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Dear Mr Noroozi,

INQUIRY INTO TAX DISPUTES

Introduction

- 1 The Taxation Committee of the Business Law Section of the Law Council of Australia (**the Taxation Committee**) welcomes the opportunity to make a submission to the Inspector-General of Taxation's (**IGT**) *Review into the Australian Taxation Office's Management of Tax Disputes with Large Businesses and High Wealth Individuals (the Review)*.
- 2 The Review is being conducted, under the IGT legislation, at the request of the House of Representatives Standing Committee on Tax and Revenue (**the HOR Committee**) in relation to its Inquiry into Tax Disputes (**the Inquiry**). The terms of reference for the Inquiry directed the HOR Committee to "*inquire into and report on disputes between taxpayers and the Australian Taxation Office (ATO)*" with particular regard to: "*collecting revenues due*"; "*fair treatment and respect of taxpayers*"; "*efficiency, effectiveness and transparency, from the perspective of both taxpayers and the ATO*"; and "*how the ATO supports the outcomes of efficiency, effectiveness and transparency through the use and publication of performance information*".
- 3 The Inquiry will be examining the above issues through six 'themes' identified in the HOR Committee's terms of reference. The IGT will undertake his Review of tax disputes on three of the HOR Committee's 'themes': large business, high wealth individuals (**HWI**) and related legal and governance frameworks.
- 4 We have had regard to the terms of reference of both the Inquiry and the Review, the role of the Taxation Committee, and the constituency of our membership. In order to avoid unnecessary duplication, the Taxation Committee will, in this submission, primarily address the HOR Committee's terms of reference being dealt with by the IGT. We note, however, that our submissions also have relevance to the remainder of the HOR Committee's 'themes'.

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- 5 This submission need not be treated as ‘in-confidence’ and may be made generally available. The Taxation Committee intends to provide a copy of this submission to the HOR Committee to be considered in its Inquiry.

Overview

- 6 The Taxation Committee makes the following key observations:
- (a) Over the last two years or so, there has been a discernible shift towards better and earlier engagement with taxpayers during tax disputes, particularly in large business and HWI (but generally less so in SME). This movement - in the right direction - began under the former Commissioner, Michael d’Ascenzo. It has noticeably accelerated and expanded since the appointment of the new Commissioner, Chris Jordan. The current emphasis at senior levels in the ATO on early, and alternative, dispute resolution is welcomed.
 - (b) A sense that there is a move by the ATO away from a ‘defend at all costs’ approach to positively seeking a ‘defensible’ resolution that is appropriate, flexible and reasonable is to be encouraged and, when it occurs, applauded.
 - (c) In addition to the positive and constructive attitude of senior ATO officers, the important administrative policies and frameworks - overseen by a First Assistant Commissioner (Review and Dispute Resolution) reporting directly to a Second Commissioner - are in place. These existing policies and frameworks should continue and remain amenable to positive refinement as the need arises. If universally applied (which is currently not the case), they will deepen the move to early and constructive dispute resolution.
 - (d) The creation, and enhancement, of various independent review processes within existing ATO administrative structures (e.g., dealing with objections) is critical and is to be encouraged. The ATO has recognised “*the importance of independent internal review*” and, in relation to objections, has a stated policy that an “*objection will be considered by a person who was not involved in the original decision*”.¹ Arguably, this clearly articulated policy, if given sufficient time and resources to be thoroughly implemented throughout the ATO, should have the same effect as a more formal separation of functions as between audit (“*original decisions*”) and internal decision review.
 - (e) At this stage, given the real and positive developments in the last 18 months or so, and despite what is still to be achieved, the Taxation Committee does not consider there to be a compelling case for the creation of a “*separate appeals area*” within the ATO, as used to exist until the early 1990s. However, if structural separation of a review function within the ATO is to be considered the Taxation Committee believes that:
 - (i) it would be important to undertake a review of learning from other jurisdictions to ensure that the benefits clearly outweigh the structural and cost duplications, particularly in the current budgetary environment;

¹ ATO, *Correct a mistake or dispute a decision*, <http://www.ato.gov.au/General/Correct-a-mistake-or-dispute-a-decision/>, Last modified: 15 Jan 2014.

