the same time, there is anecdotal evidence that the litigation costs of taxpayers engaging in tax disputes can be very high especially if professional (legal, tax or accounting) assistance is employed. The existence of such high costs can act as a barrier to the effective accessibility of the external tax dispute resolution system and to the neutrality of the outcomes of such disputes (in the sense that taxpayers with greater resources may be able to obtain more favourable outcomes than taxpayers with lesser resources). This paper provides a comprehensive review of the current state of play and sets out a future agenda for research on this topic.

Keywords: Tax disputes; Litigation costs; Access to tax justice

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1. INTRODUCTION

The operation of any modern tax system involves at least five distinct but interrelated aspects, namely, tax policy planning, tax law drafting and enactment, tax administration and enforcement, tax compliance, and tax dispute resolution.[3] A fair, impartial and independent dispute procedure accessible to all taxpayers is fundamental to the proper operation of any tax system. In fact, the availability and quality of an external tax dispute resolution system[4] can be viewed as a measure of how well developed or advanced a particular tax system under study is. In Australia the procedures for resolving tax disputes internally and externally are well-known.[5] However far less is understood about the effective accessibility of external tax dispute resolution from the taxpayer perspective.

It is apparent that there are serious gaps of knowledge in the important but neglected connection between tax dispute resolution and tax justice. Such lack of knowledge has motivated a successful Australian Research Council (ARC) Discovery project aimed at determining how effective is external tax dispute resolution in Australia, whether or not taxpayers with greater resources are relatively more successful in tax litigation, and whether or not alternative dispute resolution (ADR) is an effective way for resolving tax disputes.

The paper intends to serve three specific purposes. First, it provides a critical and comprehensive review of the state of knowledge in the field of tax disputes, litigation costs[6] and access to external tax dispute resolution. Secondly, it examines some recent developments in ADR in the area of taxation in Australia. Thirdly, it sketches out a research agenda on litigation costs, tax dispute resolution and tax justice. While the paper is motivated by Australian considerations, many of its discussions and proposals are of general applicability to comparable common law countries such as Canada, New Zealand, the United Kingdom (UK) and the United States (US).

Before proceeding any further it is helpful to clarify the meanings of 'tax dispute', 'litigation costs' and 'tax justice', and thus unambiguously define the scope of the paper. This paper focuses on disputes between taxpayers and the central revenue collection agency, the Australian Taxation Office (ATO). It is not concerned with tax disputes involving sub-national revenue collection agencies such as the various State Revenue Offices in Australia. (Further research into dispute resolution at the sub-national level would be warranted but this would be a separate project.) Tax disputes may also arise between two or more parties in a legal agreement or commercial dealing. For example, one of the parties may disagree with the meaning of a contractual agreement, or the operation of a statute, and whether or to what extent a tax is payable by one of the parties. These types of disputes are beyond the scope of this paper.

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[3] See, for example, B Tran-Nam, 'Tax Reform and Tax Simplification: Some Conceptual Issues and A Preliminary Assessment' (1999) 21(3) *Sydney Law Review* 500 at 500.

[4] We distinguish between internal and external tax dispute resolution. Internal dispute resolution refers to that conducted by the central revenue collection agency (which is a party to the dispute), whereas external or independent dispute resolution is conducted by an independent body (which is not a party to the dispute) such as a tribunal or court.

[5] See, for example, various tax law textbooks; S Mookhey, 'Tax Dispute System Design' (2013) 11(1) *eJournal of Tax Research* 79.

[6] Tax litigation costs here are broader than the conventional view of litigation costs; see the following section.

Litigation costs in this paper refer to the costs incurred by the taxpayers in seeking to resolve their tax disputes with the ATO via an external, independent body such as the Administrative Appeals Tribunal (AAT) or the courts. Defined in this way, litigation costs constitute a part of the better-known tax compliance costs. Litigation costs include both out-of-pocket expenses (such as fees for professional assistance or court costs) and value of time losses. Some elements of litigation costs are tax deductible under the current Australian income tax law.

Tax justice is itself a multidimensional concept. It can be interpreted differently in different contexts. We can, for example, make a distinction between tax policy equity and tax procedural equity. 'Tax policy equity', frequently discussed in the public finance literature, is concerned with the distribution of tax burdens among individuals in a society. 'Tax procedural equity', mainly discussed in the tax administrative and legal literature, is concerned with the fairness of the procedures involved in tax audits and disputes, and the perceived treatment the taxpayer receives from the tax authority. This paper omits tax policy equity and focuses instead on the effective access to a fair, impartial and independent process of tax dispute resolution. Further, while all taxpayers (individuals and businesses) are covered under the study, the focus is on individual taxpayers to whom the issue of social justice is perhaps more relevant.

It should by now be apparent that the primary focus of the paper is not the Australian system of tax dispute resolution *per se*. Rather, it is the effective access to external tax dispute resolution that constitutes the primary research question of the study. Obviously the correctness, or otherwise, of the outcome of the process (that is, tax legal justice) is most important to the fairness of any tax systems. After all, it is little use having equal access to a system which is inherently unfair. This is a separate and complex issue that the present paper cannot address and for present purposes the Australian tax system is assumed to be fair provided one has access to its facilities for dispute resolution.

The organisation of the remainder of this paper is as follows. In the next section, key concepts such as tax complexity, tax disputes, litigation costs and tax justice and their relationships are explored. The subsequent section provides a review of the relevant literature and discusses existing information on tax disputes that is currently available in Australia. The literature review indicates that, despite a wide range of anecdotal evidence, there is indeed a paucity of rigorous studies on the connection between litigation costs of tax dispute resolution and tax justice, not only in Australia but also elsewhere in the world. It is also suggested that the ATO could support studies on tax dispute resolution and tax justice by making more data on tax disputes available on a regular basis. In the following section, recent developments of ADR for resolving tax disputes internally are reviewed. There is some evidence that ADR may at least reduce social tax compliance costs. The penultimate section then brings all elements that have been considered together to set out a research agenda to examine the relationship between tax disputes, litigation costs and tax justice. Concluding remarks are given in the final section.

