3

The legal framework

Introduction

3.1 This chapter covers the main legal issues raised during the inquiry. At its core, the legal framework for tax disputes is simple. The Commissioner of Taxation takes a range of actions, including making assessments, determinations, and notices. If a taxpayer does not agree with the decision and wishes to take it further, then they may lodge a written objection with the Commissioner.[1]

3.2 Not all of the Commissioner's actions are subject to objection. For example, a taxpayer cannot object to some of the Commissioner's decisions in relation to interest or penalties.[2]

3.3 The default time period for lodging an objection is 60 days. However, time periods of two years or four years can also apply in special circumstances.[3]

3.4 If a taxpayer misses the objection deadline, they may still lodge the objection and ask the Commissioner to consider it as if it had been lodged on time. Further, the Commissioner has a general discretion to extend these periods. If the Commissioner does not grant an extension, the taxpayer can apply to the Administrative Appeals Tribunal (AAT) for a review of the decision.[4]

3.5 Broadly, the Commissioner is required to consider the objection within 60 days. The Commissioner can request additional information, which

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1 Sections 14ZL and 14ZU of the *Taxation Administration Act 1953.*

2 Taxation Institute, *Submission No. 11*, p. 7.

3 Section 14ZW of the *Taxation Administration Act 1953.*

4 Sections 14ZW and 14ZX of the *Taxation Administration Act 1953.*

extends the deadline until 60 days after the request is met. A taxpayer can give a written request to the Commissioner that the objection decision be made. If this has not occurred within 60 days of the notice, then the Commissioner is taken to have disallowed the objection.[5]

3.6 Taxpayers can appeal the Commissioner's objection decision, in the great majority of cases to the AAT. For certain types of income tax remission decisions, it is to the Federal Court only. The application to the AAT must be made within 60 days of the objection.[6] In these forums, the member or judge can re-make the decision.[7]

3.7 Many of the fairness concerns raised in the inquiry come from the enforcement and procedural mechanisms that surround objections and appeals. It is these that the chapter is concerned with.

An ADR concept in the law

Background

3.8 The Committee received evidence during the inquiry that the Australian Taxation Office (ATO) has become more willing to negotiate on points with a commercial approach, especially for large taxpayers.[8] This raised the question of whether a greater readiness to negotiate, or use alternative dispute resolution (ADR), should be reflected in the legislation. The Tax Institute raised the issue as follows:

> Introducing a legislative right of early engagement which can be triggered by the taxpayer. Such a legislative mechanism could formally require the Commissioner to engage in ADR at the request of the taxpayer, rather than him only doing so by virtue of his internal policies. We acknowledge that further consideration would be required as to how the legislation should describe the time at which this right of early engagement would be available.[9]

5 Section 14ZYA of the *Taxation Administration Act 1953.*

6 Sections 14ZZ and 14ZZC of the *Taxation Administration Act 1953.*

7 Mr Philip Hack SC, AAT, *Transcript of Evidence,* 16 October 2014, p. 5.

8 For example, Mr Tony Greco, IPA, *Transcript of Evidence,* 14 August 2014, p. 6.

9 The Tax Institute, *Submission No. 11,* p. 7.

3.9 CPA Australia made a related suggestion, namely that ADR should be mandated as part of the objection process.[10]

3.10 The Committee notes that, at present, there appear to be no provisions in the tax laws that refer to ADR. However, the ATO does have a practice statement that encourages staff to use ADR during disputes. The statement notes that ADR may not always be appropriate, such as when:

- it is early in the dispute and the key issues have not yet crystallised
- resolution would require departure from an established ATO precedential view
- there is a clearly identified public benefit in having the matter judicially determined
- the matter is straightforward
- there is a genuine concern that the case involves fraud or evasion.[11]

Analysis

3.11 The Committee raised this topic and ADR generally with some witnesses. The key point that came out of the discussions was that ADR is only effective when both parties approach it constructively. A tax barrister, Mr Chris Wallis, stated:

> … I do not think anybody should be allowed anywhere near ADR until they have done the legwork, because otherwise it is a waste of time and an abuse of the process.[12]

3.12 A tax practitioner, Mr Richard Wytkin, expressed a similar concern, in particular that mandating the ATO to participate in ADR could be gamed by some taxpayers as a way of delaying a dispute.[13]

Committee comment

3.13 The Committee is strongly supportive of ADR in tax disputes, as well as the ATO improving its engagement with taxpayers more generally. However, the Committee is also mindful that ADR has some costs

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10 CPA Australia, *Submission No. 7,* p. 2.

11 ATO, *Alternative Dispute Resolution (ADR) in ATO disputes,* PS LA 2013/3, 20 August 2013, paras 9, 18.

12 Mr Chris Wallis, *Transcript of Evidence,* 14 August 2014, p. 37.

13 Mr Richard Wytkin, *Transcript of Evidence,* 29 October 2014, p. 4.

associated with it and that, if a taxpayer does not wish to constructively engage in the process, it would not be an effective use of public funds.

3.14 A legislative approach is not appropriate here and the Committee makes no recommendation.

Extending the time to lodge an objection to pursue ADR

Background

3.15 The default time for a taxpayer to lodge an objection in relation to a decision of the Commissioner is 60 days. In his 2012 report on ADR, the Inspector-General of Taxation (IGT) noted that the legislation only allows taxpayers to request an extension for the time to make an objection *after* that time has expired. A taxpayer may wish to engage in ADR, but doing so would probably mean that the time for them to lodge an objection would expire by the time that process was complete.[14]

3.16 The IGT recommended that the Government consider amending the tax laws so that the ATO can grant an extension to the period for lodging an objection *before* the lodgement period has expired. In its response to the ADR report, the ATO responded that this is a matter for Government.[15]

3.17 PricewaterhouseCoopers (PwC) advised the Committee that, in September 2011, a stakeholder had registered a request through the Tax Issues Entry System to legislate along these lines. The request was declined. The reason given was that the system is currently operating as intended.[16]

3.18 During the inquiry, a number of stakeholders supported the proposal.[17]

Analysis

3.19 Taxpayers have a choice. Firstly, they can lodge an objection, and then request ADR. However, it might look unusual to request ADR with an objection outstanding, and the dispute may evolve to the extent that the

14 IGT, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution: A report to the Assistant Treasurer,* May 2012, p. 96.

15 IGT, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution: A report to the Assistant Treasurer,* May 2012, p. 97.

16 PwC, *Submission No. 23,* p. 16.

17 Taxation Institute, *Submission No. 11,* p. 7; Law Council of Australia, *Exhibit No. 2,* p. 12; Mr Philip Hack SC, AAT, *Transcript of Evidence,* 16 October 2014, p. 4.

objection needs to be amended. It could also be a waste of the taxpayer's time and money to prepare an objection that might not be needed.

3.20 The alternative is for the taxpayer to engage in ADR, miss the objection deadline, and then hope that the Commissioner exercises their discretion to accept it late. Procedurally, this makes more sense, because both the ATO and the taxpayer are likely to expend less resources overall through engaging in ADR. The drawback is that the taxpayer must accept some risk.

3.21 The Committee put this issue to the ATO, who responded that they already take into account a taxpayer's willingness to engage in ADR in deciding whether to extend the objection deadline:

> There already exists the ability for the commissioner to grant an extension of time to lodge an objection. I think what perhaps the Inspector-General may have been considering is whether or not our application of those provisions was taking into account requests for alternative dispute resolution—and clearly we would.[18]

3.22 The Committee notes that, although there was consistent support for the proposal, no witness brought forward examples of where the ATO did not grant an extension. In his ADR report, the IGT stated that the ATO accepts a large number of late objections.[19]

Committee comment

3.23 The Committee supports the IGT's recommendation in principle. All legislative amendments or administrative changes that promote ADR are worthy of consideration. However, it appears that, in practice, it is unlikely that a taxpayer will engage in ADR, miss the objection deadline, and have their request rejected for an extension of time to lodge an objection.