- (ii) it should be staffed by appropriately technically qualified and experienced officers;
 - (iii) the operations of a “*separate appeals area*” would have to extend, and its personnel would have to be available, beyond ‘Part IVC’ work (i.e., objections and subsequent AAT and Court litigation), and also cover pre-assessment/objection and debt collection disputes, and
 - (iv) adequate resourcing will have to be provided to the extent that duplication would be required.
- (f) The Taxation Committee is of the view that a “*separate agency [to] manage ATO litigation*” is, at this stage, neither justified or necessary for the proper and efficient management of tax disputes. There are existing forums for reviews of ATO decisions that are entirely independent of the ATO - these are the AAT and courts.
- (g) There has been positive, although not universal, progress on ATO audit behaviours in relation to audit teams looking for opportunities to resolve emerging disputes with taxpayers. However, there continues to be residual concerns about overly aggressive interpretations of tax laws and approaches to findings of fact. These concerns extend to a general perception of an imbalance of power in favour of the ATO (particularly in SME) that results in some audit teams not treating taxpayers with balance, fairness and respect.
- (h) Debt collection disputes continue to raise significant concerns. In particular, the perennial issue of collecting disputed debts and the fragmentation of the ATO’s management of taxpayers. The IGT’s recently announced review of the ATO’s approach to debt collection is timely and welcomed.
- (i) Other reviews undertaken by the IGT over the last 3 years have also dealt with the subject matter of the Review. Those other reviews have identified many of the issues with dispute management that continue to cause problems. Nonetheless, those other reviews have led to positive and sustained changes to ATO practices. Accordingly, reflecting on the reports of those other reviews is also valuable. We note in particular the following:
- (i) *Report into the Australian Taxation Office’s large business risk review and audit policies, procedures and practices* (May 2011) – publicly released on 7 September 2011 (**IGT Large Business Report**);
 - (ii) *Review into the ATO’s compliance approaches to small and medium enterprises with annual turnovers between \$100 million and \$250 million and high wealth individuals* (December 2011) – publicly released on 24 April 2012 (**IGT SME Report**);
 - (iii) *Review into the Australian Taxation Office’s use of early and Alternative Dispute Resolution* (May 2012) – publicly released on 31 July 2012 (**IGT ADR Report**);
 - (iv) *Review into improving the self assessment system* (August 2012) – publicly released on 13 February 2013 (**IGT Self Assessment Report**);

- (v) *Review into aspects of the Australian Taxation Office's use of compliance risk assessment tools* (November 2013) - publicly released on 2 February 2014 (**IGT CRAT Report**); and
 - (vi) *Review into the Australian Taxation Office's administration of penalties* (February 2014) – publicly released on 8 July 2014 (**IGT Penalties Report**).
- (j) The Taxation Committee believes it is important for the ATO to continue the work undertaken to date, and ensure that the changes that have been implemented in ATO policies, systems and procedures effectively 'hard wire' effective and efficient dispute resolution processes across the board. Particular effort is required in areas of the ATO outside of large business and HWI. Continuous monitoring by the ATO, consultation with stakeholders (including the Taxation Committee) and the activities of the IGT are critical. Important work and outcomes are being achieved through the ATO's Dispute Resolution Working Group (which consists of senior ATO officers and representatives of the main professional and other stakeholder Groups).
- (k) For the moment, sound policies and robust and flexible administrative practices in the ATO, rather than formal separation of functions (such as a "separate appeals area" within the ATO), are considered to be the appropriate means of ensuring the efficient, fair and effective management of tax disputes. Clearly articulated policies, transparent processes and continuous external scrutiny should lessen the risk of future ATO management taking a different, and retrograde, approach.

7 Some of the above observations are addressed in more detail below, under discussion points arising from the Review's terms of reference (in the Tax Committee's perceived order of priority).

General observations in relation to tax disputes

8 It is probably fair to say that taxpayers ultimately want certainty in relation to their tax positions. It is less about paying tax and more about understanding what their liability is or might be. However, tax law is complex and constantly changing. Certainty cannot be expected. Indeed, despite the best of intentions, uncertainty is the norm. Writing nearly 30 years ago, Professor Ross Parsons observed:

... The income tax lacks any single underlying principle which is relevant to its function of sharing command over resources between individual and Government, and which can give it coherence and a claim to fairness. ...

When underlying reason is absent, income tax will be seen as some kind of game. It is a dangerous game, in which the taxpayer is always at great risk, and not a game for the fainthearted like me. It is a game in which the odds are not fair. ... the odds favour the administrators. Yet we all must play the game, whether we like it or not, for we all must be taxed. There are penalties for losing - penalties in money and in character loss.

The administrators, too, must play the game, and they will try to be moved by underlying reason. But if reason is not written into the analytical fabric of the tax, we are ruled by the reason of the administrators and not by the law.²

- 9 Things have not improved in the intervening years. If anything, they have become worse. The inevitable negative side effect - for both taxpayers and the revenue - of this “dangerous game”, where “underlying principle” is absent, is tax disputes. The only surprising thing in all of this is not that there are tax disputes, but how relatively few there actually are. The ATO’s *Dispute Management Plan 2012-13* records that of the 15.9 million tax returns filed in the 2011-12 year:
- (a) 565,000 adjustments were made as a result of an audit (representing 3.55% of returns filed);
 - (b) 27,000 objections were lodged (representing 0.17% of returns filed);
 - (c) 534 appeals were filed in the courts or the AAT (representing 0.003% of returns filed); and
 - (d) 110 appeals were finalised by a court or AAT decision (representing 0.0007% of returns filed).³
- 10 What the above figures suggest is that the number of tax disputes is miniscule relative to total taxpayer/ATO interactions (as represented by tax filings). In addition, relatively few disputes are resolved through concluded litigation - most disputes are finalised at some stage prior to litigation. Of course, these statistics obscure the real problem of the significant time, effort and expense incurred by both taxpayers and the revenue in dealing with tax disputes, the management of which can probably be regarded as an application of the so-called ‘80/20 rule’ (that roughly 80% of the effects come from 20% of the causes).
- 11 The Commissioner is given the general administration of tax legislation by provisions such as s 8 of the *Income Tax Assessment Act 1936 (ITAA 1936)*, s 356-5 of schedule 1 of the *Taxation Administration Act 1953 (TAA)* and s 44 of the *Financial Management and Accountability Act 1997 (Cth)*. Although “*the power of general administration in such provisions is not a discretion to modify, or which modifies, the liability to tax imposed by the statute*”⁴, they do permit the Commissioner to resolve disputes (and legal proceedings) to which he is a party by settlement, compromise or other forms of ADR.⁵ The point here is that the Commissioner - in making initial assessment decisions, decisions on objection or in resolving disputes - may, and in our submission should invariably, in a manner favourable to taxpayers “*adopt a view of the law, or of its application, that may reasonably be open, or about which he may otherwise have some doubt*”⁶
- 12 The IGT ADR Report⁷ made 22 recommendations. Those recommendations, and the reasons for them, are relevant to the subject matter of this Review. All but one of them

