

Inspector-General of Taxation  
GPO Box 551  
SYDNEY NSW 2001  
Via email: [taxprofession@igt.gov.au](mailto:taxprofession@igt.gov.au)

28 July 2017

Dear Sir,

### Review into the Future of the Tax Profession

The Taxation Committee of the Business Law Section of the Law Council of Australia (**Committee**) welcomes the opportunity to make a submission to the Inspector General of Taxation in relation to the Review into the Future of the Tax Profession (**Review**).

The Committee recognises the significance of the technological advances that are transforming all aspects of modern society and their current and potential impact on the tax profession. It appreciates the importance of the Review, and its ability to assist with planning for the impact of these sweeping changes, on the administration of the taxation system.

The Committee also recognises that while a significant part of the changes affecting the taxation system is the result of technological advances, there are other sources of change, including social, policy and regulatory developments, both in Australia and globally. An example of these is the Organisation for Economic Co-operation and Development (**OECD**) Base Erosion and Profit Shifting Project (**BEPS Project**), reflecting the increased globalisation of tax administration. The BEPS Project highlights how social, policy and regulatory developments occurring overseas can, and do, have an impact on the Australian taxation system.

The Committee notes that the tax profession comprises a broad spectrum of participants, including accountants, lawyers, and tax agents. This spectrum continues to expand. For the purposes of this submission, given its purview, the Committee has focussed on observations from the perspective of the legal profession and its role in the taxation system in providing legal advice and facilitating the resolution of disputes.

With that background, the Committee provides its observations below by reference to the issues raised in the Terms of Reference for the Review. Please note that the following submission covers most, but not all elements of the Terms of Reference, and therefore in some instances the headings may not be sequential.

GPO Box 1989, Canberra  
ACT 2601, DX 5719 Canberra  
19 Torrens St Braddon ACT 2612

Telephone +61 2 6246 3788  
Facsimile +61 2 6248 0639

Law Council of Australia Limited  
ABN 85 005 260 622  
[www.lawcouncil.asn.au](http://www.lawcouncil.asn.au)

**BLS**

## 1. The opportunities, risks and challenges presented by new technological, social, policy and regulatory developments on the administration of the tax system

### *General observations*

- 1.1. In many respects, the technological and other developments are intertwined and have a compounding effect on the administration of the taxation system. Technological advancements have given rise to new business models and services, resulting in social changes and requiring policy and regulations to adapt.
- 1.2. An example of the intertwined nature of these developments is the impact of evolving digital business models on the concept of a 'taxable presence' by a foreign enterprise in a country. The impact of these business models is evident in the perceived need to amend the definition of a 'permanent establishment' in the OECD Model Tax Convention on Income and on Capital.<sup>1</sup> Prior to the amendment, this definition had remained largely unchanged for decades. It is also evident in the growing reliance by jurisdictions on the indirect taxation of these business models and services,<sup>2</sup> as well as targeted anti-avoidance measures.<sup>3</sup>
- 1.3. In a similar way, technological developments and evolving business models have also had an impact on tax compliance and the administration of the tax system. For example, technological developments have allowed and fostered the outsourcing of tax compliance functions to overseas services centres. At the same time, they have also increased the ability of tax authorities to collect and exchange taxpayer data, with other tax jurisdictions.
- 1.4. There is nothing to indicate that these developments will slow or cease anytime soon. It may be considered that change has always been a feature of the tax system. Notable examples include the introduction of Capital Gains Tax, Fringe Benefits Tax and Goods and Services Tax; the ongoing rewrite of the *Income Tax Assessment Act 1936* (Cth); and more recently, transfer pricing reforms and the introduction of the Diverted Profits Tax.
- 1.5. The administration of the tax system needs to emphasise flexibility and a forward-looking approach to applying tax laws to changing business models and relationships. For example, pure technology companies now count amongst the biggest providers of transport services (Uber) and of short-term accommodation (AirBnB). How the tax system responds to these new models is critical to Australia being seen as great place to do business and the ATO has a huge role to play in this regard with the approach that is taken, across the spectrum from case officers to the Commissioner.