3.24 The Committee acknowledges that there is consistent stakeholder support for the proposal. However, evidence was not presented that there is a problem that warrants legislative amendment. The Committee also accepts that taxpayers would like additional comfort in their dealings with the ATO. But given the lack of evidence of an abuse of process, the Committee is reluctant to recommend legislative change for a problem

18 Mr Andrew Mills, ATO, *Transcript of Evidence,* 16 July 2014, p. 13.

19 IGT, *Review into the Australian Taxation Office's use of early and Alternative Dispute Resolution: A report to the Assistant Treasurer,* May 2012, p. 96.

that only exists in theory. The Committee would prefer to prioritise other matters.

Interest charges

Background

3.25 Two interest charges apply on tax debts. The shortfall interest charge (SIC) is the base interest rate plus 3 per cent; the base interest rate is a 90-day Bill rate supplied by the Reserve Bank of Australia.[20] The IGT describes its application as:

> Where the liability was self-assessed incorrectly and there was a shortfall in tax paid, however, once the correct liability was determined the tax was paid by the due date of the amended assessment …[21]

3.26 The general interest charge (GIC) applies to other tax debts, but is the base interest rate plus 7 per cent.[22] The IGT has described two circumstances where it applies:

> Where the liability was self-assessed correctly but not paid by the due date of the original assessment …
>
> The liability was self-assessed incorrectly and there was a shortfall in tax paid, however, once the correct liability was determined the tax was not paid by the due date of the amended assessment …[23]

3.27 The interest charges operate to prevent taxpayers using the ATO as a source of cheap finance and not to disadvantage taxpayers who pay their debts on time. The SIC was introduced following Treasury's review of self-assessment in 2004. The consensus during the review was that it was unfair to taxpayers to be subject to such a high rate of interest without them knowing that the debt existed.[24]

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20 Section 8AAD and section 280-105 of Schedule 1 of the *Taxation Administration Act 1953.*

21 IGT, *Review into improving the self-assessment system: A report to the Assistant Treasurer,* August 2012, p. 118.

22 Section 8AAD of the *Taxation Administration Act 1953.*

23 IGT, *Review into improving the self-assessment system: A report to the Assistant Treasurer,* August 2012, pp. 118-19.

24 The Treasury, *Report on Aspects of Income Tax Self-Assessment,* August 2004, pp. 49-57.

3.28 Interest charges accrue as a matter of law. The flexibility lies in the Commissioner's discretion to remit them. For GIC, there are different criteria, but the Commissioner can always remit if it would be fair and reasonable, or otherwise appropriate, to do so. The main criterion for remitting SIC is that it would be fair and reasonable to do so.[25]

3.29 The ATO has issued a number of practice statements on remitting interest. The SIC or GIC for shortfall periods will generally be remitted when:

- the ATO exceeds benchmarks for starting or completing an audit
- the ATO does not action a case for 30 days
- taxpayer delay is out of their control, such as through a natural disaster or serious illness
- a taxpayer needs extra time to collect information, and this is warranted.[26]

3.30 An important administrative innovation is that the ATO will remit GIC for the taxpayer if both sides agree to enter into a 50/50 arrangement. Broadly, if a taxpayer pays half the principal tax up front, then the ATO will 'remit 50 per cent of the GIC which would otherwise accrue in the event that the taxpayer's dispute is unsuccessful.'[27] In evidence, the ATO stated that this arrangement was more commonly used for large liabilities.[28]

3.31 The IGT has not conducted a specific review on interest charges, but has commented on them as they have arisen throughout his work program. The Committee raises two matters from IGT reports.

3.32 The first is that, in his review into objections, the IGT recommended that the ATO should remit GIC where a taxpayer has acted in good faith and the ATO has taken longer than the statutory 60 day period to finalise the objection. The ATO rejected this recommendation, stating that it takes into account all the facts of a case to appropriately address ATO delay and does not see value in a pre-determined formula.[29]

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25 Section 8AAG and section 280-160 of Schedule 1 of the *Taxation Administration Act 1953.*

26 ATO, *Remission of shortfall interest charge and general interest charge for shortfall periods,* PS LA 2006/8, 28 August 2014, paras 47-79.

27 ATO, *Collection and recovery of disputed debts,* PS LA 2011/4, 23 December 2014, para. 28.

28 Mr Andrew Mills, ATO, *Transcript of Evidence,* 26 November 2014, p. 5.

29 IGT, *Review into the underlying causes and the management of objections to Tax Office decisions: A report to the Assistant Treasurer,* April 2009, pp. 17-18.

3.33 The IGT discussed another issue in his review of compliance activities for small and medium enterprises (SMEs) and high wealth individuals. This was in relation to a change in argument by the ATO after an assessment has been amended. In other words, if the ATO changes a taxpayer's liability for a particular reason, and then afterwards changes this reason, then the taxpayer should have GIC remitted because they would not have been responding to the pertinent arguments. The IGT's specific recommendation was that this policy should be included in an ATO booklet for taxpayers and the ATO agreed.[30] However, the Committee is not aware of this policy occurring in current ATO material.

3.34 The main issue raised during the inquiry was that, during a dispute, the GIC can keep accumulating and effectively becomes leverage in favour of the ATO against the taxpayer. Mr Tony Fittler from HLB Mann Judd noted there is little incentive on the ATO to resolve a dispute quickly, which prompted the comment, 'there is a lot going in the Commissioner's favour and not much in favour of the taxpayer.'[31]

Analysis

3.35 The rationale for the interest charges is to level the playing field between taxpayers and between a taxpayer and the Commonwealth. In this sense, the interest charges should operate so that a taxpayer is no better or worse off by deferring payment of tax. However, it is clear that they also fit within the mechanisms and incentives that promote taxpayer compliance. The 50/50 arrangements are an example of this; the ATO is prepared to reduce the GIC for a taxpayer who will reduce the risk to the revenue.

3.36 Currently, the system works on the basis that full interest applies, with the opportunity for the ATO to reduce it if there is taxpayer compliance (for example, 50/50 arrangements) or if there is unfairness. Evidence to the Committee was that the 50/50 arrangements were not practical to smaller taxpayers because it was often difficult for them to manage their cash flow. Further, the raising of a tax liability impacts on their ability to borrow and may also impact lending covenants.[32] However, the

30 IGT, *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: A report to the Assistant Treasurer,* December 2011, pp. 17-18.

31 Ms Judy Sullivan, PwC, *Transcript of Evidence,* 18 August 2014, p. 25; Mr Tony Fittler, HLB Mann Judd, *Transcript of Evidence,* 18 August 2014, p. 1.

32 Mr Tony Fittler, HLB Mann Judd, *Transcript of Evidence,* 18 August 2014, p. 1.

Committee heard that taxpayers usually received fair treatment from the ATO at the end of a dispute in remitting GIC.[33]

3.37 Mr Michael Bersten from PwC advised the Committee that one of the problems with applying full interest by default is that the system appears to be focussed on non-compliant taxpayers, rather than the general population:

> The policy behind the imposition of interest in the law, which is actually reflected in many countries—it is not just Australia—is designed to put a price on taxpayers and their cooperation with revenue authorities. It is to say, 'The longer you take, the longer it's going to cost you.' The problem we have here is that it is very general. The 95 per cent of taxpayers are trying to do the right thing, and that is the statement the current commissioner has been making. For the five per cent who are not doing the right thing, we are getting a rule which is defined around the five per cent, not the 95 per cent.[34]

3.38 Mr Bersten suggested that the ATO should publish clearer standards about appropriate time frames for both ATO and taxpayer actions. Although there is currently some guidance, PwC argued that there was still too much uncertainty involved.[35]

3.39 The Committee notes that the IGT's recommendations about remitting GIC for overdue objections and changes in ATO argument are examples of PwC's suggested approach.