² Ross W Parsons, ‘Income Taxation - An Institution in Decay?’, *Australian Tax Forum*, 1986, Vol. 3 No. 3, 233, at 235.

³ See also the ATO’s response to the IGT ADR Report, reproduced at 147.

⁴ *Macquarie Bank Limited v COT* [2013] FCAFC 119, Middleton, Pagone, Davies JJ at [11].

⁵ *Macquarie Bank Limited*, at [11] (citing *Grofam Pty Ltd v COT (1997)* 36 ATR 49 and *Cox v Deputy Commissioner of Land Tax* (1914) 17 CLR 450).

⁶ *Macquarie Bank Limited* at [11].

⁷ See para 6(i)(iii) above.

(*Recommendation 6.1*, which dealt with the “*the perceived lack of independence in the objection process*”, and which the ATO did not accept) were broadly aimed at:

- Ensuring the ATO and the taxpayer engage earlier to ascertain and agree on those matters that are agreed and those that remain in contention;
- Streamlining of information exchange between the parties to ensure that the matters in dispute are understood;
- Ensuring clear escalation channels to appropriate ATO personnel to engage in dispute resolution processes;
- Bringing early engagement and ADR to the forefront of ATO dispute resolution efforts and only litigating cases which turn on genuine and fundamental disputes as to law and where there is a public benefit in having the matters judicially determined;
- Enhancing the skills and understanding of both ATO staff and taxpayers of the different types of engagement available in ADR and the circumstances in which these may be appropriate through increased training and publication of information respectively; and
- Identifying opportunities for continuous improvement through implementing processes to enable feedback to be provided regarding the use of ADR in the tax dispute context.⁸

13 The Taxation Committee strongly supported, and continues to support, the above aims.

14 The recommendations in the IGT ADR Report were largely accepted by the ATO. The ATO subsequently published its *Disputes Policy*, the key principles of which are⁹:

- Disputes should be avoided wherever possible.
- Efforts to resolve disputes should be made as early as possible, including both before and throughout legal proceedings.
- The merits of each dispute (including risks for the ATO and the revenue) should be assessed in a timely fashion.
- Disputes should be managed in a courteous, honest and respectful manner, reflecting the highest ethical standards of public governance.
- Disputes should be managed fairly and flexibly, in a manner which recognises that Commonwealth agencies serve the Australian community and which respects the diversity of the Australian community.

⁸ IGT ADR Report, ‘Executive Summary’, page v.

⁹ ATO, *Disputes Policy*, “Key principles of dispute management”, https://www.ato.gov.au/General/Correct-a-mistake-or-dispute-a-decision/In-detail/Avoiding-and-resolving-disputes/Resolving-disputes/Disputes-policy/?page=2#Key_principles_of_dispute_management, Last modified: 19 Sep 2012.

- Disputes should be resolved in the simplest and most cost-effective way that is appropriate to the circumstances. Where appropriate, the parties in dispute should consider the use of effective and professional dispute resolution practitioners whose costs are proportionate to the issues in dispute.
- Disputes should be resolved collaboratively, by listening to other views and putting forward and considering options to resolve the dispute.
- Everybody should have access to, and seek out, information that enables them to choose suitable dispute resolution processes.
- Our employees have a responsibility to take genuine steps to resolve or clarify disputes and will be supported to meet that responsibility by the ATO.

15 Importantly, the ATO has stated that it wants to “*resolve disputes as early as possible, even, if possible, before our decision has been made*”¹⁰. We agree with these key principles.