2. ISSUES AND CONTEXT

2.1 Tax complexity, tax disputes and social justice

As tax complexity has been extensively discussed in the literature,[7] it suffices to focus on selected aspects of tax complexity which are relevant to this paper. A quick examination of the literature reveals that traditional indicators of tax complexity such as the number of taxes, length and readability of tax codes, extent of the use of tax agents, tax operating costs (sum of tax compliance and administrative costs) tend to disregard the extent of tax disputes as a possible measure of tax complexity. The main advantage of tax disputes as a measure of tax complexity is that it can be precisely measured (for example, number of tax disputes per thousand of taxpayers per annum) and may readily be available (secondary data from tax collection agencies, administrative tribunals and the courts). The main disadvantage with using tax disputes as a complexity indicator is that a number of cases at the tribunal level have little to do with legal complexity and more to do with factual disputes.

Analysis of the impact of tax complexity has traditionally focused on efficiency costs of tax complexity. This has resulted in a substantial literature on tax operating costs, especially tax compliance costs. In addition, due to its adverse effect on economic incentives, tax complexity may also cause losses of output or a decrease in foreign direct investment inflows.[8] Attention has also been drawn to the fact that tax complexity, via regressive tax compliance costs, can also reduce the progressivity of the income tax,[9] thus damaging the equity objective of tax policy.

However, the literature is largely silent on the impact of tax complexity on social justice that demands that every person be treated equally by the law.[10] Statutory and administrative tax complexity (primarily statutory complexity) gives rise to tax disputes. In view of the fact that taxation is one of the more important (and most common) relationships between a citizen and the government, fairness in resolving tax disputes is very significant, particularly from a social justice perspective (to be further elaborated later in the paper). While there exists a comprehensive system of tax dispute resolution in Australia, it is by no means clear whether or not those taxpayers who are in dispute with the ATO can equally access the external mechanisms for resolving tax disputes. It is thus imperative that a systematic and rigorous study of the effective access to external tax dispute resolution be undertaken with a view to safeguarding the tax system, a part of the social infrastructure critical to Australia's continuing prosperity.

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[7] See, for example, J A Roth, and J T Scholz (eds.), *Taxpayer Compliance, Volume 2: Social Science Perspectives*, (University of Pennsylvania Press, Philadelphia, 1989); C Evans, R Krever and P Mellor, (eds), *Tax Simplification* (Wolters Kluwer Law and Business, The Netherlands, 2015).

[8] B Tran-Nam, 'An Integrated Approach to the Economic Measurement of the Costs of Tax Complexity' in C Evans, R Krever and P Mellor (eds), *Tax Simplification* (Wolter Kluwer Law and Business, the Netherlands, 2015) 55.

[9] A theoretical discussion can be found in B Tran-Nam, 'Tax Compliance Costs Methodology: A Research Agenda for the Future' in C Evans, J Pope. and J Hasseldine (eds.), *Taxation Compliance Costs: A Festschrift for Cedric Sandford* (Prospect, Sydney, 2001) 51, whereas supporting evidence is available from B Tran-Nam, C Evans and P Lignier, 'Personal Taxpayer Compliance Costs: Recent Evidence from Australia' (2014) 29(1) *Australian Tax Forum* 135.

[10] See further elaboration in the third section of this article.

2.2 Tax disputes and tax dispute resolution

Disputes are a common feature of any human society, regardless of time, space, social traditions or level of development. Tax disputes are thus a familiar feature of modern tax systems around the world. However, as argued elsewhere by the authors,[11] tax disputes are of special importance not only to tax academics. The reasons include:[12]

- Tax laws, particularly income tax law, tend to be more complex than civil or commercial laws.
- There is a reversal of onus[13] in tax disputes when they are considered by the Tribunal or the courts (in comparison with civil dispute cases).
- Unlike most civil or commercial disputes, tax disputes typically involve a perceived asymmetry between the two parties concerned (the ATO and individual/small business).
- Tax disputes differ fundamentally from other civil and commercial disputes and criminal trials in terms of impact.[14]
- Unlike most civil and commercial disputes, the two parties to a tax dispute are also unevenly positioned with respect to the ability of each to influence the law after the court's judgment has been handed down.

Tax disputes 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.[15] 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:[16]

1. Complaints;
2. Objections to reviewable rulings;
3. Disputes as to facts or the application of tax law by a taxpayer as matters are being assessed (by the ATO)
4. Objections to assessments (including self-assessment and Commissioner adjustments).

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[11] B Tran-Nam and M Walpole, 'Independent Tax Dispute Resolution and Social Justice in Australia' (2012) 35(2) *UNSW Law Journal* 470.

[12] In this context, it is worthwhile to briefly mention the ATO's test case litigation program. There are important issues where it is in the public interest to have the tax law clarified through litigation. Since the ATO cannot commence such litigation, they are willing to provide financial assistance to taxpayers to do so in order to develop legal precedents to such issues.

[13] In tax dispute cases, the onus is on the taxpayer to prove that the ATO's assessment is incorrect.

[14] Tax disputes and the legal ramifications of court decisions in them often have a high level of generality and applicability to other taxpayers.

[15] In view of procedural justice briefly mentioned in the introductory section, 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.