3.40 During the inquiry, the Committee raised the practical difficulties of interest charges with the ATO and whether there should be any provisions for 'stopping the clock'; that is, there could be circumstances where GIC would no longer accumulate, rather than it initially building up and the Commissioner then remitting it. The ATO responded that these concerns were reasonable and that the proposal 'should be examined.'[36]

Committee comment

3.41 The Committee supports the concept that taxpayers should pay interest where they do not meet their tax obligations on time and supports the use of interest charges in the tax system. In an ideal world, the interest charges

33 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 20.

34 Mr Michael Bersten, PwC, *Transcript of Evidence,* 18 August 2014, p. 25.

35 Mr Michael Bersten, PwC, *Transcript of Evidence,* 18 August 2014, p. 25.

36 Mr Andrew Mills, ATO, *Transcript of Evidence,* 26 November 2014, p. 5.

would seamlessly operate to equalise the position of taxpayers and the Commonwealth.

3.42 However, in practice the interest charges can be a 'huge pressure point for taxpayers.'[37] The Committee concludes that this occurs because the system is designed around non-compliant taxpayers, reducing the ATO's options for encouraging compliance.

3.43 The Committee very much appreciates that the ATO has agreed that the interest charges should be examined. The Committee notes that there is a range of actions that could be taken at both the legislative and administrative levels. Options include:

- PwC's proposal that the ATO publish clearer standards about appropriate time frames for both ATO and taxpayer actions to guide remission decisions
- converting all interest charges to the SIC rate and relying on the penalty provisions to address taxpayer conduct, with the possibility of reviewing them in this light
- making the SIC rate the default position and giving the ATO the ability to raise the rate based on taxpayer conduct
- the ATO communicating with taxpayers during a dispute to give a commitment to remit interest, based on the taxpayer's conduct or the circumstances of the case
- a formal 'stop the clock' provision in the legislation to be triggered by the ATO.

3.44 The Committee understands this is a complex area that has implications for taxpayer incentives and compliance. It may be that the current legislation is the best that can be managed under the circumstances and that improvements will be administrative. Nonetheless, the Committee supports a review and thanks the ATO for its support on this proposal.

37 Ms Judy Sullivan, PwC, *Transcript of Evidence,* 18 August 2014, p. 25.

Recommendation 2

3.45 **The Committee recommends that the Government amend the tax laws and the Australian Taxation Office consider other administrative means by which interest charges would not act as leverage against a taxpayer during a tax dispute.**

3.46 In the interim, the Committee believes that the ATO can implement the IGT's recommendations in relation to remitting GIC for overdue objections and changes in ATO argument. These are common sense suggestions that are fair to taxpayers. In the vast majority of these cases, there would be no doubt that remitting the GIC would be the right thing to do.

3.47 The Committee appreciates that, in a small number of circumstances, full remission may not be warranted having regard to all the facts of a case. But the Committee believes that remitting the GIC across the board is nonetheless the preferable outcome because it shows the ATO's commitment to treating taxpayers fairly, which is a goal in its own right in tax administration.

Recommendation 3

3.48 **The Committee recommends that the Australian Taxation Office amend its internal and external guidance so that it remits interest where:**

- **the Australian Taxation Office takes longer than the 60 days available to it to finalise an objection and the taxpayer has acted in good faith; and**
- **the Australian Taxation Office changes arguments after assessments have been made (such as during an objection or litigation).**

Fraud and evasion

Background

3.49 Under the tax laws, the ATO can reconsider a taxpayer's affairs after issuing the notice of assessment, subject to time limits. For income tax, the

ATO can issue an amended assessment. The default time limit is four years, but this is generally reduced to two years for individuals and small business entities. For indirect taxes, the Commissioner can only recover underpaid amounts four years after notice. The major exception to these limits is where the Commissioner forms the view that there has been fraud or evasion. In this case, there is no time limit.[38]

3.50 The aim here is that, if a taxpayer has engaged in fraud and evasion, they should not be able to take advantage of a limitations period. Treasury's review of self-assessment (ROSA) in 2004 stated that almost all respondents to the discussion paper agreed that 'people who engage in calculated behaviour to evade tax should remain permanently at risk.'[39] This is fine in principle. However, the quality and quantity of records decreases over time. Taxpayers are only required to retain their records for five years, and for taxpayers with simple affairs, this is reduced to two years.[40]

3.51 The ATO has issued guidance on fraud and evasion. Having reference to the case law, it defines fraud as 'making false statements knowingly, recklessly or without belief in their truth, to deceive the Commissioner.' It defines evasion as a 'blameworthy act or omission on the part of the taxpayer.'[41]

3.52 The guidance also states that the ATO decision maker must personally form the opinion that fraud or evasion has occurred. Executive Level 2 officers are authorised to make the determination (one level below the Senior Executive Service).

3.53 Obviously, a finding or allegation of fraud or evasion is a serious matter in its own right. But the open-ended time frame for reconsidering a taxpayer's affairs also has important implications for taxpayers. The ATO's guidance makes clear that ATO officers need to carefully form their opinion in these cases:

> 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

38 Section 170 of the *Income Tax Assessment Act 1936* and para. 105-50 of Schedule 1 of the *Taxation Administration Act 1953*.

39 The Treasury, *Report on Aspects of Income Tax Self-Assessment,* August 2004, p. 31.

40 For example, where income comprises no more than salaries, bank or government interest, or dividends from a company listed on the Australian Stock Exchange. See ATO, *Shortened Document Retention Periods (Individuals with Simple Tax Affairs) Determination 2006,* SDR 2006/1.

41 ATO, *Fraud or evasion,* PS LA 2008/6, 8 December 2012, paras 15, 17.

> 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.[42]

3.54 The IGT reported on this issue in 2011 in his review of compliance activities for small and medium enterprises and high wealth individuals. Industry expressed concern during the review that suggestions of evasion were sometimes made as leverage to extend the four year review period. The review found that findings of fraud and evasion received scrutiny from senior officers, although suggestions of evasion did not. The IGT recommended that suspicions of evasion should be referred to senior officers and, if confirmed, should then also be referred to a technical panel. The ATO stated that this was already its current process and it would reiterate it to staff.[43]

3.55 Despite ATO guidance and the IGT's comments on the importance of robust processes for fraud and evasion matters, the Committee received consistent evidence during the inquiry that ATO processes were sometimes not robust. The Law Council stated:

> 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 PS LA 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 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.[44]

Analysis

3.56 The evidence during the inquiry often made a number of important points about the operation of the fraud and evasion provisions. The first of these

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42 ATO, *Fraud or evasion,* PS LA 2008/6, 8 December 2012, para. 37.

43 IGT, *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: Report to the Assistant Treasurer,* December 2011, pp. 57-58.

44 Law Council of Australia, *Exhibit No. 2,* pp. 13-14. See also Mark West, McCullough Robertson, *Transcript of Evidence,* 16 October 2014, p. 13; Taxation Institute, *Submission No. 11,* p. 3.

was that the ATO sometimes does not turn its mind to whether fraud and evasion has occurred. Witnesses who stated this included Mr Philip Hack SC, a Deputy President of the Administrative Appeals Tribunal (AAT).[45] The Committee received a practical example from David Hughes from Small Myers Hughes:

> There have been a slew of letters recently … looking at offshore payments, money that has been received from overseas. These letters are all pro forma. They are identical in every respect. They are computer generated, no doubt. The information is gathered from the bank account records, almost certainly using AUSTRAC information, and automatically generated by computer. Every single one of these letters—and I have seen well over two dozen—states: 'We have formed the view that there has been fraud or evasion and so we are going to extend the period in which we will amend your assessments.' That is, frankly, impossible. There is no way known that a human being has looked at those transactions and positively formed the view, based on evidence, that there has been fraud or evasion.[46]

3.57 The Committee heard two other pieces of evidence that corroborate this. For example, notifications of fraud and evasion from the ATO to taxpayers tend to have little explanation.[47] Further, the ATO generally bundles fraud and evasion together in its claims, when fraud is clearly more severe. This bundling has a significant impact on taxpayers because a claim of fraud is damaging in itself.[48]

3.58 The second issue was that taxpayers face a significant evidentiary burden trying to disprove the ATO's case when much of the evidence no longer exists. The Committee notes that taxpayers are only legally required to hold their records for five years. In this context, Justeen Dormer from Dormer Stanhope stated that, 'It is almost like the taxpayer is set up to fail.'[49] Witnesses commented that the ATO would make an allegation of fraud and evasion with little evidence and then leave it to the taxpayer to disprove it, when they had little evidence due to the passage of time. Lance Cunningham from BDO stated:

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45 Mr Philip Hack SC, AAT, *Transcript of Evidence,* 16 October 2014, p. 4. See also Lance Cunningham, BDO, *Transcript of Evidence,* 18 August 2014, p. 6.

