



11 November 2011

Dr Richard Grant
Acting Secretary
Senate Standing Committee on Economics, SG.64
PO Box 6100
Parliament House
Canberra ACT 2600

By Email: economics.sen@aph.gov.au

Dear Dr Grant,

**Submission - Tax Laws Amendment (2011 Measures No. 8) Bill
2011**

The Taxation Committee of the Business Law Section of the Law Council of Australia (**Committee**) welcomes the opportunity to make a submission in relation to the Tax Laws Amendment (2011 Measures No. 8 Bill) 2011 (the **Bill**).

In respect of the submission relating to Schedule 3 of the Bill, this submission is supported by the Insolvency and Reconstruction Law Committee of the Business Law Section of the Law Council of Australia.

Schedule 2 of the Bill

Schedule 2 of the Bill deals with Petroleum Resource Rent Tax (**PRRT**). In relation to Schedule 2 of the Bill, this submission is specifically concerned to address the retrospective nature of those amendments.

The PRRT amendments are said to be necessary 'to provide certainty regarding how the 'Taxing Point' is determined for the purposes of the Petroleum Resource Rent Tax'¹.

¹ See page 3 of the Explanatory Memorandum to the Bill and the comments of the Assistant Treasurer in the Second Reading at page 8 of Hansard dated 13 October 2011.

Presumption against retrospective application of laws

It is a fundamental principle that laws need to be certain, so that people are able to understand in advance the rules and principles that apply to their conduct and behaviour.

Parliament should be loath to apply changes made to the law retrospectively. Where Parliament does so it is not possible for citizens to know and understand in advance, the consequences of their behaviour, resulting in the potential for injustice.

This principle is reflected in the practice of the Senate's Standing Committee on the scrutiny of Bills which generally maintains an in principle objection to the practice of retrospective legislation '*as it operates to make life very uncertain for people who may be affected by this legislation*'². The OECD Committee on Fiscal Affairs, in *Taxpayers' Rights and Obligations – Practice Note* observes the taxpayers have a right to a high degree of certainty as to the operation of the tax laws in order to be able to anticipate the taxation consequences of their ordinary personal and business affairs.³

The PRRT amendment

While there may be limited exceptional circumstances in which it is appropriate to amend legislation retrospectively, beyond the date of an announced change it does not appear that such exceptional circumstances exist here. Legislation should only be amended retrospectively:

1. to resolve situations that have caused undue hardship, due to the unintended application of provisions to particular taxpayers;
2. to deal with major interpretative changes arising as a consequence of litigation, where the Court's decision is totally unanticipated by Government, the ATO or taxpayers.

In each of these circumstances, taxpayers are not prejudiced by the amendment.

Absent these special circumstances, legislation should not be amended retrospectively, particularly where the amendment is to be retrospective to a date earlier than the date of any announced change.

In the present case, it is suggested that the PRRT amendments merely confirm the long established application of the PRRT.⁴ Yet it is clear that even the Government recognises that the changes alter the legal tests to be employed.⁵

² The Honourable Senator Amanda Vanstone, 'The Five Principles: The Committee's Terms of Reference' (Speech delivered at the Tenth Anniversary of the Senate Standing Committee for the Scrutiny of Bills, Parliament House, Canberra, 25 November 1991) http://www.aph.gov.au/senate/committee/scrutiny/10_years/index.htm. See also Senate Standing Committee for the Scrutiny of Bills, Parliament of Australia, *Tenth Report of 2005* (2005) 204-207.

³ OECD Committee on Fiscal Affairs, 'Taxpayers' Rights and Obligations – Practice Note' *Tax Guidance Series* (2003) 4.

⁴ See paragraph 2.3 at page 13 of the Explanatory Memorandum to the Bill and the first paragraph of page 9 of Hansard for the 13th October 2011.

⁵ See the submissions made by Council for the Commissioner for Taxation to the Full Federal Court in *Esso Australia Resources Pty Ltd v Commissioner of Taxation* on Wednesday, 26 October 2011 Transcript pages 2-4.

The surrounding circumstances do however suggest that the retrospective nature of this change is not without some controversy, may well be unnecessary, and indeed can only really be necessary if the change has the effect of taking away a taxpayer's rights, in litigation which is as yet incomplete.

It is apparent that at least one taxpayer, Esso Australia Resource Pty Ltd has been in dispute with the Commissioner for Taxation about the interpretation of the law for a period in excess of 20 years⁶. It is understood that case is on appeal and that the courts have yet to make a final decision on the prior interpretation of the point. The existence of this legislation and the context of the proposed amendment suggests that it cannot be said that no taxpayer will necessarily be prejudiced by the amendment and nor can it accurately be suggested that the amendments confirm the long established application of the law.

If the law were clear, there would be no need for retrospective amendment.

The need for current and prospective taxpayers to obtain certainty about how the PRRT applies to their specific projects⁷ could be addressed by having the PRRT amendments effective either from the date of royal assent or from the date of the 2011/12 budget⁸. A prospective change would avoid the possibility of unfairness and provide certainty for current and prospective taxpayers.

The Law Council is concerned by what appears to be an increasing tendency, to assume that it is appropriate for the Government to change the law retrospectively going back over many years, where the Government finds that it does not like the interpretation which may be placed upon the law by the Courts. On 1 November 2011 the Assistant Treasurer issued a press release in which he indicated that the Government was looking to amend the transfer pricing provisions of the Income Tax Assessment Act 1936 retrospectively to all income years commencing on or after 1 July 2004.