[16] Commissioner of Taxation, 'In Search of Solutions', (Speech delivered at the Administrative Appeals Tribunal and the ACT Bar Association seminar, Canberra, 26 August 2009).

Categories 2 and 4 generally refer to statutory rights, while 1 and 3 relate to administrative due process. The remedies of 1 and 3 are thus founded in administrative due process largely recognised in common law principles. Categories 2 and 4 are slightly different as they are based on rights established under the relevant statutes which allow, and set out the process for, review of decisions and the precise terms and extent of objections to assessment. They are thus statutory rights, but their scope and effect can overlap with rights available under administrative due process. Of these categories only 2 to 4 could result in litigation.

As mentioned previously, the institutions and processes for resolving tax disputes in Australia have been well discussed in the literature, including tax law textbooks. Suffice to say tax disputes can be ultimately resolved via judicial determination, as affirmed by the then Federal Assistant Treasurer:[17]

> 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.

Apart from the ATO's internal review (before the dispute is taken further) and the AAT, the Federal Court of Australia (Federal Court) and ultimately the High Court of Australia (High Court) have jurisdiction to finalise substantive federal 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 Inspector-General of Taxation, 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 ADR, which will be further discussed in the paper.

2.3 Litigation costs, effective access and tax morale

The effective access to a fair, impartial and independent process of dispute resolution is important not only from a social justice viewpoint but also from a more practical perspective on 'tax morale'. 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, that is, the willingness to comply voluntarily. Tax morale, a term first introduced in 1969 by Strümpel,[18] 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.[19] It seems plausible to expect that, other things being equal, the fairer the taxpayer's perception of tax dispute resolution, the more positive attitude the taxpayer will have toward the tax authority and voluntary tax compliance.

There are clearly institutions, mechanisms and processes set up to ensure that Australian taxpayers can obtain legal justice in resolving disputes with the ATO. However, the elaborate system of administrative tribunals or courts can be ineffective

[17] W Shorten, 'Tax as Social Solidarity', (Speech delivered at the Tax Forum, Canberra, 5 October 2011).

[18] B Strümpel, 'The Contribution of Survey Research to Public Finance' in A Peacock (ed), *Quantitative Analysis in Public Finance* (Praeger, The Hague, 1969) 13.

[19] See, for example, B Torgler, *Tax Compliance and Tax Morale* (Edward Elgar, Cheltenham, 2007); J Pope and M McKerchar Understanding Tax Morale and Its Effect on Individual Taxpayer Compliance' (2011) 5 *British Tax Review* 587, 592.

if, for a variety of reasons, taxpayers are discouraged or deterred from using those forums for dispute resolution. It is apparent the social costs of resolving tax disputes are high, especially from the taxpayer's perspective. Note that 'social costs' refer to costs borne by the society including those incurred by the taxpayer (litigation costs), ATO, AAT and the courts. While little systematic and reliable information about taxpayers' litigation costs is available, anecdotal evidence, based on plausible assumptions about legal representation costs, suggests these costs can be prohibitive to taxpayers, particular low-income personal taxpayers.[20]

Excessive litigation costs of tax dispute resolution (relative to the potential benefits) to the taxpayer have several implications some of which are negative to social justice. First, the observed (ex post) level of tax disputes at the ATO level (internal review) is likely to be lower than that which would prevail if the objection costs to taxpayers were very low. Thus, the ATO statistics on internal tax dispute resolution most likely underestimate the true extent of taxpayers' disagreement (as some taxpayers who disagree with the ATO's assessment may not wish to formally object to the ATO's assessment for a number of reasons[21] including objection costs relative to the tax amount in dispute). Secondly, and similarly, the observed level of tax disputes beyond the ATO is also lower than would prevail if the litigation costs to taxpayers were sufficiently low.[22] Thus, taxpayers' effective access to independent tax dispute resolution can be compromised.

Significant litigation costs may have a further negative social justice implication, even if taxpayers who disagree with the ATO's assessment are willing to seek external resolution to their tax disputes. Due to the highly technical nature of tax law, it is conceivable that taxpayers with relatively more resources at their disposal are likely to achieve more favourable outcomes relative to taxpayers with fewer resources. That is, excessive litigation costs can also adversely affect the neutrality of the final outcome. Perhaps the clearest example is the case of a self-represented taxpayer at the AAT. In this situation, inadequate representation also acts as an effective barrier to tax justice just as the costs of professional assistance do. In this context, it has been argued, at least in relation to courts, that 'the court's capacity to discharge its societal function is impaired when it engages with the self-represented litigant, thus preventing strict compliance with the rule of law'.[23] It is known that the AAT will sometimes assist taxpayers (who are not vexatious or tendentious) in presenting their cases. The

[20] See Tran-Nam and Walpole, above n 9.

[21] These may include taxpayers' concerns about the effect on reputation or future relationship with the ATO.

[22] It can be argued that tax disputes may not truly be a dispute on a tax matter, but rather a delaying tactic for payment of tax. This may be possible although, in Australia, tax delaying is of very limited benefit to taxpayers because (i) under the '50/50' arrangement', if the taxpayer risks external review then the taxpayer is required to pay at least 50% of the disputed tax now (Commissioner of Taxation, *Practice Settlement Law Administratio*n 2011/4, 2011, 50/50 arrangement), and (ii) if the tribunal/court decision is in favour of the Commissioner of Taxation, the taxpayer must pay the ATO the balance plus interest (*Taxation (Interest on Overpayments and Early Payments) Act 1983* (Cth), Pt III and *Taxation Administration Act 1953* (Cth), s 8AAD). Delaying could still be helpful to taxpayers especially when the amount of tax in dispute is large and the time required to resolve the dispute is very long. Instances of this can be made part of our primary data collection.