46 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 18.

47 Mrs Sarah Blakelock, McCullough Robertson, *Transcript of Evidence,* 16 October 2014, p. 12.

48 Mr Tony Fittler, HLB Mann Judd, *Transcript of Evidence,* 18 August 2014, p. 6; Mr Michael Bersten, PwC, *Transcript of Evidence,* 18 August 2014, p. 28; Ms Justeen Dormer, Dormer Stanhope, *Transcript of Evidence,* 1 October 2014, p. 2.

49 Ms Justeen Dormer, Dormer Stanhope, *Transcript of Evidence,* 1 October 2014, p. 2.

> … I have seen situations where the tax office has not really got any evidence to prove that an amount is assessable or an amount is not deductible; it is just that, unfortunately, the taxpayer has not got really good evidence for their side either. But the tax office still …say that the evidence is not there and, therefore, they put the onus on the taxpayer to prove that it is not income—even though there is no real evidence to say that it is…. They just say, 'We say it is, you prove it isn't.'[50]

3.59 The Committee received some suggestions to address this problem. Dormer Stanhope suggested that the Commissioner should initially prove a prima facie case in relation to fraud and evasion, and then the taxpayer would have the legal burden to show that the assessment was excessive. The firm then suggested that the fraud and evasion period be limited to eight years, with a judge having discretion to extending this period, similar to the statute of limitations.[51]

3.60 David Russell QC brought the Model Taxpayer Charter to the attention of the Committee. It states that the burden of proof on fraud and evasion should lie with the revenue authority because the finding of fraud and evasion is similar to a penal offence. The Charter document provides a comparison on how 37 countries perform against this criterion: 15 are similar to Australia; 19 place the burden on the revenue authority, and there was no data for two.[52] Lance Cunningham from BDO also suggested that the burden of proof could be transferred to the Commissioner where significant time had elapsed and records were sketchy.[53] This is similar to a suggestion made by the Past President of the Tax Institute, Ken Schurgott, who recommended that the burden of proof should switch to the Commissioner when the statutory period for the retention of records has expired.[54]

3.61 The third issue raised during the inquiry was that, in many cases where fraud and evasion is alleged, it is not proven or sustained.[55] Mr Mark West

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50 Mr Lance Cunningham, BDO, *Transcript of Evidence,* 18 August 2014, p. 6.

51 Ms Justeen Dormer, Dormer Stanhope, *Transcript of Evidence,* 1 October 2014, p. 3; Dormer Stanhope, *Submission No. 25,* p. 6.

52 Mr David Russell QC, *Submission No. 33,* p. 2; Michael Cadesky et al, *Exhibit No. 5,* pp. 58, 170 and survey matrix.

53 Mr Lance Cunningham, BDO, *Transcript of Evidence,* 18 August 2014, p. 6.

54 Ken Schurgott, 'Evasion – who should bear the "burden of proof"?' *Taxation in Australia,* August 2012, 47(2), p. 61.

55 Mr Lance Cunningham, BDO, *Transcript of Evidence,* 18 August 2014, p. 6; Mr Michael Bersten, PwC, *Transcript of Evidence,* 18 August 2014, p. 28.

from McCullough Robertson stated to the Committee that cases are often resolved on alternative points:

> In our experience it hasn't been sustained, or the matter gets resolved on other bases, which I suppose is also my comment about tactical in the assessments.[56]

3.62 Finally, the Committee notes PwC's common-sense observation that fraud or evasion is often a gateway matter. When an assessment is over four years old, the only way that the ATO can pursue an issue is when it finds or alleges that the taxpayer engaged in fraud or evasion. In other words, for an aged assessment, a taxpayer's affairs are irrelevant without a finding or allegation of fraud or evasion. PwC expressed concern that the reasoning for the finding is often only made at the end of an audit, when, as a gateway matter, the issue should be resolved early.[57]

Committee comment

3.63 The Committee is concerned that there was a consistent theme throughout the inquiry that findings or allegations of fraud and evasion are made without an ATO officer turning their mind to the question and that they are often not proven or sustained. The Committee notes that the ATO has undertaken to reiterate the correct processes to staff, although this has not yet had an effect in the disputes that practitioners are currently dealing with. The breadth of concerns amongst taxpayers and practitioners suggests to the Committee that further measures are required.

3.64 The Committee believes that the formal finding, or suspicion, of fraud and evasion needs to be elevated within the ATO to ensure that the decision-making process is robust. PwC suggested that ATO officials be required to consult a semi-independent panel on these findings, similar to the General Anti-Avoidance Rules panel.[58] The Committee supports this approach in principle, but notes that it could be overly bureaucratic. The ATO would achieve a similar effect if SES officers made the findings, instead of EL2 officers.

56 Mr Mark West, McCullough Robertson, *Transcript of Evidence,* 16 October 2014, p. 6.

57 PwC, *Submission No. 23,* p. 25.

58 PwC, *Submission No. 23,* p. 26.

Recommendation 4

3.65 **The Committee recommends that the Australian Taxation Office amend its internal guidance so that findings or suspicion of fraud or evasion can only be made by an officer from the Senior Executive Service.**

3.66 The Committee is also concerned about the effect that a mere allegation of 'fraud and evasion' can have on a taxpayer, when the evidence in a particular case might at best support evasion only. The ATO's approach should be to make an allegation of evasion and then only make an allegation of fraud when evidence for fraud clearly exists.

Recommendation 5

3.67 **The Committee recommends that the Australian Taxation Office only make allegations of fraud against taxpayers when evidence of fraud clearly exists.**

3.68 The Committee notes PwC's common sense suggestion that fraud and evasion should be resolved early in an audit to determine whether action on an aged assessment should continue. However, the Committee also notes that some matters can be very complex and that coming to a considered decision on this issue may take time. Therefore, the Committee would like the ATO to address it early in audits where practicable.

Recommendation 6

3.69 **The Committee recommends the Australian Taxation Office should ensure that allegations of fraud or evasion are addressed as soon as practicable in an audit or review.**

3.70 Finally, the Committee notes that a finding or allegation of fraud or evasion has penal connotations and there is an argument that the ATO should have the burden of proof on these occasions. However, the Committee has come to the view that, where a taxpayer has the proper records and been compliant, they should be able to rebut a suggestion of fraud or evasion. This would typically occur during the statutory period for keeping records.

3.71 The Committee is concerned about the taxpayer having the burden of proof after the record keeping period has expired. In a practical sense, the

possibility of a finding or allegation of fraud or evasion means that a taxpayer has a limitless record-keeping period. Given the inimical nature of fraud and evasion to the tax system, the Committee does not support a time limit on the ATO investigating this conduct.

3.72 However, the Committee is attracted to the idea that the burden of proof should switch to the ATO after a certain period of time has expired. This brings some balance back into the framework. It also recognises the costs to business and taxpayers of keeping records for an extended time. A good candidate for the switching point is the statutory period of when a taxpayer is no longer required to retain records. The Committee notes that it may be worth revisiting the limits in this context, subject to the regulatory costs of such a change on taxpayers and business.