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<sup>1</sup> For example, refer to OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris and OECD (2015), *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

<sup>2</sup> Some examples of this include: the expansion of Australia's Goods and Services Tax (**GST**) to digital supplies; in India the introduction of the equalisation levy; in South Korea the application of Value Added Tax (**VAT**) to electronic services; and in Taiwan the application of VAT to the supply of digital services.

<sup>3</sup> For example, the Multinational Anti-Avoidance Law and in the United Kingdom, the Diverted Profits Tax.

- 1.6. The current and foreseeable impact of technological advances should not be understated. From the perspective of the legal profession, these changes will have an impact on the two core functions and services performed by the legal profession. That is, they will impact the provision of legal advice and dispute resolution.
- 1.7. Furthermore, the effect will be not just on the nature of the functions and services performed by the legal profession, but also on how these functions are performed. For example, cloud computing is already having a profound effect on how lawyers interact with their clients. Services such as Dropbox are already being used by lawyers to access, review and advise on documents more effectively and efficiently. In a similar way, the Federal Court's pioneering eServices Strategy and the use of electronic court files, has resulted in the legal profession moving away from printed submissions and boxes of folders of documents. While these changes are welcomed by many, some still prefer to work with printed materials, which has resulted in slower and more fragmented adoption of these tools.
  - a. *Changing nature of automated and online services*

#### Robotic Process Automation

- 1.8. The Committee notes the growing awareness and use of Robotic Process Automation (**RPA**), a feature of intelligent process automation, in tax functions. It would appear that the use of RPA will only increase. This is due to its many benefits, including cost reduction, efficiency and freeing up tax professionals to work on value-added activities.
- 1.9. However, the Committee also submits that RPA potentially increases the risk of unintentional non-compliance with tax provisions. This can arise due to the difficulty in being able to code a program that is able to cater for the complexities of the tax system. This complexity can arise in two ways.
- 1.10. It can arise when different tax provisions apply to a particular class or type of instrument or transaction depending on when this was entered into – due changes in the legislation (**temporal complexity**). For example, different income tax provisions may apply to a loan, depending on when it was entered into. In some cases loans may have been entered into prior to the introduction of the Taxation of Financial Arrangements (**TOFA**) rules (Stages 3 and 4), which came into effect, for many taxpayers, for income years commencing on or after 1 July 2010.
- 1.11. In a similar way, complexity can arise due to the operation of the tax provisions, specifically their application to the taxpayer's circumstances (**operational complexity**). For example, a taxpayer may make a "hedging election" under the TOFA rules with respect to specific loans on its balance sheet – but not all loans. The taxpayer will need to ensure that the RPA is able to differentiate between those loans which are subject to the hedging election and those which are not. It will also need to determine whether the requirements for the hedging election are met. This is in addition to being able to differentiate between those loans which are subject to the TOFA rules and those which are not. By way of further example, the complexity can be compounded if the taxpayers has formed or joined a tax consolidated group and/or made a functional currency election.

- 1.12. Furthermore, RPA also creates the risk of replicating and systemic non-compliance which may be difficult to identify. For example, a software engineer, not conversant with the intricacies of the tax provisions, may unintentionally code an RPA which results in tax calculations being incorrect. This RPA may be replicated throughout the organisation and even to other taxpayers. Unless a review of the RPA is undertaken by a lawyer, or a tax professional that is conversant with both the operation of the RPA and the operation of the tax provisions, the error may not be identified. Naturally, the error may ultimately result in either the overstatement or understatement of tax liability.
- 1.13. From the perspective of the legal profession, lawyers can advise on the tax treatment of particular transactions. However, the difficulty will arise in the implementation of that tax advice – ensuring that the manner in which the transaction is documented is consistent with the advice provided.
- 1.14. In a similar way, in the case of tax audits and disputes, the difficulty will arise in taxpayers being able to prove that a particular RPA complies with the tax provisions, which will require an understanding of both the technology behind the RPA and also the tax provisions.