[23] R. Stewart, The Self-Represented Litigant: A Challenge to Justice' (2011) 20(3) *Journal of Judicial Administration* 146. Although lawyers or accountants can choose to represent themselves without necessarily being at a significant disadvantage, in reality they still tend to employ professional advisers to present their cases.

assistance provided by the tribunal/courts to the taxpayers would, to some extent, redress the issue of effective accessibility being discussed. However, there is a limit to how much the tribunal/court can do to assist taxpayers whilst maintain their neutrality as required by law.

2.4 Accessibility and neutrality in a broader context

The accessibility and neutrality of independent tax dispute resolution should be placed in the broader context of socioeconomic changes in Australia, especially over the past 30 years. As a young nation, the notion of a 'fair go' has been enshrined in the Australian ethos. However, while data is limited, there is an agreement that income inequality in Australia has been on the rise since the 1980s.[24] Lack of access to and neutrality of independent tax dispute resolution accentuates this inequality. First, the inability of certain individuals to access an essential government service can be construed as a violation of social justice. Secondly, if tax dispute resolution is indeed not neutral between the 'haves' and the 'have-nots', then this may be regarded as a violation of distributive justice. Both undermine egalitarianism, a notion that many Australians continue to value.

Finally it is worthwhile to note that tax disputes are, in general, not socially wasteful from a pure economic point of view. This is because the outcomes of the disputes may help to clarify the tax law, especially in test cases sponsored by the ATO. In this case, while tax disputes will increase current operating costs of the tax system, it may reduce future tax operating costs. On the negative side, however, tax disputes may indeed sometimes increase future tax operating costs, for example, if unclear/testable outcomes generate more cases.

3. BRIEF REVIEW OF LITERATURE AND DATA AVAILABILITY

3.1 Literature review

Because of the country-specific nature of taxation, we will first review the Australian tax literature and then the international tax literature. The process of tax dispute resolution in Australia is thoroughly explained in Commonwealth statutes such as *Taxation Administration Act 1953* (Cth), Pt IVC; *Administrative Appeals Tribunal Act 1975* (Cth) and *Administrative Decisions (Judicial Review) Act 1977* (Cth). It has become textbook material[25] and there is some literature associated with it.[26] However, as indicated in the introductory section, there is only an insubstantial body of literature relating to the present study. In particular, there are no known Australian studies on whether the tax dispute resolution system favours the 'haves' over the 'have-nots'.

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[24] See, for example, P Saunders, 'It's Official: Inequality Is Increasing Again', (2003) Oct *Impact* 4; P Whiteford, 'Are the Rich Getting Richer and the Poor Getting Poorer?', *Inside Story* (online), 28 September 2011, http://inside.org.au/are-the-rich-getting-richer-and-the-poor-getting-poorer/; D Neal, M Norton, D Ariely and C Govan, *Australian Attitudes Towards Wealth Inequality and Progressive Taxation'*, (Report prepared for the Australian Council of Trade Unions, 2011), http://www.actu.org.au/media/121429/ACTU_Report_Inequality_and_Progressive_Taxation.pdf.

[25] See, for example, R Wollner, S Barkoczy, S Murphy, C Evans and D Pinto, *Australian Taxation Law 2016* (Oxford University Press, South Melbourne, 2016) 1725.

[26] See, for example, D Bentley, 'Problem Resolution: Does the ATO Approach Really Work?' (1996) 6(1) *Revenue Law Journal* 17 at 19–20; Mookhey, above n 5.

Indirectly related to the spirit of the study is a group of papers by Murphy,[27] Mookhey[28] and Jone.[29] From a compliance perspective, Murphy examined the relationship between procedural justice and tax non-compliance in order to design a more effective tax compliance framework. Mookhey and Jone evaluated the ATO's internal review system. While they found that the ATO dispute resolution model possesses much of the best-practice principles such as clear multi-step procedure and emphasis on negotiation, notification and consultation, the ATO model is still deficient in several respects. Specifically, Mookhey recommended that 'there is an increase in transaction costs at each level and affordable access to first-level external review is highly desirable, so as to increase the pressure for a negotiated outcome at an early stage'[30] whereas Jone proposed that the ATO provides 'taxpayers with the ability to enter the dispute resolution procedures at either the internal review level or external appeal level'.[31]

There are only a handful of Australian studies that explicitly consider the issue of compliance costs and accessibility to external tax dispute resolution. The first is a study by Chapple,[32] 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.[33] While this information is almost 25 years old, it nevertheless provides a solid basis for checking new cost estimates. The second is an outdated, exploratory study by Tran-Nam and Blissenden,[34] which attempted to estimate the costs of tax dispute resolution from the social perspective.

More recently, Tran-Nam and Walpole[35] conducted perhaps the first systematic examination of the accessibility of the system of independent tax dispute resolution in Australia and the social justice implications of ineffective access to such a system. In addition to deriving plausible estimates of the compliance costs of tax dispute resolution from the taxpayer perspective under different scenarios, they also constructed a simple decision model to analyse the choice of an informed taxpayer using the traditional cost-benefit analysis. Under various assumptions, it is possible to determine whether the taxpayer will (i) settle with the ATO, or (ii) seek the AAT review without professional assistance, or (iii) seek the AAT review with professional assistance.[36]

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[27] K Murphy, 'Regulating More Effectively: The Relationship Between Procedural Justice, Legitimacy and Tax Non-compliance' (2005) 32(4) *Journal of Law and Society* 562.

[28] See Mookhey, above n 5.

[29] M Jone, 'Evaluating Australia's Tax Dispute Resolution System: A Dispute Systems Design Perspective' (2015) 13(2) *eJournal of Tax Research* 552.