16 In the above context, we would make the following additional general points:

- (a) Many tax disputes are incapable of clear answers. Obvious examples include disputes involving issues of residency, valuations, transfer pricing and the debt/equity divide. Taxpayers who have understood their obligations and obtained external advice should not be treated with suspicion or have to effectively bear an ‘administrative’ onus of proof that requires taxable facts to be established beyond reasonable doubt. As the ATO’s *Disputes Policy* states, disputes “*should be resolved collaboratively, by listening to other views and putting forward and considering options to resolve the dispute*”.
- (b) As the ATO acknowledges, the cost of disputes can be significant and, for some taxpayers, ruinous. Any change to current ATO policy, systems and practices must take into account resource and cost issues for both the ATO and taxpayers.
- (c) It goes without saying that a right of review - whether informal or formal - is worthless if a taxpayer does not have the financial means to pursue that right. The cost of tax disputes falls hardest on individual taxpayers (who are not HWIs) and small business. In addition, as the IGT has observed, there is a clear perception of the strength of the ATO outweighing the strength of the taxpayer, which unfavourably distorts outcomes.¹¹ As Professor Parsons put it, “*It is a game in which the odds are not fair*”. As a result, tax disputes are invariably extremely stressful and often prohibitively expensive for smaller taxpayers. If uniformly applied across the ATO - which requires appropriate resourcing, training and professional development - the key principles clearly articulated, and embraced, by the ATO in its *Disputes Policy* will go a long way to address negative outcomes.
- (d) There is sufficient anecdotal evidence to suggest that a potential catalyst for disputes, or their escalation, is the imposition by the ATO of unrealistic or

¹⁰ ATO, *Disputes Policy*, “Early resolution of a tax or super dispute”, https://www.ato.gov.au/General/Correct-a-mistake-or-dispute-a-decision/In-detail/Avoiding-and-resolving-disputes/Resolving-disputes/Disputes-policy/?page=7#2_Early_resolution_of_a_tax_or_super_dispute, Last modified: 19 Sep 2012.

¹¹ IGT Self Assessment Report, [6.13].

arbitrary timeframes for providing documents or information, or responding to ATO position papers. Indeed, the ATO's approach to information gathering (when compared, unfavourably, to the ATO's provision of information to taxpayers or the time taken by the ATO to analyse information and make decisions) is the subject of perennial complaints by taxpayers. The ATO has a job to do and must do that job as efficiently and expeditiously as possible. However, wanting things done quickly may not necessarily lead to efficient and effective outcomes. The ATO's legitimate need for information must be dealt with flexibly and realistically, and be balanced against the particular circumstances of taxpayers.

- (e) There is a fair amount of anecdotal evidence that objection processes are no longer a 'rubber stamp' of audit team decisions (as they previously were). This is a welcome development. As indicated, functional independence of the objection and review decision makers from the audit decision makers is paramount to the early resolution of disputes. This independence should extend also to TCN resources used respectively by auditors and objection decision makers.
- (f) Above all, the essential guiding principle in managing tax disputes is pragmatic and defensible decision making on the part of the ATO. In making initial assessment decisions, decisions on objection or in resolving disputes the Commissioner should, in a manner favourable to taxpayers, invariably, "*adopt a view of the law, or of its application, that may reasonably be open, or about which he may otherwise have some doubt.*"¹² A move by the ATO away from a 'defend at all costs' approach is necessary and appropriate.

Matters affecting fair treatment and respect of taxpayers

- 17 The key matters affecting the fair treatment and respect of taxpayers have been identified and addressed in other reviews undertaken by the IGT over the last 3 years (see para 6(i) above) and are reflected in the clearly expressed ATO *Disputes Policy* (see para 14 above). Some of those matters are referred to in paragraphs 18 to 28 below.
- 18 The IGT Large Business Report¹³ identified the following three broad areas for improvement (at [3.42]):
 - greater certainty and transparency in the risk review and audit processes and procedures;
 - more consistent and proportionate application of the risk review and audit principles and practices as set out in the LBTC booklet and the LB&I Compliance Manual; and
 - greater engagement and dialogue and aspiring to a greater level of trust between taxpayers and the ATO so as to minimise compliance costs.
- 19 The IGT Large Business Report noted that:
 - 7.41 A strong theme across nearly all submissions is that there is considerable room for improving the efficiency (taxpayers incurring significant and unnecessary costs associated with information gathering requests especially where the request is broad and there has been little engagement by

¹² See note 6.

¹³ See para 6(i)(i) above.

the ATO around scope and purpose) and objectivity (searching for information to confirm the risk hypothesis rather than understanding the matter or transaction) of information requests.

7.42. Taxpayers and advisers have expressed a range of concerns relating to the information gathering process including the level of engagement, the scope of information requests, the timeframes for taxpayers to respond, the use of section 264 notices and the ATO's approaches to legal professional privilege and the accountants' concession.

...

7.112. Where the ATO adopts a more transparent and cooperative approach to information gathering, the ensuing relationship is more likely to be productive and ongoing. However, where the ATO does not engage with taxpayers in an open, transparent and cooperative manner, it creates considerable uncertainty for taxpayers, increases their compliance costs and causes significant damage to the relationship between the ATO and taxpayers.

20 The lack of transparency around ATO thinking in relation to technical positions is a perennial concern. Taxpayers do not want the ATO position paper to be the first time that the ATO's technical views are communicated. In addition, ATO timeframes for taxpayers to respond to position papers continues to raise issues. In that regard, the IGT Large Business Report observed:

9.19 A number of taxpayers and advisers commented that position papers were still being issued after little or no contact from the ATO for many months, creating real surprises for them regarding the facts and issues identified as presented by the ATO.