Recommendation 7

3.73 **The Committee recommends that the Government introduce legislation to place the burden of proof on the Australian Taxation Office in relation to allegations of fraud and evasion after a certain period has elapsed. The change should be harmonised with the record keeping requirements. These periods could be extended, subject to concerns of regulatory costs on business and individuals.**

Departure prohibition orders

Background

3.74 Departure prohibition orders (DPOs) have their origin in a more comprehensive system where taxpayers were unable to leave Australia without clearing all tax debts. If they left Australia while owing tax, their travel operator became liable for their tax liabilities. As international travel developed, the system became onerous and was scrapped in 1962. The benefits of international travel were considered to outweigh any potential loss to the revenue. Restrictions were re-introduced in 1984, although in a limited form.[59]

3.75 The Commissioner may prohibit a person departing Australia where they have a tax liability and the Commissioner has a reasonable belief that they

59 *Pattenden v Commissioner of Taxation* [2008] FCA 1590, paras 4-6.

should either discharge the liability or make arrangements to discharge the liability before they leave the country. If a person knows they have a DPO, the penalty for leaving Australia is either 50 penalty units or 12 months imprisonment, or both. A taxpayer can apply to the Federal Court or a State or Territory Supreme Court to have their DPO set aside.[60]

3.76 Instead of revoking a DPO, the Commissioner has the option of issuing a departure authorisation certificate to allow a taxpayer subject to a DPO to leave the country. The reasons for issuing the certificate include:

- humanitarian grounds
- the taxpayer is likely to return to Australia
- they are likely to pay their tax debt
- they have provided suitable security.[61]

3.77 The ATO has issued guidance on DPOs. It discusses the legislation and case law, but also makes clear that issuing a DPO is not a routine matter. The guidance states:

> A DPO imposes a significant restriction on the normal rights of tax debtors in that it deprives them of their liberty to travel outside Australia. The ATO recognises the impact of this restriction on a tax debtor's liberty and freedom of movement …
>
> Whilst Part IVA of the TAA is primarily concerned with the protection of the revenue, consideration of the risks to the revenue needs to be balanced with the severe intrusion into a person's liberty, privacy and freedom of movement that a DPO represents.[62]

3.78 DPOs were discussed with Mr David Hughes from Small Myers Hughes. His criticism was that it is too easy for a DPO to be approved, given the ramifications for a taxpayer:

> Certainly there are cases where departure prohibition orders are warranted; however in my view it is far too easy for the commissioner to issue them and far too difficult for the taxpayer to disprove them. There was a genuine argument while the matter was running through the court for the first departure prohibition order—a genuine argument from the commissioner—that they did

60 Sections 14R, 14S and 14V of the *Taxation Administration Act 1953*. A penalty unit is $170. See section 4AA of the *Crimes Act 1914*.

61 Section 14U of the *Taxation Administration Act 1953*.

62 ATO, *Enforcement measures used for the collection and recovery of tax-related liabilities and other amounts,* PS LA 2011/18, 3 July 2014, paras 139, 150.

> not have to be right; they simply had to form the view that the person was disposing of their assets to leave the country. Regardless of whether that view was correct or incorrect, the mere fact of forming the view was sufficient to allow that departure prohibition order to stand.[63]

3.79 Small Myers Hughes' experience came from a case where the ATO inaccurately assessed a taxpayer, who operated an insurance business from Vanuatu, as a tax risk. The tax liability, of at least $6 million, was wrong, and further, the taxpayer had assets in Australia, making them less of a flight risk. The ATO believed that these assets had been disposed of because they had been put up for sale, but in fact had been withdrawn from sale. The taxpayer had the DPO quashed by a court.

3.80 The next day, the taxpayer went to the airport to travel to New Zealand, but was stopped by police because the ATO had applied for a second DPO. The taxpayer went back to court and the ATO withdrew the DPO. Mr Hughes stated:

> We got to court and the commissioner withdrew the second departure prohibition order and the court made comment that it was just as well they had because, had they not, he would consider contempt of court proceedings against the officers who had issued the second departure prohibition order and a jail term would result.[64]

3.81 In 2010, there were media reports that the ATO had issued a DPO to the entertainer Paul Hogan, who had returned to Australia from his residence in the United States to attend his mother's funeral. Mr Hogan's lawyer commented that the DPO was unnecessary because he had retained a significant connection with Australia and that he was already cooperating with the Australian authorities. The media reported that Mr Hogan was allowed to return home after providing security.[65]

3.82 The IGT discussed DPOs in the tax disputes report. The IGT received similar concerns to the Committee about DPOs and gave a recent example of a taxpayer who was delayed in travelling overseas for family reasons, despite engaging with the ATO and offering security for the disputed debt. The IGT suggested that, although the ATO requires a senior official

63 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 19.

64 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 19.

65 Hannah Low, 'Tax Office stops Hogan leaving,' *Australian Financial Review,* 26 August 2010, p. 6; Hannah Low and Katie Walsh, 'Hogan a "prisoner" in tax case,' *Australian Financial Review,* 27 August 2014, p. 4; Hannah Low, 'Hogan free to leave after ATO deal,' *Australian Financial Review,* 4 September 2010, p. 5.

to sign off on a DPO, a more robust process, such as judicial oversight, may be warranted.[66]

Analysis

3.83 Issuing a DPO is a serious event. In criminal law, a penalty involving a reduction of liberty is considered more serious than a financial penalty and this is reflected in the ATO's guidance. Of course, a taxpayer can travel freely within Australia while a DPO is in force. This means the stakes are higher when a taxpayer lives overseas because they are potentially being denied the right to re-join their family.

3.84 The Committee notes that, where a DPO is issued in error, it can take a substantial period of time to be corrected through appeal. In the Small Myers Hughes' case, the DPO was issued in May, the hearings were in July and August, and judgement in October.

3.85 On the other hand, if a taxpayer has a liability and there is a risk of assets being dissipated, then an enforcement mechanism such as a DPO may be warranted. The Committee notes that the arrangements were re-introduced in 1984 after a 20 year period, which the Committee interprets as indicating a need for the provisions. In evidence, Mr David Hughes of Small Myers Hughes stated that DPOs had a place in tax administration.[67]

Committee comment

3.86 The Committee accepts that the ATO should retain the power to prevent a taxpayer leaving the country when there is an outstanding tax liability and there is a substantial risk that the taxpayer will not discharge it. However, the Committee believes that the current restraint on the ATO, namely an appeal to the Federal Court after the event, is insufficient because it is expensive to conduct and, more importantly, involves substantial delay.

3.87 The Committee would like to see more restraint on the ATO in the exercise of the DPO before it is issued. Mr John Hyde Page, a tax barrister, suggested that responsibility for issuing a DPO (and similar enforcement mechanisms) should lie with an agency similar to the Director of Public Prosecutions.[68] Given the effects on individuals' liberty, the Committee supports this sort of reform, although a new agency is not necessarily

66 IGT, *The Management of Tax Disputes: A Report to the Assistant Treasurer,* January 2015, p. 98.

67 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 19.

68 Mr John Hyde Page, *Submission No. 22,* p. 8.

warranted. The Committee prefers the alternative of requiring the ATO to seek judicial approval for a DPO, as suggested by the IGT.

Recommendation 8

3.88 **The Committee recommends that the Government introduce legislation to require judicial approval for the Commissioner of Taxation to issue a departure prohibition order.**

Garnishee notices

Background

3.89 The Commissioner has a broad power to garnish money held on behalf of a taxpayer by a third party. Where a taxpayer has a tax-related liability or related debt, the Commissioner may give written notice to a third party that owes money to the taxpayer. This includes where the third party holds money on account for the taxpayer. The notice is to specify the amount to be paid and when. A copy of the notice must be provided to the taxpayer.