[30] See Mookhey, above n 5 at 94.

[31] See Jone, above n 29 at 577.

[32] S Chapple, 'Income Tax Dispute Resolution: Can We Learn from Other Jurisdictions?' (1999) 2(5) *Journal of Australian Taxation* 312, 326.

[33] Attorney-General's Department (Cth), 'Submission to Senate Standing Committee on Legal and Constitutional Affairs', *Discussion Paper No 6, The Courts and the Conduct of Litigation*, (Commonwealth of Australia, Canberra, 1992) at [2.32] and [2.36].

[34] B Tran-Nam and M Blissenden, 'Compliance Costs of Tax Dispute Resolution in Australia: An Exploratory Study' in M Walpole and C Evans (eds), *Tax Administration and the 21st Century*, (Prospect, Sydney, 2001) 287.

[35] B Tran-Nam and M Walpole, 'Access to Tax Justice: How Costs Influence Dispute Resolution Choices' (2012) 22(1) *Journal of Judicial Administration* 1.

[36] See Tran-Nam and Walpole, above n 35 at 18.

There is also a paucity of international evidence on whether independent tax dispute resolution is accessible and the implications.[37] There is, however, a more substantial literature on the application of economic analysis to dispute resolution.[38] While these papers were concerned with legal disputes in general, their approaches and insights may be modified for analysing tax disputes. In a seminal work on the dynamics of litigation, Galanter[39] made an important distinction between one-shotter (OS) and repeat player (RP) in analysing whether the US legal system is effectively neutral between the 'haves' and the 'have-nots.' His framework has been widely adopted[40] and recently applied to tax litigation in the UK.[41]

3.2 Australian data availability

There is some published secondary data on tax disputes and tax dispute resolution in Australia. The main sources include various annual reports such as the

- Commissioner of Taxation Annual Report
- AAT Annual Report
- Federal Court Annual Report
- High Court Annual Report
- Commonwealth Ombudsman Annual Report
- Inspector General of Taxation Annual Report.

A particularly informative ATO publication on tax disputes is the *Your Case Matters: Tax and Superannuation Litigation Trends*. Unfortunately, this publication is only published on an irregular basis and the latest edition available is the third edition covering July 2007 to December 2012. This is therefore somewhat out-of-date.

While the data are reliable, they are only available in aggregate form and thus of limited value for the purposes of the present study. Unit record data on tax disputes are collected but they are generally unavailable to researchers.

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[37] See, for example, P E Treusch, 'What to Consider in Choosing a Forum to Resolve an Ordinary Tax Dispute' (2001) 55(1) *Tax Lawyer* 83; L Lederman and W B Hrung, 'Do Attorneys Do Their Clients Justice? An Empirical Study of Lawyers' Effects on Tax Court Litigation Outcomes' (2006) 41 *Wake Forest Law Review* 1235; A Maples, 'Resolving Small Tax Disputes in New Zealand—Is There a Better Way?' (2011) 6(1) *Journal of the Australasian Tax Teachers Association* 96.

[38] See, for example, G L Priest and B Klein, , 'The Selection of Disputes for Litigation' (1984) 13(1) *Journal of Legal Studies* 1; R D Cooter and D L Rubinfield, 'Economic Analysis of Legal Disputes and Their Resolution' (1989) 27(3) *Journal of Economic Literature* 1067; S Shavell 'Alternative Dispute Resolution: An Economic Analysis' (1995) 24(1) *Journal of Legal Studies* 1; E Friedman and A L Wickelgren, 'No Free Lunch: How Settlement Can Reduce the Legal System's Ability to Induce Efficient Behavior' (2008) 61 *SMU Law Review* 1355.

[39] M Galanter, 'Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change' (1974) 9(1) *Law and Society Review* 95.

[40] See, for example, H K Kritzer and S Silbey (eds.), *In Litigation Do the 'Haves' Still Come Out Ahead?* (Stanford University Press, Stanford, 2004).

[41] M Blackwell, 'Do the Haves Come Out Ahead in Tax Litigation? An Empirical Study of the Dynamics of Tax Appeals in the UK' (Working Paper No WP 13/20 Oxford University Centre for Business Taxation, Oxford, 2013).

Other potential sources of data are the various Australian studies on tax compliance costs.[42] Since taxpayers' compliance tasks are typically broken into activities, including tax dispute resolution, it should be, in principle at least, possible to derive estimates of taxpayers costs specifically related to tax dispute resolution. However, the send-out samples of taxpayers provided to the researchers by the ATO did not include any taxpayers who are currently disputing with the ATO. Thus the effective samples did not contain sufficient number of taxpayers who have been in dispute with the ATO so that no reliable estimates of taxpayer costs of tax dispute resolution could be derived.

In the interest of academic pursuit and social benefits, it is recommended that the ATO publishes data on tax disputes and tax dispute resolution on an annual basis and also makes limited form of (anonymous) unit record data on tax disputes and tax dispute resolution available to tax researchers upon formal requests.

4. RECENT DEVELOPMENTS IN ALTERNATIVE DISPUTE RESOLUTION IN AUSTRALIA

4.1 What is alternative dispute resolution?

ADR is a term that emerged in Australian legal circles in the 1980s.[43] Initially it was used to describe a procedure by which legal disputes are resolved by mediation. However, its meaning has been considerably expanded. ADR is now defined as 'an umbrella term for processes, other than judicial determination, in which an impartial person assists those in dispute to resolve the issues between them'.[44] ADR often takes the form of negotiation, mediation and arbitration.[45] Each of these can be observed in the current tax administration system. For example:

- Negotiation (no third party): Tax audits often conclude with a negotiated settlement[46]
- Mediation (with mediator): The process followed in the AAT (via conferences) or Commonwealth Ombudsman's Office (via the Special Taxation Adviser)
- Arbitration: The AAT also provides an example of formal arbitration in the sense that it 'makes a binding determination of the law and facts in dispute'.[47]

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[42] See, for example, Tran-Nam, Evans and Lignier, above n 7; C Evans, R Ritchie, B Tran-Nam and M Walpole, *A Report into Taxpayer Costs of Compliance*, (Australian Government Publishing Service, Canberra, 1997).