9.20 They also asserted that given the lack of prior engagement, the facts set out in position papers are not agreed or tested prior to the ATO forming a technical view. This means that the ATO's technical specialists are providing views based on incorrect facts in those circumstances. Taxpayers also remarked that by this stage it is often too difficult to change the ATO's view of the facts and evidence.

9.27 A common theme in nearly all submissions was that the ATO did not provide a reasonable opportunity for taxpayers to adequately respond to position papers. A number of taxpayers and advisers asserted that it was rare to obtain a position paper without an accompanying time pressure, with many instances of position papers being issued late in the audit process leading to increasing costs and tension in finalising audits.

9.28 Taxpayers have also complained of unreasonable timeframes to respond to position papers or have a meaningful discussion, especially where there has been little engagement leading up to the provision of the position paper. Some taxpayers have indicated that they have had to respond to a position paper and at the same time deal with a large number of other ATO compliance activities such as risk reviews, other information requests and compliance obligations (for example, business activity statements and various return obligations).

21 A related concern is the noticeable tendency of the ATO taking the approach of including arguments (whether strong or meritless) on all conceivable points, rather than just narrowing the focus to the real issue(s) at the heart of the dispute. While this approach might well be aimed at ensuring the ATO's position is, in good faith, reserved on all matters (if it is simply aimed at giving the ATO some additional 'bargaining

chips', it is totally unacceptable), it results in unnecessary cost and delay in dealing with peripheral issues.

22 The IGT SME Report¹⁴ identified key opportunities for improvement in a number of areas, including:

- (a) technical capability and support;
- (b) initial compliance decision making;
- (c) project management;
- (d) audit conduct;
- (e) communication and engagement; and
- (f) information gathering.¹⁵

23 Tax disputes, or their later escalation, can have their genesis at the very earliest phase of an ATO review: the application of the ATO's risk differentiation framework (**RDF**). This was recognised in the IGT CRAT Report¹⁶, that noted (at [1.17]) the following broad categories of concerns with the RDF process identified by stakeholders in large business and SME:

- (a) the governance and transparency of the risk assessment process;
- (b) the accuracy or relevance of inputs used in the risk assessment process;
- (c) the resultant risk rating or categorisation, and the quality of communication and due process afforded to taxpayers in relation to it; and
- (d) the proportionality of subsequent ATO compliance activity to the purported or actual risk level.

Focussing on, and addressing, the above concerns would, at the very least, allow for productive engagement at the earliest opportunity to minimise disputes.

24 The ATO's administration of the penalties regime is another matter that continually raises issues for taxpayers. The IGT Penalties Report¹⁷ noted (at [1.159] to [1.177]) that the ATO's administration of penalties has been the subject of, or been considered in, numerous reviews previously undertaken by the IGT, the Federal Parliament's Joint Committee of Public Accounts and Audit, the Treasury and the ATO. The IGT Penalties Report identified (at [2.3]), and dealt with in detail, a number of concerns raised by stakeholders relating to aspects of the current penalty regime's legislative framework, including:

- stratification of penalties relating to taxpayer statements;
- the burden of proof and the ATO's 50:50 payment arrangements for tax debts whilst disputing assessments;

¹⁴ See para 6(i)(ii) above.

¹⁵ IGT SME Report, 'Executive Summary', Page 1.

¹⁶ See para 6(i)(v) above.

¹⁷ See para 6(i)(vi) above.

- the inability to receive interest for payment of unsustainable penalties; and
- uncertainty with the scope of false or misleading statement penalties where no tax shortfall arises.

25 In addition to penalties for false or misleading statements, a penalty can also be imposed if a taxpayer adopts a position that was not reasonably arguable and the shortfall that arises for not having taken a reasonably arguable position (**RAP**) is more than the greater of \$10,000 or 1 per cent of the income tax payable (ss 184-75(2) and 284-90 of the TAA). A position is reasonably arguable if “...it would be concluded in the circumstances, having regard to relevant authorities, that what is argued for is about as likely to be correct as incorrect, or is more likely to be correct than incorrect” (s 284-15(1) of the TAA). The IGT Penalties Report noted (at [2.6] to [2.8]) that:

- 2.6 ... stakeholders observed harsh outcomes arising from insufficient stratification of the no RAP penalty, as the penalty was effectively a ‘cliff face’. If the RAP standard is not met, the strength of taxpayers’ positions taken or the probative value of the information and evidence relied upon may not be considered in determining the amount of the applicable penalties, that is, the treatment of a position that just falls below the RAP standard could be the same as a position that falls far below it.
- 2.7 Stakeholders have also observed that some ATO officers assume that better resourced taxpayers ought to have self-assessed their tax positions with a high degree of accuracy and, therefore, any substantial adjustments would automatically attract a no RAP penalty.
- 2.8 Although stakeholders recognise that the increased stratification of penalties would introduce complexity, they consider that overall it would be more equitable (in terms of horizontal equity) and in keeping with the purpose of the penalty regime.