*b. Changes in work and communication practice*

Digital tax advice

- 1.15. The Committee welcomes the benefits of the digital initiatives being undertaken by the Australian Taxation Office (**ATO**), such as the introduction of the virtual assistant “Alex” and the peer-to-peer online forum “ATO Community.” It also notes the potential for increased use and reliance on automated digital tax advice, which operates without human input and which is provided commercially, such as the service being marketed as “Ailira.”<sup>4</sup>
- 1.16. However, greater awareness is and will be required about the limitations of these systems. In particular, while they may be adequate for simple and specific questions, there is a risk that taxpayers may not appreciate the limitations of these systems to provide accurate and comprehensive advice. In particular, an answer to a specific question merely forms one part of the process of determining how the tax law applies to a particular taxpayer. In this regard, the process of providing tax advice could be described as comprising the following steps:
  - a) Determining the facts, including knowing what questions to ask.
  - b) Identifying the issue/s which arise and which may have tax consequences.
  - c) Identifying the relevant tax provisions - operationally and temporally (noting that different tax provisions may apply, depending on when events occurred). It may also be necessary to identify relevant case law and regulations, as well as non-tax provisions.
  - d) Where there is uncertainty about the operation of the tax provisions, referring to case law and extrinsic sources to form a view on how the provisions should apply.

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<sup>4</sup> Also referred to as “Artificially Intelligent Legal Information Research Assistance” and available on the following website: <http://ailira.com/>

- e) Applying the tax provisions to the facts and issues identified, and forming a view on tax outcomes. In many cases, this may involve an exercise of judgment, based on the experience of the tax professional.
- 1.17. In light of the above, current digital services may be considered to simply assist with step c). However, they do not cater for identifying the provisions that may be relevant temporally, nor assist with identifying the relevant issues and questions, or how the answer to their question may apply in their context.
  - 1.18. The Committee appreciates that sophisticated taxpayers will continue to seek specialist tax advice from tax professionals. However, it notes that less experienced taxpayers may place undue reliance and expectations on the accuracy and relevance of these digital services. It also notes that taxpayers who try to be 'economical' with the amounts they pay for advice, may rely on these systems, to reduce costs, at the risk of the integrity of their tax compliance.
  - 1.19. A further consideration with respect digital advice is the relevance of such advice, when it comes to protection from penalties. While such protection is afforded where taxpayers rely on public rulings, taxpayers should be made aware that the position may be different where they rely on digital automated advice. Alternatively, the ATO may consider providing some 'safe harbours' where taxpayers rely on automated advice, provided by its systems.
  - 1.20. Examples of these sorts of issues can already be found in the context of taxpayers relying on the use of online ATO questionnaires to determine issues such as their individual tax residency or their status as an employee (v a contractor). Many taxpayers who have relied upon these automated tools, despite whatever warnings are extended by the ATO concerning their use, have become dismayed when they discover the ATO disagrees with the outcome upon a closer enquiry.

c. *Entry of new intermediaries into the tax system*

- 1.21. The Committee welcomes the benefits of the broadening of the spectrum of participants in the tax profession. However, it also notes that taxpayers may not appreciate that not all 'tax advice' is the same. That is, there may be a difference between legal tax advice, provided by a solicitor, and tax advice provided by other tax professionals. Legal professional privilege and comprehensive legal and risk analysis, are just some of the differentiating factors.
- 1.22. Given the current operation of the self-assessment regime, steps should be taken to ensure that taxpayers are fully appraised of the character, nature and quality of the advice that they are receiving and for which they are ultimately responsible.

2. **The strategies necessary to assist the tax profession**

a. *Changing demographic and role played by other third parties*

- 2.1. The Committee notes the increasing importance of and reliance placed by lawyers and taxpayers on expert assistance, particularly in relation to transfer pricing issues. This arises both in the context of advice and also dispute resolution.