[43] D Porrester, 'Review of H Astor & CM Chinkin, *Dispute Resolution in Australia*, Sydney: Butterworths. $55.00' (1992) 22(2) *UWA Law Journal* 447.

[44] National Alternative Dispute Resolution Advisory Council, *Dispute Resolution Terms* (NADRAC, Canberra, 2003) 4, https://www.ag.gov.au/LegalSystem/AlternateDisputeResolution/Documents/NADRAC%20Publications/Dispute%20Resolution%20Terms.DOC

[45] See Bentley, above n 26 at 19–20.

[46] See, for example, R Bryant, 'Tax Audit Experience—Key Issues' (Paper presented at the 31st Victoria Taxation Convention, Lorne, 29–31 October 1992); M D'Ascenzo, 'A Tax Office Insight into Business Audits' (Paper presented at the 23rd Queensland Tax Convention, 4–6 June 1993).

[47] H Astor and C M Chinkin, *Dispute Resolution in Australia* (LexisNexis Butterworths, Chatswood, 2002) 297.

4.2 Advantages and disadvantages of ADR

Five major advantages of ADR have been identified in the literature:[48]

- reduced time in dispute
- reduced costs relating to the dispute resolution
- increased probability of settlement
- improved satisfaction among disputants with the outcome or manner in which the dispute is resolved
- increased compliance with agreed solutions.

The main disadvantage of ADR is that there is very limited opportunity for judicial review of an arbitrator's decision.

There is some Australian evidence suggesting that the above general advantages carry over to tax disputes. Sourdin and Shanks have recently provided an empirical analysis of the costs and benefits of ADR in taxation disputes.[49] They surveyed and analysed the experiences of ATO internal staff members, taxpayers, ADR practitioners, taxpayer representatives and ATO representatives who were involved in ADR processes in relation to taxation and superannuation disputes that took place between 1 July 2013 and 30 June 2014. The ADR processes that were considered include conciliation, mediation, neutral evaluation and case appraisal.

Sourdin and Shanks found that the median cost saved in the successful resolution of disputes after ADR was approximately $70,000 per matter.[50] They noted, however, that in many instances significant costs had been incurred prior to commencing ADR processes.[51] In particular, the study revealed that taxpayers involved in dispute resolution expended a considerable amount for external non-lawyer professionals such as external valuers.[52]

Some cautionary remarks are in order. First, the estimated cost saving refers to self-reported, assumed saving in legal costs only (time costs and other incidental costs were excluded). Secondly, all five groups of respondents were asked more or less the same question about legal cost saving[53] and there is no clear explanation how the overall cost saving was aggregated. It seems that the legal costs saved refer to saving made by both the taxpayer and ATO, and it is not possible from the study to deduce the average or median value of legal cost saving enjoyed by the taxpayer only (which

[48] K Saville-Smith and R Fraser, *Alternative Dispute Resolution: General Civil Cases*, (NZ Ministry of Justice, Wellington, 2004) 25, http://www.justice.govt.nz/assets/Documents/Publications/ReportFinal3.pdf

[49] T Sourdin and A Shanks, 'Evaluating Alternative Dispute Resolution in Taxation Disputes: Exploring Selected ADR Processes that Took Place From 1 July 2013–30 June 2014', (Evaluation of ADR Paper No. 4, Australian Centre for Justice Innovation, Melbourne, 2015).

[50] See Sourdin and Shanks, above n 49 at [4.9].

[51] See Sourdin and Shanks, above n 49 at [4.10]. This may be particularly so in recent times where ADR may have been mandated by the AAT or Federal Court after proceedings have been instituted and preliminary conferences, etc, have been held.

[52] See Sourdin and Shanks, above n 49 at [4.12]; [4.15].

[53] See Sourdin and Shanks, above n 49 at Appendix C.

is the focus of our research). Thirdly, the sample size of taxpayers was small (19) and many of them did not report on costs incurred or saved.[54] So even if a separate estimate of legal cost saving for the taxpayer was available, this could not be validly generalised. As a result, the finding on legal cost saving must be interpreted with caution, as recognised by Sourdin and Shanks.[55]

Sourdin and Shanks also found that the earlier the ADR intervention took place, then the more likely the dispute would be resolved with greater cost savings.[56] Of note, the survey results indicated that the timing of ADR referral varied between states, which the authors attributed to a range of factors including the approaches of the ATO, the AAT and the Federal Court, and whether there were 'ADR champions' who supported earlier referral.[57] As such, the authors concluded that the costs of dispute resolution to taxpayers could be reduced by an earlier clarification of issues and earlier use of ADR.[58]

Despite some reservations, the thorough research by Sourdin and Shanks nevertheless suggests that ADR may provide an alternative option that can reduce not only taxpayers' litigation costs but also social compliance costs of tax disputes. ADR thus deserves to be explored much more deeply and extensively as a mechanism for resolving tax disputes.

4.3 Recent developments at the ATO

There have been many initiatives to improve the ATO's resolution of tax disputes following the 2015 Report of the House of Representatives Standing Committee on Tax and Revenue, and the 2015 Report of the General-Inspector of Taxation on tax disputes for large businesses and high wealth individuals.[59] Those initiatives include:

- move all objections into the Review and Dispute Resolution area
- a revised Code of Settlement practice
- early engagement
- 'pick-up-the-phone' approach
- in-house facilitation
- independent review
- development of communications protocols to enhance independence
- measuring fairness in disputes
- dispute resolution training.