26 In relation to the above concerns with the RAP penalty (which the Taxation Committee shares), the IGT Penalties Report observed (at [2.18]) that, given the ATO’s apparent position that it would not use the penalty remission power in s 298-20 of the TAA, “it seems that any further differentiation or stratification of penalties relating to a statement would require legislative change”. The Taxation Committee is of the view that the following legislative changes should be considered:

- (a) That the ‘quantitative’ thresholds for the RAP penalty should be lifted from the shortfall being greater than the larger of \$10,000 or 1% of the tax payable, to greater than the larger of, say, \$10m or 25% of the tax payable.
- (b) That the ‘qualitative’ threshold for the penalty be changed from the ‘hair trigger’ (or ‘cliff face’) definition of ‘not reasonably arguable’ to a much lower formulation, such as the argument being ‘without merit’.

27 The burden of proof imposed on taxpayers in relation to penalties is a matter that requires careful consideration. In that regard, we would endorse the following observations made in the IGT Penalties Report:

- 2.37 It could be argued that placing the burden of proof on taxpayers should be the same for penalties and primary taxes as taxpayers have better understanding of facts involved. However, the imposition of a penalty for a false or misleading statement, unlike a primary tax matter, may also be understood by taxpayers as a pejorative judgment on their behaviour and that it effectively requires them to prove their innocence.

2.38 Under other areas of the law involving such judgments of behaviour, for example torts, the burden is placed on the person seeking to pursue remedies for another's culpable behaviours. This burden exists notwithstanding the fact that the respondent may be better placed to provide information about their behaviours.

2.39 Furthermore, although this burden technically arises on appeal, it can shape ATO auditor approaches to address shortcomings in the evidentiary basis for penalty decisions. In these cases, it is incumbent upon the taxpayer to prove the basis for any remission of the penalty or that the application of the penalty itself is incorrect. There are ATO staff instructions that emphasise an expectation that penalty decisions will be supported by facts and evidence. However, this may not necessarily take place and may be a reason for a significant proportion of unsustainable penalty decisions being adjusted due to evidentiary issues as discussed in more detail in the next two chapters of this report.

2.40 Taxpayers may experience substantial adverse impacts arising from unsustainable penalty decisions, including commercial and other regulatory implications and damage to reputation. The ATO's administrative costs in correcting unsustainable penalty decisions may also be significant.

28 The Taxation Committee would also endorse the following observation made in the IGT Penalties Report:

3.16 In the absence of more specific data being collected and reported by the ATO, taxpayers may be justified in their perception that a significant proportion of penalties are being imposed at a high rate initially to coerce them to submit to the ATO view in return for a reduction of penalties on a subsequent review. Without greater transparency and improved information capture, these claims or perceptions will persist.

29 In addition, the following legislative changes to the TAA could also be considered:

- (a) An issue that can raise impediments to early resolution of disputed tax assessments is the timing rules in the TAA for lodging objections. It is not uncommon for settlement processes to be disrupted, delayed or complicated when objections are required to be lodged by taxpayers to preserve their Part IVC review rights. Under s 14ZX(1) of the TAA, the Commissioner has the power to effectively grant an extension of time to lodge an objection. However, that power can only be exercised in considering an application made by a taxpayer under s 14ZW(2) of the TAA. That provision permits a taxpayer, after the period within which an objection is required to be lodged has passed, to lodge the objection with the Commissioner together with a written request asking the Commissioner to deal with the objection as if it had been lodged within that period. That is to say, the Commissioner does not have the statutory power to extend the period within which an objection is required to be lodged before the time when the objection is required to be lodged. This raises an obvious jeopardy for taxpayers - they must let the objection period pass and then make a request. It would be beneficial to early dispute resolution to amend s 14ZW(2) to permit taxpayers to lodge applications for extensions to the objection period, and for the Commissioner to decide the application, before the objection period actually expires.
- (b) The 'uplift' interest amounts in the SIC and GIC rates have become disproportionate as the 'base rate' has sunk in line with general interest rates (the 3% SIC uplift rate now being more than the 2.5% 'base rate', and the 7%

GIC uplift rate being nearly 3 times the 2.5% 'base rate'). This could be dealt with by redefining the uplift rates as a proportion of the 'base rate' (capped at the current rates) - so that:

- (i) by amending s 280-105(2) of the TAA, the uplift for the SIC might be an extra 25% on top of the 'base rate' (e.g., 2.5% + 0.56% = 3.06%, instead of 2.5% + 3% = 5.50% currently); and
 - (ii) by amending s 8AAD(1) of the TAA, the uplift for the GIC might be an extra 50% of the 'base rate' (eg. 2.5% + 1.25% = 3.75%, instead of 2.5% + 7% = 9.5% currently).
- (c) While a taxpayer can, in some circumstances¹⁸, object against a decision not to remit SIC, there are no objection rights against a remission decision relating to GIC. A taxpayer can seek formal review of GIC (and some SIC) remission decisions under the *Administrative Decisions (Judicial Review) Act 1977*. Great mischief can be worked by denying Part IVC review rights in relation to GIC (and, in some circumstances, SIC). If the Commissioner refuses to any extent to remit an amount of GIC, a taxpayer ought to have rights to object against the decision in the manner set out in Part IVC of the TAA and to have rights for full merits review, in the same way as decisions not to remit shortfall penalties are dealt with under s 298-20(3) of the TAA.