3.90 The third party is to be indemnified for the payment. In other words, the taxpayer cannot sue them. If the third party does not make the payment, they can be convicted of an offence with a penalty up to 20 penalty units. They can also be ordered to pay an additional sum to the Commissioner, not exceeding the original amount.[69]

3.91 The ATO has issued guidance on the exercise of this power. It states that garnishee notices are an effective way of recovering a tax debt, although care must be exercised in their use:

> Collection through third parties by serving garnishee notices is often an efficient and cost-effective way of obtaining payment of outstanding debts. We will use garnishee notices in circumstances where we consider that action to be the most effective method of obtaining payment of a debt.

69 Subdivision 260-A of Schedule 1 of the *Taxation Administration Act 1953.* A penalty unit is $170. See section 4AA of the *Crimes Act 1914*.

> The issue of a garnishee notice is an exercise of a coercive power so care must be taken when exercising this power.[70]

3.92 The main considerations that ATO staff should take into account are:

- the financial position of the taxpayer and steps taken to make payment
- the taxpayer's other debts
- revenue risk due to the taxpayer's actions, such as paying other creditors
- the effect of a garnishee notice on the taxpayer's family or business.[71]

3.93 The guidance suggests some other limitations on garnishee notices. For example, ATO staff are instructed not to garnish more than 30 per cent of salary and wages unless the taxpayer has other income. When a tax dispute is still current, the ATO should consider whether a garnishee notice would have a significantly adverse effect on the taxpayer's ability to continue the dispute.[72]

3.94 The main issue raised during the inquiry was that garnishee notices can be inappropriately issued against taxpayers. A tax barrister, Mr Graeme Halperin, stated that garnishee notices are being used more often and they can have a devastating impact on a small business. Further, they have no judicial oversight:

> It is not like I can get involved in a proceeding where the ATO wishes to freeze assets of a taxpayer who they think is going to dissipate those assets; if they want to get a freezing order, they have to march off to the Supreme Court and go before a judge. The judge will look at affidavit material from both parties in relation to whether he should grant a freezing order. So it is subject to judicial scrutiny; but garnishee notices are not. So, at the end of the day, the ATO issues a garnishee notice to the bank, and, before you know it, your money is gone. You will not necessarily be alerted to this beforehand; you just find out later on that, suddenly, that money that you put in to pay wages or for other working capital expenditure has been seized by the ATO—and there is really nothing you can do about it. There is nothing more certain to bring

70 ATO, *Enforcement measures used for the collection and recovery of tax-related liabilities and other amounts,* PS LA 2011/18, 3 July 2014, paras 100-01.

71 ATO, *Enforcement measures used for the collection and recovery of tax-related liabilities and other amounts,* PS LA 2011/18, 3 July 2014, para. 102.

72 ATO, *Enforcement measures used for the collection and recovery of tax-related liabilities and other amounts,* PS LA 2011/18, 3 July 2014, paras 108, 112.

> a taxpayer to their knees, particularly a small business, than taking away their working capital.[73]

3.95 Similar complaints were raised with the Committee by Agape Ministries, BDO and Mr Ian Hashman. In Mr Hashman's case, he stated that his difficulties were exacerbated by the ATO declining to communicate with his advisers.[74]

3.96 A judicial example was the *Denlay* case where the ATO issued a garnishee notice against a taxpayer who was involved in litigation against the Commissioner. The Federal Court quashed the notice because the ATO had failed to take into account important criteria, including the merits of the Denlays' appeals and the effect the notice would have on their ability to pursue the appeals.[75]

Analysis

3.97 The ATO's position on garnishee orders is that it rarely uses them for individuals and small businesses, and that it only does so when there are significant risks involved. Further, it is open to alternative means of payment such as instalments:

> In most lower-risk cases, we defer active recovery action until after the dispute has been resolved. We actively manage cases where the debt is greater than $1 million, the taxpayer is either in the large market or is a high wealth individual, or where there are significant revenue or other risks. These cases generally constitute about 10-15% of all disputed debts where there is a formal dispute. In other words, payment is not actively pursued for most individuals and small businesses until after the dispute is resolved …
>
> Where the level of risk necessitates action to secure payment of the debt before the resolution of a dispute, the following options are considered as an alternative to legal recovery action:
>
> - payment of the whole debt in full upon demand
> - payment of the whole debt by instalments
> - payment of 50% of the disputed debt in a lump sum with the balance being paid by instalments

73 Mr Graeme Halperin, *Transcript of Evidence,* 14 August 2014, p. 21.

74 Agape Ministries, *Submission No. 34,* p. 5; Mr Lance Cunningham, BDO, *Transcript of Evidence,* 18 August 2014, p. 5; Mr Ian Hashman, *Transcript of Evidence,* 24 September 2014, p. 2.

75 *Denlay v Commissioner of Taxation* [2013] FCA 307.

- payment of 50% of the disputed debt together with the provision of acceptable security
- provision of acceptable security for the whole debt
- provision of financial documents to substantiate that payment of the disputed debt would cause serious hardship.[76]

3.98 The evidence from stakeholders during the inquiry was mixed. Although many practitioners expressed concern about the use of garnishee notices, others had a different view. One adviser, Mr Richard Wytkin, suggested that 'a lot of the time it is the client's fault for not doing something about his debt.'[77]

3.99 Mrs Sarah Blakelock from McCullough Robertson noted that garnishee notices were 'an important and useful tool … for securing the revenue' and accepted that giving prior warning to a taxpayer was often not practicable when there was a revenue risk. Further, it was difficult to generalise about these cases because each one turned on its own facts. The firm suggested that the ATO should better engage during compliance activities to reduce the chance that it would need to rely on recovery proceedings.[78]

3.100 The Committee notes the Ombudsman's observation that the ATO is less ready to engage with taxpayers as a dispute progresses to litigation.[79]

Committee comment

3.101 On balance, the Committee has decided not make a recommendation. The Committee recognises the importance of being able to issue garnishee notices in a timely way to manage revenue risk. Further, the ATO offers taxpayers flexibility in how they meet their debts. However, the Committee is also concerned that garnishee notices have sometimes been used inappropriately and this has caused hardship or injustice to taxpayers.

3.102 The ATO should be able to better manage its fairness risk if it improves its engagement with taxpayers and their advisers. As a dispute progresses, it may appear that there is less to be gained from engagement. However, the Committee believes that engagement is still warranted and that demonstrating engagement with a taxpayer is one of the best ways the

76 ATO, *Submission No. 10*, p. 33.

77 Mr Richard Wytkin, *Transcript of Evidence*, 29 October 2014, p. 4.

78 Mrs Sarah Blakelock, McCullough Robertson, *Transcript of Evidence*, 16 October 2014, p. 11.

79 Commonwealth Ombudsman, *Submission No. 14*, p. 10.

ATO can demonstrate that it has dealt fairly with a taxpayer, or taxpayers generally. This topic is discussed further in the next chapter.

Model litigant rules

Background

3.103 The model litigant rules are based on the idea that the Crown, with its significant resources and stewardship role, should observe certain standards in litigation. An early expression of this view is from a High Court case in 1912:

> The point is a purely technical point of pleading, and I cannot refrain from expressing my surprise that it should be taken on behalf of the Crown. It used to be regarded as axiomatic that the Crown never takes technical points, even in civil proceedings, and *a fortiori* not in criminal proceedings.
>
> I am sometimes inclined to think that in some parts—not all—of the Commonwealth, the old-fashioned traditional, and almost instinctive, standard of fair play to be observed by the Crown in dealing with subjects, which I learned a very long time ago to regard as elementary, is either not known or thought out of date. I should be glad to think that I am mistaken.[80]

3.104 This principle has been codified in the *Legal Services Directions 2005* made under the *Judiciary Act 1903.* The directions cover a range of issues, including the model litigant rules. In relation to being a model litigant, the key requirements are:

- dealing with claims promptly
- considering ADR before litigating and participating fully and effectively when it occurs
- not requiring the other party to prove a matter that the Commonwealth knows to be true
- not taking advantage of a litigant that has few resources

80 Griffith CJ, *Melbourne Steamship Company v Moorehead* [1912] HCA 69.

- not pursuing appeals unless the Commonwealth believes it has reasonable prospects for success, or it would be in the public interest.[81]

3.105 An important component of the rules is that they do not bestow any rights or enforceable remedies on a taxpayer or parties outside the Commonwealth. Section 55ZG of the *Judiciary Act 1903* states that enforcement is a matter for the Attorney-General. Non-compliance with the rules can only be raised in a proceeding by the Commonwealth. In practice, this means that a taxpayer may have a well-founded belief that the ATO is not complying with the rules during litigation, but this of itself will not affect the outcome of their case.