[54] See Sourdin and Shanks, above n 49 at [1.16]; [4.12].

[55] See Sourdin and Shanks, above n 50.

[56] See Sourdin and Shanks, above n 49 at [4.13].

[57] See Sourdin and Shanks, above n 49 at [4.20].

[58] See Sourdin and Shanks, above n 49 at [4.12]; [4.15].

[59] A Orme, 'Australian Taxation Office Dispute Resolution' (Paper presented at the Victorian 3rd Annual Tax Forum, Melbourne, 8 October 2015) at 3.

According to the ATO, some of those measures have so far yielded positive results in reducing the number of disputes or the time required to resolve disputes.[60] For example, the 'pick-up-the-phone' strategy provides taxpayers the opportunity to explain their views and clarify the any misunderstanding about the facts and the law. Similarly, in-house facilitation is designed to provide taxpayers with an opportunity to meet with ATO case officers and an ATO impartial facilitator in an early, direct and open manner. However, a more thorough and independent analysis is necessary to confirm whether (i) ATO facilitators are impartial, and (ii) the results are indeed positive and, if so, sustainable.

5. A FUTURE RESEARCH AGENDA

To study the effective accessibility and neutrality of tax dispute resolution in Australia, it is proposed that a holistic approach be employed. The proposed approach should examine relevant issues under study from all stakeholders' perspectives using a mixed method of quantitative and qualitative analyses of both primary and secondary data. Key elements of the research agenda, including recognition of relevant stakeholders, development of theoretical models and hypotheses, data collection, and data analysis, are briefly discussed in turn below.

5.1 Recognition of stakeholders

Relevant stakeholders include taxpayers (individuals and businesses) who have been in disputes with the ATO, the ATO and their legal representatives, professional tax practitioners who advise both the ATO and taxpayers in disputes, and AAT members and judges. In principle, those taxpayers who are dissatisfied with the ATO's decisions but do not formally object should also be included. However, in practice it would be impossible to identify those taxpayers even with the assistance of the ATO.

5.2 Development of theoretical models and hypotheses

Once stakeholders have been recognised, it is necessary to conceptualise the decision facing the taxpayer who is in dispute with the ATO and state relevant hypotheses. In terms of theoretical modelling, two approaches can be employed:

(i) taxpayer's decision from the perspective of the taxpayer only, taking the ATO's decision as given

(ii) taxpayer's decision taking into account the interaction and negotiation between the ATO and the taxpayer.

Under approach (i), the taxpayer's decision whether to settle or to litigate can be modelled by the standard cost–benefit analysis. This will build upon an earlier model developed by the authors and discussed previously.[61] Under approach (ii), the interaction between the ATO and the taxpayer in dispute resolution can be modelled using the game-theoretic approach.

[60] C Jordan, 'Commissioner of Taxation Keynote Address' (Presented at the 12th International Conference on Tax Administration, Coogee, 31 March 2016).

[61] See Tran-Nam and Walpole, above n 35.

The modelling of the taxpayer's decision under approach (i) involves identifying the taxpayer's motive (maximising/minimising financial gains/losses), choices (settle before dispute, settle during dispute, or litigate with or without legal representation), and the consequences of each of these choices, which in turn depend on institutional factors (for example, legal costs are tax deductible or the AAT does not award costs to 'winners' while courts do award costs to 'winners'). There are several complications that need to be considered. For example, in addition to financial considerations, there are non-financial factors that cannot be easily captured quantitatively. Similarly, financial gains/losses can be either one-off or ongoing (especially if taxpayers seek clarity of the tax laws so that they can continue to engage in tax planning or make deduction claims in the future). These issues may be resolved by (i) incorporating a non-financial variable as a determinant of the taxpayer's objective function and (ii) formulating the taxpayer's motive as a multi-period objective function. Another relevant issue in this theoretical approach is the determination of the taxpayer's subjective probability of success in the AAT or the courts, which will depend, amongst other things, on whether or not professional assistance is engaged.

A more sophisticated approach is to take the role of the ATO into account and model the interaction between the ATO and the taxpayer as a game with mixed strategies (probabilistic approach to game theory). As previously reviewed, game theory has been applied with some success to the problem of paying taxes and auditing taxpayers[62] but not to tax dispute resolution. This study will develop a game with mixed strategies to capture the process of tax dispute resolution. A major challenge in so doing is how to incorporate the role of tax advisers in the game.

There will be no formal model developed for investigating the neutrality of independent tax dispute resolution. There will instead be a comprehensive legal analysis as to whether the ATO (as ultimate repeat player (RP)) or large businesses (as RPs with non-trivial bargaining power) enjoy a position of advantage over one-shotters (OSs) in tax dispute resolution. Further, a number of testable hypotheses will also be proposed. They are:

(i) *Alternative hypothesis A*: Costs to taxpayers and duration of tax disputes render access to independent tax dispute resolution ineffective

(ii) *Alternative hypothesis B*: Legal representation of taxpayers makes a difference in the outcomes of the disputes

(iii) *Alternative hypothesis C*: The ATO is more likely to lose against a RP than an OS

(iv) *Alternative hypothesis D*: The ATO is more likely to appeal losses against OSs (individuals, trustees, etc) than RPs (large or foreign companies)

(v) *Alternative hypothesis E*: RPs are more likely to appeal losses against the ATO than OSs.