30 The periods in which the ATO may amend an assessment are specified in the table in s 170(1) of the ITAA 1936. The period permitted by s 170(1) for amendment is generally either two or four years after the ATO gives notice of the assessment to the taxpayer. However, there is no restriction on the time period within which the ATO can amend an assessment where the Commissioner "*is of the opinion there has been fraud or evasion*".¹⁹ In Practice Statement Law Administration PS LA 2008/6 (**PSLA 2008/6**), after noting that the "*policy of Australian income tax law is generally to provide finality after a specified period, both for the taxpayer and for the Commissioner, in regard to the income tax liability of the taxpayer for a year of income*", the ATO states:

Fraud and evasion are both serious matters, **never lightly to be inferred**. The opinion that there has been fraud or evasion in relation to an assessment is therefore to be formed carefully and advisedly by senior officers in accordance with this practice statement and other Tax office procedures, bearing in mind the weight Parliament has placed on the benefit of certainty for taxpayers. **Amended assessments based on fraud or evasion are expected to be very much the exception to the rule**. The making of an amended assessment based on fraud or evasion would normally be justified only if action to amend the assessment has been prevented by the fraud or evasion or prompted by its disclosure. **Item 5 is no basis for making corrections to assessments that could and should have been made within the ordinary time limits but were not.**²⁰ [emphasis added].

31 Despite what the ATO does say about this, we are concerned with reports of ATO auditors making allegations of fraud or evasion (particularly in the context of HWIs) to do the very thing PSLA 2008/6 directs ATO staff not to do – to overcome the ordinary statutory time limits. There is a clear perception that allegations of fraud or evasion

¹⁸ A taxpayer may object against a decision of the Commissioner not to remit an amount of SIC, using the provisions in Part IVC of the TAA, where the amount not remitted is more than 20% of the additional amount of income tax on which it is calculated (s 280-170 of the TAA).

¹⁹ ITAA 1936, item 5 of the table in s 170(1).

²⁰ PSLA 2008/6, Appendix 1 (Policy).

are becoming less of an exception. Not only do these allegations have the obvious tax consequences, they also raise potential serious criminal consequences for taxpayers. The IGT SME Report identified this issue and observed:

- 3.29 Some private sector submissions to the IGT review claim that allegations of evasion are suggested by SME officers for several reasons, including as leverage to extend the periods for review. In an extreme example, one tax adviser claimed that SME officers asked for information outside the periods for review because of suspected evasion. In this case the taxpayer's Senior Counsel opinion supported the position adopted by the taxpayer, there was no penalty imposed by the ATO on the taxpayer and the ATO had earlier acknowledged that this was a case where two reasonable people could come to different conclusions.
- 3.30 The SME business line has a procedure of internally reviewing any conclusion of evasion before applying it in a taxpayer's case. Also, there are internal measures that require SME officers to refer any suspected fraud to the ATO's Serious Non-Compliance (SNC) area. Also any cases that involve 75 per cent penalties are required to be considered for fraud referral.
- 3.31 The IGT notes that although conclusions of evasion are internally reviewed, suggestions of evasion are not. Some submissions commented that the suggestions appeared to be offered as a 'magic bullet' in lieu of other legal reasons. They also commented that SME officers making such suggestions did not appear to understand the evidence that was required to establish a finding of evasion.

Collecting revenues due

- 32 On 26 May 2014 the IGT announced the terms of reference for his *Review into the ATO's approach to debt collection*. This review is timely and welcomed.
- 33 By way of general comment, we note the following:
- (a) If a taxpayer is legitimately disputing an assessment in a timely manner, debt collection should only be undertaken in exceptional circumstances, with a lesser rate of interest applied (e.g., at the base rate).
 - (b) We remain concerned about the apparent fragmentation of the ATO's management of taxpayers with outstanding tax debts. A good (or bad, if you like) example of this fragmentation was provided in the decision of Logan J in *DC of T v ABW Design & Construction Pty Ltd* [2012] FCA 346. As his Honour explained (at [15] and [16]):

Given the location of ABW's registered office [on Logan Road, Upper Mt Gravatt] it may perhaps be a source of surprise to the reader that the making of the statutory demand was effected by an officer of the Australian Taxation Office stationed in Townsville in North Queensland. That surprise may be tinged with a note of irony by the following.

It was common ground in this case, that, amongst the many other offices throughout Australia which the Commissioner maintains, there is an office of the Australian Taxation Office at Logan Road, Upper Mt Gravatt, on the opposite side of that road and about 1 km away from ABW's registered office. Other features at [sic] the evidence in this case were that the affidavit in support of the originating process was deposed to by another officer of the Australian Taxation Office, on this occasion stationed at the Commissioner's office at 140 Elizabeth Street, Brisbane. The audit which underpinned the various taxation debts comprising the "running balance account deficit

debt” was apparently conducted by an officer of the Australian Taxation Office based in Penrith, New South Wales. The Australian Taxation Office advice (dated 28 October 2010) to ABW of the completion of that audit specified yet another address of the Australian Taxation Office, an address at Albury, New South Wales, as the address to which to request the remission of any interest charge associated with the taxation debts which were raised. A yet further Australian Taxation Office address was specified in that letter as the address to send any objection in respect of the assessments raised. That address was in Sydney, New South Wales. Though it was but a short walk away from ABW’s registered office, the Commissioner’s Upper Mount Gravatt office appears not to have been assigned any role either in relation to service of the statutory demand, audit or otherwise.