- 2.2. The Committee emphasises the importance of legal professional privilege applying to external assistance. That is, it is important that the scope of the privilege is not eroded. This is important, particularly in factually complicated situations, to ensure that lawyers are provided with all relevant facts, assistance and analysis, to provide comprehensive legal advice.
- 2.3. In this regard, the Committee refers to the decision in *Pratt Holdings Pty Limited v Commissioner of Taxation* [2004] FCAFC 122, where the Commissioner unsuccessfully sought to challenge the application of the privilege in the circumstances where a taxpayer sought advice from an accounting firm, which was to be used in obtaining legal advice.
- b. Skills, training and on-going education that tax professionals may require*
- 2.4. Given the constant state of change in the tax system, the tax profession is accustomed to continually adapting and learning. That said, future developments impacting the tax profession will arise not just in relation to changes in tax law, but also commercial and technological developments. An example is the increasing use of cryptocurrencies, such as Bitcoin and the rise of blockchain technology for smart contracts.
- 2.5. In this regard, the tax profession will need to stay abreast of these and other developments, perhaps more so than before, as they are likely to impact on the commercial arrangements of their clients and, in turn, the tax advice that they are required to provide.
- c. Support that the tax profession would require from the ATO, TPB, tax academics and educators, as well as professional bodies and industry associations*
- 2.6. The Committee recognises and appreciates the extensive resources that are already devoted by the Commissioner and the ATO in providing public guidance, including in the form of rulings and public compliance guidelines. It notes that this public guidance will continue to be relevant and important to the tax profession and taxpayers, in the future. It would be beneficial and desirable if this commitment was maintained and these guidance materials were constantly reviewed to ensure they remain relevant and useful in a changing world.
- 2.7. Likewise, the Committee recognises and appreciates the important role and support that academia and professional associations provide to the tax profession. Again, this support will become even more important in the future, with the increasing complexity and sophistication of developments impacting the administration of the tax system.

**3. How the ATO and the TPB can seize the opportunities presented by technological, social, policy and regulatory developments to work with the tax profession in providing contemporary, reliable, accessible and secure services that foster voluntary compliance by meeting the increasing expectations of taxpayers and tax professionals and improving their productivity**

3.1. The Committee welcomes ATO initiatives such as the “ATO Community” and the “Let’s Talk Legal practitioners community.” It considers that online forums and digital mediums, such as these, present a good platform and opportunities for increased engagement with and assistance to the tax profession, that is both timely and relevant.

**4. Other concerns or potential improvements**

4.1. It is not controversial that the tax system is, and will continue to be, impacted by significant developments. The effect of these developments is expected to result in greater complexity of the taxation system and increase the scope for the application of the tax law to be uncertain.

4.2. While it may be considered that there have always been instances where the application of the tax provisions has not been clear or simple, these instances have the potential to increase in the future. For example, the operation and scope of the transfer pricing provisions continues to develop and evolve. In a domestic context, this is in the form of judicial decisions such as that in *Chevron Australia Holdings Pty Ltd (CAHPL) v Commissioner of Taxation* [2017] FCAFC 62 and transfer pricing reform, including the new reconstruction provisions in Subdivision 815-B of the *Income Tax Assessment Act 1997* (Cth). In a global context, this is evident from amendments to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, which are incorporated into Australia’s domestic income tax provisions.<sup>5</sup>

4.3. All of the participants in the tax profession have a role to play in the development and application of Australia’s tax system in the future. Only through keeping the lines of communication open can we continue to provide leadership in times of seemingly rapid technological and social change.

\*We trust these observations are of assistance.

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<sup>5</sup> Refer section 815-135 of the *Income Tax Assessment Act 1997* (Cth).

Should you have require any further information on any of these matters, in the first instance please contact the Committee Chair, Adrian Varrasso, on (03) 8608 2483 or Deputy Chair Clint Harding on (02) 9226 7236.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Teresa Dyson', written in a cursive style.

**Teresa Dyson, Chair**  
Business Law Section