It is totally inappropriate for the Government to act to amend the law retrospectively in this way, particularly when the Government has been aware that the legislation in question may produce a particular outcome and has not taken the opportunity to act to clarify or amend the legislation prospectively.

Schedule 3 of the Bill

Schedule 3 of the Bill proposes new rules relating to measures to address fraudulent phoenix activity measures.

The Law Council of Australia Business Section has lodged two previous submissions relating to the consultation paper that preceded the introduction of the measures in this Bill. Specifically, submissions were lodged by the Insolvency and Restructuring Subcommittee on 4 March 2010 and the Taxation Committee on 10 February 2010 (together, the **Previous Submissions**). A copy of each of the Previous Submissions is **attached**.

The arguments raised in the Previous Submissions continue to be relevant in relation to the measures proposed in the Bill.

⁶ See the reference at paragraph 2.18 of the Explanatory Memorandum to the Bill.

⁷ See the comments of the Assistant Treasurer in the Second Reading Speech on 13 October 2011.

⁸ Being the date of announcement. See paragraph 2.27 of the Explanatory Memorandum to the Bill.

In particular:

- fraudulent activity deserves, and should attract, the full force of the law
- criminal sanctions currently exist that could be applied in the case of fraudulent phoenix activity, and indeed, those sanctions should be applied in the case of fraudulent phoenix activity with vigour;
- without clear definitional guidance as to the scope of the proposed legislation and, particularly, the meaning of "fraudulent phoenix activity", innocent directors will be unintentionally caught by the proposed penalties.

Please refer to the arguments previously put by the Law Council of Australia in relation to these matters in the Previous Submissions.

PAYG withholding non-compliance tax (PAYG NCT)

The introduction of the PAYG NCT also has the potential to attach a liability to innocent directors, or their associates.

The proposed PAYG NCT can only be recovered from a director or associate where the director is not liable to a penalty under Division 269. Given the circumstances in which the penalty arises are essentially the same as the circumstances in which a liability for PAYG NCT arises, it appears to us that the only case in which a director would not be liable to the Division 269 penalty is where one of the "defences" in section 269-35 are available (eg illness or all reasonable steps). For present purposes, we will refer to these matters as defences even though they would no longer be framed as defences following the proposed amendments.

Prima facie, the PAYG NCT liability would only arise where a director has a defence against the penalty. Further, the Commissioner must reduce the amount of an PAYG NCT liability of a director by notice where he is satisfied of the existence of the same circumstances that give rise to the defence in the first place (though the timeframes are slightly different). It therefore seems that a director will rarely be liable for PAYG NCT because he or she would either be subject to the penalty (based on the timing difference between the penalty arising when imposed, compared with the PAYG NCT liability attaching to an annual income tax return, which would be generally significantly later) or entitled to the "defences" applying to both types of liability.

However, those same defences are not available to associates so it would seem possible for a director to be excused from both the penalty and the PAYG NCT but an associate to remain subject to PAYG NCT. This would seem itself unfair and unreasonable. Although the drafters have attempted to build in safeguards to the operation of the provisions, it is not clear that they are adequate in the circumstances, for instance:

- PAYG NCT arises where an associate "knew, or could reasonably be expected to have known" of the failure to remit amounts because of the associates relationship with the director or the company. This would appear to be unreasonably broad. It may well be thought that, simply by virtue of being associates, a person "could reasonably be expected to have known" what another person was doing, whether or not the first person *actually* knew. It would not be difficult to foresee a court

holding that a wife could reasonably be expected to have known what her husband was doing because of their relationship;

- the associate must also have taken all reasonable steps to influence the director to do certain things or to report the non-payment to the Commissioner or another authority. This seems to raise potential issues of spousal immunity as well as asking associates to go further than directors are required to do;
- further, the previous two points depend on the Commissioner's being satisfied of those facts, not the existence (or otherwise) of the facts themselves. This may make it difficult to effectively object to the PAYG NCT liability; and
- PAYG NCT also arises where the individual was an associate and was treated "more favourably" than other employees of the company. In this case, the associate need not have any knowledge or constructive knowledge of, or otherwise have participated in, the company's failure or the more favourable treatment.

In these changes, like the directors' penalty provisions, there is no requirement that the person have acted dishonestly in any way, despite the stated aim of the PAYG changes to "detering fraudulent phoenix activity".

The Commissioner can also not seek recovery of the PAYG NCT unless he is satisfied that it is "fair and reasonable". However, given the terms on which it is drafted and as discussed above, PAYG NCT seems most likely to arise in unfair and unreasonable circumstances. This raises the issue as to whether it will ever be able to be imposed or whether the Commissioner can have regard to the terms on which it is drafted to determine what is "fair and reasonable" (and to whom). Of course, in principle, amendments should not be made to the (tax) law which are ineffective.

We would suggest that the PAYG NCT provisions and/or policy need to be substantially re-thought.

Generally

Should you wish to discuss any aspect of this matter please do not hesitate to contact the Committee Chair, Teresa Dyson on (07) 3259 7000.

Yours sincerely

Tony O'Malley
Section Chairman