Not only does this fragmentation lead to the incurring of unnecessary time and costs, it makes resolving disputes very difficult. This difficulty is exacerbated by matters being handled by junior ATO officers who can often be inflexible and uncompromising. Positive results can be achieved by escalating (if a taxpayer knows how and can afford to do it) the matter to a senior officer but this takes time and further effort.

- (c) We are also concerned about the apparent lack of ownership of some debt collection matters, illustrated by the following example from Queensland. The ATO made a claim (originating process) for director’s penalties purporting to comply with court rules by providing a ‘1300’ call centre number in Parramatta, NSW. A call to that number was answered by a call centre operator with no ability to transfer the call to a lawyer responsible for the matter. Indeed, there was no ability to identify, from the court file number or taxpayer details, who might have been responsible for the matter at the ATO.

Governance framework for disputes

- 34 The Media Alert issued by the HOR Committee stated that the Inquiry would cover, amongst things, “*whether a separate agency should manage the ATO litigation, whether the ATO should have a separate appeals area, or if current arrangements should continue*”. At present, the Taxation Committee is inclined to the last of these options.
- 35 As noted above, the ATO did not accept *Recommendation 6.1* of the IGT ADR Report, which proposed that the ATO undertake a pilot separation of its objection and litigation functions from its audit function in the management of its most complex disputes. As indicated, although the Taxation Committee strongly endorses (as does the ATO) the functional independence of the objection and review decision makers from the audit decision makers, the Taxation Committee does not consider there to be a compelling case for the creation of a “*separate appeals area*” within the ATO to manage tax disputes.
- 36 There may, at some point, be merit in considering (re-)creating a “*separate appeals area*” and the proposal to do so cannot be criticised for the sentiment. What is open to question is the practical utility of doing so. Nonetheless, a serious exploration of the proposal might be warranted if:
 - (a) the existing administrative policies and frameworks have demonstrably failed;
 - (b) it materially advances, for instance, the key principles of dispute management as expressed by the ATO in its *Disputes Policy* (see para 14 above).

- (c) there is a proper review of alternative systems and the experiences of benefits and disadvantages actually experienced;
- (d) a review is conducted of learning from other jurisdictions which clearly indicates that the benefits would outweigh the structural and cost duplications, particularly in the current budgetary environment;
- (e) there were appropriate administrative safeguards put in place to ensure that it did not lead to detrimental barriers to case (and outcome) ownership, to 'silo' effects and to bad work practices that actually discouraged early dispute resolution;
- (f) it was to be staffed by appropriately technically qualified and experienced officers;
- (g) the operations of the "*separate appeals area*" extended to, and its personnel were available, beyond 'Part IVC' work (i.e., objections and subsequent AAT and Court litigation) and also covered pre-assessment/objection and debt collection disputes, and
- (h) there was adequate resourcing provided to the extent that duplication would be required.

- 37 The Taxation Committee's view is that, in addition to the positive and constructive attitude of senior ATO officers, the important administrative policies and frameworks - overseen by a First Assistant Commissioner (Review and Dispute Resolution) reporting directly to a Second Commissioner - are in place. These sound policies just have to be uniformly implemented. The existing policies and frameworks should continue and remain amenable to positive refinement as the need arises (the ATO's Dispute Resolution Working Group plays an important and constructive role in that endeavour). If universally applied (which is currently not the case), they will deepen the move to early and constructive dispute resolution.
- 38 The Taxation Committee is of the view that a "*separate agency [to] manage ATO litigation*" is, at this stage, neither justified or necessary for the proper and efficient management of tax disputes. In addition to the obvious cost and resourcing implications, the real possibility for conflicts or discord - both in terms of tax policy and its practical application - between the ATO and an independent review agency is not something that can be regarded as desirable for taxpayers or the revenue.
- 39 There are existing forums for reviews of ATO decisions that are entirely independent of the ATO - these are the AAT and courts.
- 40 For the moment, sound policies (as reflected in the ATO's *Disputes Policy*) and robust and flexible administrative practices in the ATO, rather than formal separation of functions, are considered to be the appropriate means of ensuring the efficient, fair and effective management of tax disputes. Clearly articulated policies, transparent processes and continuous external scrutiny should lessen the risk of future ATO management taking a different, and retrograde, approach.

Conclusion

- 41 The Taxation Committee would be pleased to provide you with any further details on the matters set out above.

42 Please do not hesitate to contact the Taxation Committee Chair, Mark Friezer, on 02 9353 4129 or by email: mfriezer@claytonutz.com should you wish to discuss these matters further.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'John-ISK' with a long horizontal flourish extending to the right.

John Keeves
Chairman, Business Law Section