3.106 The issue in the inquiry was the claim that the ATO regularly breaches the model litigant rules. Mr David Hughes from Small Myers Hughes stated:

> I would suggest that the model litigant rules are not hard-and-fast rules that the commissioner adopts, or that litigation people within the commissioner's office would adopt, in every single case. In fact, it is a bit of a running joke amongst practitioners that the model litigant rules are more often disobeyed than they are observed.[82]

3.107 The Committee heard about two types of cases where the ATO tends not to comply with the model litigant rules. The first was that it does not participate in mediations fully and effectively.[83] The second was that it requires taxpayers to prove all the facts necessary to overturn the Commissioner's decision, when often many of these could be conceded.[84]

3.108 The courts have occasionally criticised the conduct of the ATO, or its representatives, with reference to the model litigant rules. In *Phillips,* the Federal Court found that the ATO had disobeyed its directions, leading to excessive delay. The Court found for the taxpayer on this basis, and then noted that the ATO's conduct did not meet the standards that might be expected of a model litigant.[85] Similar comments have been made in other cases.[86]

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81 Paras 2 and 5 of Appendix B of the *Legal Services Directions 2005.*

82 Mr David Hughes, Small Myers Hughes, *Transcript of Evidence,* 16 October 2014, p. 21.

83 Ms Justeen Dormer, Dormer Stanhope, *Transcript of Evidence,* 1 October 2014, p. 1; Mr John Hyde Page, *Transcript of Evidence,* 29 October 2014, p. 10.

84 Ms Judy Sullivan, PwC, *Transcript of Evidence,* 14 August 2014, p. 27.

85 *Phillips, in the matter of Starrs & Co Pty Limited (In Liquidation) v Commissioner of Taxation* [2011] FCA 532, para. 8.

86 For example, *LVR (WA) Pty Ltd v Administrative Appeals Tribunal* [2012] FCAFC 90, paras 41-42; *Deputy Commissioner of Taxation v Clear Blue Developments Pty Ltd (No 2)* [2010] FCA 1224, para. 48.

3.109 However, in *Huynh,* the AAT noted that the ATO had acted in the spirit of being a model litigant by filing some documents with the Tribunal that were of assistance to the taxpayer.[87]

3.110 The Productivity Commission recently released a report on access to justice that included discussion about the model litigant rules for all Australian jurisdictions. It noted reviews which had found that the rules have been 'reasonably effective' in modifying how the Commonwealth conducts litigation. The Productivity Commission also suggested that compliance approached 100 per cent in the Crown Solicitors' offices and the Australian Government Solicitor (AGS). Compliance mechanisms are currently based on self-reporting, which the Commission did not regard as adequate. It recommended that litigants be able to formally complain to the Ombudsman where they perceived a breach of the rules.[88]

Analysis

3.111 The Committee sought some advice from the ATO about its compliance with the rules. The ATO stated that, between 1 July 2007 and 31 December 2012, there were 47 claims made that the ATO had breached the model litigant rules. Five of these related to external solicitors and the rest to ATO staff. The ATO noted that only six breaches were confirmed and these were all in relation to ATO staff. There was no pattern or trend to the breaches.[89]

3.112 The ATO's evidence suggests that ATO compliance with the rules is reasonable. A tax barrister, Mr John Hyde Page, did not think that the ATO's conduct as a litigant was problematic, even if it was open to the allegation that it asked litigants to prove matters that they knew were true:

> The ATO has a practice of including in its pleadings in court cases and in the AAT a boilerplate that says, 'We put the taxpayer to proof on everything except that which is expressly admitted in this pleading.' That boilerplate is always there. Having said that, I never really see it playing much of a part in the determination of tax disputes. I think usually the issues are reasonably well defined in Part IVC appeals. I do not regard there as being any huge issue there, at least based on what I have seen…

87 *Huynh and Anor and Commissioner of Taxation* [2008] AATA 305, para. 16.

88 Productivity Commission, *Access to Justice Arrangements,* Report No. 72, September 2014, pp. 429-42.

89 ATO, *Submission No. 10.3,* p. 1.

> I think the ATO, at least in some respects, is a more diligent and conscientious litigant than a lot of private sector litigants.[90]

3.113 The Committee considers what may be occurring is that taxpayers expect the ATO will make concessions or litigate in a benevolent manner. However, the ATO has no obligation to do this. The model litigant rules state that they do not 'prevent the Commonwealth and its agencies from acting firmly and properly to protect their interests'.[91] Further, litigation is complex and the Federal Court has declined to criticise the ATO where it believed that it was entitled to test the evidence or spent time and resources covering a range of contingencies.[92]

3.114 CPA Australia commented to the Committee that the ATO does not communicate to taxpayers before litigation about what the model litigant rules require of it. Further, the Ombudsman noted that communication from the ATO tends to fall away as litigation draws near.[93] The evidence corroborates the argument that taxpayer expectations are not being managed.

Committee comment

3.115 Arguably, a taxpayer's legal representatives should be advising them about the scope of the model litigant rules. But since much of the criticism is directed at the ATO, the Committee believes that it has an interest in managing taxpayer expectations. The solution is to respond to the Ombudsman's observation and better engage with taxpayers as litigation draws near.

Recommendation 9

3.116 **The Committee recommends the Australian Taxation Office better engage with taxpayers prior to litigation so that they are aware of what the model litigant rules require, and do not require, of the Australian Taxation Office.**

3.117 Considering the information provided by the ATO, the Committee accepts that it largely complies with the model litigant rules. However, the Committee would like to see the ATO achieve a 100 per cent compliance

90 Mr John Hyde Page, *Transcript of Evidence,* 29 October 2014, p. 10.

91 *Legal Services Directions 2005,* Appendix B, p. 24.

92 *Clark v Commissioner of Taxation* [2010] FCA 415, paras. 164, 168; *Heran v Commissioner of Taxation* [2006] FCA 110, para. 3.

93 CPA Australia, *Submission No. 7,* p. 3; Commonwealth Ombudsman, *Submission No. 14,* p. 10.

rate, similar to the AGS. The Committee believes that the ATO could benefit by approaching the AGS to determine if there were practices or systems it could adopt to improve compliance, even if this were done on an informal basis.

Recommendation 10

3.118 **The Committee recommends the Australian Taxation Office approach the Australian Government Solicitor to determine if they can provide advice and assistance to the Australian Taxation Office in terms of best practice in complying with the model litigant rules.**

3.119 Finally, the Committee notes the Productivity Commission's recommendation for more formal compliance mechanisms in relation to the model litigant rules. This broader topic is outside the scope of the Committee's inquiry. However, the Committee supports it in principle because it would give stakeholders more assurance about compliance.