[62] See, for example, M Graetz, J F Reinganum and L L Wilde, 'The Tax Compliance Game: Toward an Interactive Theory of Law Enforcement' (1986) 2(1) *Journal of Law, Economics and Organization* 1; B Erard and J S Fienstein, 'Honesty and Evasion in the Tax Compliance Game', (1994) 25(1) *Rand Journal of Economics* 1.

5.3 Data collection

The study will utilise both primary and secondary data from a variety of sources. Secondary data will be sought from publicly available sources (such as annual reports of the ATO, the AAT, Federal Courts and the High Court) as well as unpublished sources, principally the ATO. In addition, primary data will also be collected from a variety of surveys and structured interviews of relevant stakeholders. Like most empirical studies, primary data collection represents a very challenging aspect of the study.

The proposed primary data collection is summarised in the following table.

Table 1: Primary data collection by hypothesis

Hypothesis	Primary data
A	Interviews of tax advisers who have represented either taxpayers or the ATO at hearings or trials Survey of taxpayers who have been in dispute of the ATO Small scale e-survey of ATO officers
B	Interviews of tax advisers, tribunal members and judges
C	Interviews of tax advisers Small scale e-survey of ATO officers
D	Interviews of tax advisers Small scale e-survey of ATO officers
E	Interviews of tax advisers Small scale e-survey of ATO officers

The main survey will involve taxpayers who have been in dispute with the ATO. This will be a large scale, anonymous survey of appropriate scale (about 1,700, that is, half a percent of the objections lodged in 2011–12).[63] Particular information to be sought from such participants includes their time costs and out of pocket expenses, their perceptions of any non-monetary motives (such as issues of reputation, future relationship with the ATO, risk avoidance, the psychological satisfaction of winning against ATO or exercising inherent taxpayer rights, etc), their formation of subjective probability of success and whether the gains/losses are one off or recurring. In addition, based on information obtained from public sources (for example, AAT's open hearings), a small number (about 20) of taxpayers who have been in dispute with the ATO will be approached to participate in the study via structured interviews. The purpose of the interviews is to validate and elaborate the data obtained from the large-scale survey of taxpayers.

5.4 Data analysis

A variety of mixed methods will be employed to analyse the data obtained using the theoretical frameworks which will be developed. These methods include:

[63] Assistance from the ATO will be sought in conducting this survey.

- legal and qualitative analyses of qualitative data obtained from surveys and interviews of taxpayers, ATO officers, tax advisers, and members of the AAT and judges
- the Delphi method for triangulating responses from ATO officers and tax advisers
- statistical analyses of quantitative data derived from the survey.

The Delphi method is a technique that aims to obtain the most reliable consensus of a group of experts such as ATO officers or tax advisers. The participating experts are encouraged to revise their previous answers in view of the 'collective intelligence' so that the panel may move to a consensual view. Further, both descriptive and inferential statistical methods will be employed to summarise quantitative data and test the hypotheses stated above, respectively. In addition, econometric methods such as regression analysis will also be used to isolate the partial effects of various factors on key variables under study. In particular, the probit estimation (a type of regression where the dependent variable typically takes on two values only) will be applied to study the taxpayer's decision and the outcome of their objections/appeals.

6. SUMMARY AND CONCLUSION

This paper has discussed conceptual issues, reviewed the literature and set out a research agenda related to an ARC Discovery project on tax disputes, compliance costs and access to tax justice. The aims of the study are to investigate whether or not (i) access to independent tax dispute resolution is effective, (ii) taxpayers with greater resources may obtain more favourable outcomes than taxpayers with lesser resources, and (iii) ADR is an effective way for resolving tax disputes. In addition, the study also examines the costs and benefits of external tax dispute resolution and social justice implications of accessibility to independent tax dispute resolution.

The study is motivated by several considerations. The primary driver of the study is the relative lack of knowledge of the procedural justice dimension of tax dispute resolution as an integral aspect of the operation of the tax system in Australia. Note that procedural justice is unrelated to the legal correctness of the outcome of the process.

In discussing conceptual issues and context four key points have been made. They are (i) the literature on tax complexity tends to ignore the impact of statutory and administrative complexity on tax justice, (ii) tax disputes differ fundamentally from other civil and commercial disputes in many important respects, (iii) litigation costs may act as a barrier to effective accessibility and neutrality of tax dispute resolution mechanisms, and (iv) lack of accessibility and neutrality can give rise to a violation of social and distributive justice, respectively.

The review of literature suggests that the body of relevant literature is insubstantial. Indirectly relevant to the purpose of the study is a small set of papers on tax dispute resolution system design in Australia. The more relevant literature on compliance costs and accessibility is very thin and not sufficiently authoritative. Further, there are no Australian studies on the effects of compliance costs on the neutrality of tax dispute resolution. There is some secondary data on tax dispute resolution published by the

ATO, AAT and the courts. However, the published data are aggregative and unit record data is not available. It is recommended that the ATO either publishes the same aggregate data annually or makes unit record data more readily available to researchers.

In recent years, the ATO has introduced many initiatives aimed at improving the internal resolution of tax disputes. While it seems to be somewhat premature to reach a definite conclusion, the improved ADR approach by the ATO has the potential of not only reducing the social compliance costs and the stress but also producing socially fairer outcomes for taxpayers.

In conclusion, the effective accessibility and neutrality of tax dispute resolution in Australia (and elsewhere) is a relatively neglected area of study among tax researchers. For a number of reasons, including social justice, distributive justice and tax morale, it is imperative that a systemic and comprehensive study of external tax dispute resolution in Australia be undertaken. Such a study necessitates a holistic approach that examines the issues under study from all stakeholders' perspectives using mixed methods of quantitative and qualitative analyses of both legal and economic data. Key components of the research methodology for such a study have been sketched out in the previous section.