Scope of appeals from the AAT

Background

3.120 Under section 44 of the *Administrative Appeals Tribunal Act 1975,* a person may appeal a decision of the AAT to the Federal Court on a question of law. This is the usual pathway for appealing a decision of the AAT.[94]

3.121 During the inquiry, Mr John Hyde Page, a tax barrister, raised the issue of whether appeals to the Federal Court should also consider questions of fact.[95] During evidence, he stated that some of the factual findings in tax matters, such as fraud or evasion, were so serious that appeals on those issues should also be allowed:

> Since the formation of the Administrative Appeals Tribunal, appeals from the AAT to the Federal Court have always been restricted to questions of law. In that sense it is by legislative design, but that has always been the treatment that anybody going to the AAT with some sort of administrative question that they are seeking to have reviewed will get. However, where one is dealing

94 Attorney-General's Department, *Submission No. 30,* p. 3.

95 Mr John Hyde Page, *Submission No. 22,* p. 8.

> with, in some cases, exceptionally large amounts of money and matters that do touch upon whether there has been fraudulent conduct or intentional disregard of the law, I do think it is necessary to make an exception for tax cases and I do think there should be appeals on questions of fact.[96]

Analysis

3.122 As this chapter discusses, fraud and evasion was one of the major issues in the inquiry. Therefore, the Committee asked the Attorney-General's Department to advise on whether taxpayers should be able to appeal to the Federal Court on questions of fact.

3.123 The Department stated that it did not support extending the grounds of appeal to the Federal Court. Its reasons were:

- a court's primary focus is on enforcing and declaring the law, rather than fact-finding
- the AAT is suited to fact-finding because it is not bound by the laws of evidence and can investigate issues
- the AAT has Members that are skilled in tax law, including some Federal Court judges who hold appointments to the AAT
- it would expand the workload of the Federal Court and require additional resources
- taxpayers achieve finality earlier
- the Administrative Review Council considered this proposal in 1997 and rejected it.[97]

Committee comment

3.124 The Committee accepts that the AAT can make serious factual findings about a taxpayer. However, the Committee does not prefer the alternative of allowing appeals to the Federal Court on matters of fact. This is due to the increased cost and complexity, as well as the observation that the Committee did not receive evidence that errors of fact consistently occur at the AAT.

3.125 Therefore, the Committee makes no recommendation for change.

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96 Mr John Hyde Page, *Transcript of Evidence,* 29 October 2012, p. 7.

97 See generally Attorney-General's Department, *Submission No. 30.*

Small Taxation Claims Tribunal

Background

3.126 The AAT has two forums for hearing reviews of taxation decisions: the Taxation Appeals Division (TAD); and the Small Taxation Claims Tribunal (STCT). Where the amount of tax in dispute is $5,000 or over, the matter goes to the TAD. The STCT deals with the remainder.[98] The $5,000 threshold has not changed since the STCT was created in 1997.[99]

3.127 The processes in the STCT are designed to be quicker and simpler for taxpayers than in the TAD. The fees for the two jurisdictions are increased every two years under a statutory formula.[100] Importantly for taxpayers, there is an $800 difference in the application fee between the two jurisdictions. A comparison of them is below.

Table 3.1 Comparison of the Taxation Appeals Division and the Small Taxation Claims Tribunal

Process	TAD	STCT
Dispute amount	$5,000+	Less than $5,000
General application fee for taxpayers	$861	$85
Hardship application fee for taxpayers	$100	NA
Referral to ADR if the AAT thinks it will assist	may occur	must occur
Time period for ATO to lodge documents	28 days	14 days
Usual number of pre-trial conferences	2	1
Notice period before conferences	6+ and 12+ weeks	4 weeks
Statement of agreed facts	14 days before 2nd conference	7 days before hearing
Parties can explicitly request mediation	No	Yes
ATO lodging statement of facts it does not dispute	No	Yes
Parties lodging a certificate prior to hearing	Yes	No

Sources AAT, General Practice Direction, March 2007; AAT, Small Taxation Claims Tribunal Practice Direction, March 2000; AAT, Direction under section 37(1AB) of the AAT Act for matters in the Taxation Appeals Division; Part IIIAA of the Administrative Appeals Tribunal Act 1975; AAT, 'Information about application fees,' viewed at http://www.aat.gov.au/FormsAndFees/Fees.htm on 3 February 2015.

3.128 In 1999, the Ralph Review of Business Taxation argued that there should be a shift away from adversarial procedures in resolving disputes in favour of greater engagement and use of ADR. It also suggested that current processes for deciding small disputes were too involved compared

98 Sections 24AB and 24AC of the *Administrative Appeals Tribunal Act 1975.*

99 Schedule 1 of the *Law and Justice Legislation Amendment Act 1997.*

100 Regulations 19A and 19B of the *Administrative Appeals Tribunal Regulations 1976.*

with the amounts at stake and that the quicker processes of the STCT could be more widely used through lifting the $5,000 threshold:

> There is a compelling argument for extending dedicated, streamlined arrangements for dealing with taxation matters where the amount of tax in dispute is small (up to, say, $50,000 rather than the current $5,000). In the absence of such arrangements, disputes can drag on for long periods and involve costs both to the taxpayer and to the government (not the least in the form of administrative costs) out of all proportion to the amount at issue.[101]

3.129 An academic paper in 2012 argued that the $5,000 threshold has become much smaller in real terms since 1997 due to inflation and economic growth. It argued that the threshold should be increased to $10,000 or $15,000.[102]

Analysis

3.130 The Committee raised this topic with witnesses during the inquiry. There was some industry support for increasing the $5,000 threshold, at the very least to keep pace with inflation.[103]

3.131 However, Mr Philip Hack SC, a Deputy President of the AAT, had a different perspective. He suggested that the STCT should be abolished because it gave taxpayers false hope and that time and effort is usually required to properly adjudicate a dispute, even if the amount involved is small:

> It is a burden that oftentimes holds out false hopes that people will be able to resolve their disputes very quickly. Sometimes even very minor disputes take a long time to thrash out the ground work. One notable example that happens all the time concerns tax debt release applications, which are dealt with in that tribunal. They are cases where people invariably want to present vast amounts of material about their personal circumstances. It takes people a long time to do that, and meeting a deadline of 84 days

101 Review of Business Taxation, *A Tax System Redesigned: More certain, equitable and durable,* July 1999, p. 147.

102 Binh Tran-Nam and Michael Walpole, 'Access to tax justice: How costs influence dispute resolution choices,' 2012, *Journal of Judicial Administration,* vol. 22, pp. 3-28.

103 Mr Tony Greco, IPA, *Transcript of Evidence,* 14 August 2014, p. 8; Mr Michael Croker, CAANZ, *Transcript of Evidence,* 18 August 2014, p. 11.

from lodgement to finalisation in those sorts of cases is unrealistic.[104]

3.132 An accounting practice made a similar comment, noting that prosecuting a case at the AAT could still be expensive, despite there being less than $5,000 in dispute.[105]

3.133 Mr Hack argued that the processes under the TAD were sufficiently flexible to handle small disputes.[106]

Committee comment

3.134 The Committee appreciates the intent behind the Ralph Review's desire to expedite the resolution of tax disputes by allowing more disputes to be dealt with at the STCT. However, the Committee also notes that a tax dispute for a small amount can be a complex matter. The Committee received further evidence to this effect, which was discussed in chapter 1.

3.135 Therefore, the Committee does not make any recommendation to greatly increase the $5,000 threshold for the STCT. Rather, the Committee believes there is value in deciding whether the STCT should continue. If so, it should be put on a more sustainable footing through increasing its threshold to adjust for inflation since 1997, and then applying a mechanism whereby the threshold increases over time. If the AAT can increase its application fees every two years, then a similar arrangement should apply to the threshold.

Recommendation 11

3.136 **The Committee recommends that the Government review the Small Taxation Claims Tribunal and determine whether it should continue. If so, there should be a one-off increase to the $5,000 limit to take account of inflation since 1997 and a system introduced so the threshold increases incrementally in future to keep pace with inflation.**

104 Mr Philip Hack SC, AAT, *Transcript of Evidence,* 16 October 2014, p. 1.

105 Mr Brian Hrnjak, GHR Accountants & Financial Planners, *Transcript of Evidence,* 18 August 2014, p. 45.

106 Mr Philip Hack SC, AAT, *Transcript of Evidence,* 16 October 2014, p. 3.