

Mr Russell Chafer
Committee Secretary
Joint Committee of Public Accounts and Audit
Department of the House of Representatives
Parliament House
Canberra ACT 2600
AUSTRALIA

27 February 2006

Dear Mr Chafer

**RE: SUBMISSION - INQUIRY REVIEWING "CERTAIN TAXATION MATTERS"
WITHIN AUSTRALIA**

Please find attached my submission highlighting deficiencies in the Australian Taxation Office's settlement guidelines.

Yours sincerely

Christopher Seage

BREEDING MISTRUST IN THE TAX SYSTEM

INTRODUCTION:

My background:

I was employed in the ATO for 23 years between 1973-96 in the Sydney and Chatswood branches. I spent time in various roles in the tax office including taxpayer audit group where I rose to manager level. I spent 18 months on the large case audit program as a team member. I appeared before the Public Accounts Committee in 1993 which produced a report titled "An Assessment of Tax". I am presently self employed as a partner in a cleaning business, tax consultant and more recently a freelance journalist contributing, in the main, to Crikey.

Purpose of my submission:

To highlight deficiencies in the ATO's settlement guidelines particularly as they relate to transparency and accountability.

Outcomes I'm seeking from my submission:

That this committee recommends the formation of a bi-partisan parliamentary committee to oversee ATO settlements with big corporate taxpayers. To facilitate this, the committee should recommend changes to the tax secrecy laws.

PUBLIC PERCEPTION:

If King Canute lived in the 21st century it wouldn't be the waves he tried to turn back – it would surely be the rush of top company directors trampling all in their way wanting to do a "settlement" with the tax commissioner. Such is the perception of the ATO with ordinary Australians on Struggle Street these days, particularly in light of the notorious Gerard Industries case where the company had its tax bill halved without penalties or prosecution even though the company allegedly was involved in international tax avoidance. Aggravating Struggle Street even further was when details emerged of then tax commissioner Michael Carmody providing Rob Gerard with a comfort letter, effectively clearing him of any tax foibles, which facilitated Gerard's promotion to the Reserve Bank Board. It seems that the big end of town, with access to the upper echelons of the ATO, can have the odd favour done.

There are two other settlements on the public record which have done damage to the reputation of the tax administration. They are Adsteam and Lowy which are mentioned later in the report.

Associate Professor Cynthia Coleman from Sydney University is one of Australia's leading academics in taxation law and research. Her research has indicated that small business taxpayers justify not declaring their cash and overstating their tax deductions by saying that big business don't pay their fair share. *"The most discouraging feature of recent research is that the biggest area of mistrust in the Australian community is between taxpayers themselves and whether other taxpayers are paying their fair share of tax. While that perception may overstate the actual level of vertical inequity, it nevertheless breeds mistrust of the tax system"*, she said.

DUBIOUS SETTLEMENTS ON THE PUBLIC RECORD:

Possibly one of the biggest settlements in Australia's history was recorded in 1992 when the Sydney Morning Herald headline screamed, ***"POLITICAL URGING GOT ADSTEAM \$800M TAX BREAK."*** Written by Colleen Ryan (now China correspondent with the AFR) the story revealed how The Adelaide Steamship Group, one of the lowest corporate taxpayers in Australia in that decade, was given tax assessments against them totaling a staggering \$1.058 billion. This bill was reduced by \$800 million after negotiations with the ATO which left a balance of \$250 million, a quarter of what originally was owed. Adsteam paid less than 1c in the dollar tax in both 1987 and 1988, 15c in the dollar in 1989 and 5c in the dollar in 1990.

Quoting from an internal Tax Office memo, titled "Analysis of Adsteam Recovery", Ms Ryan says there were fears the tax bill could send Adsteam into liquidation and that sources within the Tax Office have told the Herald that there was political urging to ensure that Adsteam was not tipped over the edge due to a tax bill. Employment consequences and the impact on the local economy of such a large corporate collapse were thought to be the motivation behind this concern. The Australian Small Business Association, said at the time: "There is certainly a double standard. I don't know whether they should be putting anyone into liquidation in the present economic climate. But they have absolutely no qualms about putting small businesses under. The whole damn thing is inequitable." They have a point. Indeed "the capacity to pay" principle which seemed to apply in this case was novel and there were no internal guidelines in place to guide officers in making a decision. In my view it falls outside the client settlement guidelines and is not an aspect the ATO should get involved in.

So it seems that the Gerard case now has a big sister and that political interference has reared its ugly head not for the first time. It would also appear that disgruntled tax auditors had leaked the internal memo to Ms Ryan, obviously upset that a company with a history of paying as little tax as possible was given a write off of \$800 million.

If you are wondering like me how \$800 million would have improved our economy you are not alone. Former senior ATO audit manager and 35 year veteran Bob Fittton has highlighted in past commentary one of the audits he was involved in where half a million dollars in penalties was wiped off by someone in Canberra. The company complained to Carmody alleging that the senior officer from Canberra would not negotiate with them a "settlement". Shortly after, without any regard to the facts of the case, and with one stroke of her pen, wiped over \$500,000 off the penalty. *"It made me puke",* said Fitton. *"When that happens you have to question the moral side of the equation. I'm Australian first, tax officer second and as far as I'm concerned it was not right. The whole thing about these settlements has to be looked at by someone independent",* he said. *"Whinge and win. I've seen too many cases reduced just because the company has access to senior people so they can whinge. And they were not reduced because of any technical point of law. We're not talking small change here. The reductions I'm talking about could build more hospitals and schools. In my view the secrecy provisions of the tax act are hiding gross deficiencies in the administration of tax law in this country. At the moment the ATO is not accountable to Parliament for settling these large corporate cases because the government cannot ask the ATO questions because of the secrecy provisions and the potential for corruption is huge. We need to have someone like*

the Auditor General or a bipartisan parliamentary committee to review these settlements because the country is losing potentially billions of dollars."

RESERVE BANK BOARD NOMINEE SETTLEMENTS:

There is an aura of shadiness around two settlements on the public record. The stench of malfeasance pervades around the corridors of the ATO quickly wafting its way through to Struggle Street because the cases have become public knowledge and without proper explanation from the ATO or the government on what happened and why, the stench lingers on. The similarities of the two cases are intriguing. The taxpayers were wealthy and influential businessmen and political party donors. Both were appointed to the Reserve Bank Board while in dispute with the ATO over millions of dollars. Both cases were settled by the former tax commissioner Michael Carmody.

Australia's second richest man and recent Reserve Bank Board member Frank Lowy has also had controversial arm wrestles with the taxman. In 1995 Colleen Ryan reported in the Sydney Morning Herald that ***"TAX DISPUTE SETTLEMENT SAVES LOWY FAMILY \$25M"***. This was after his family settled its long-running dispute with the ATO. The dispute involved amounts of \$42.8 million and \$5 million received by a Lowy family company, Cordera Pty Ltd, in January 1987 and November 1988. Cordera was the primary vehicle for the family's shareholding in Westfield Holdings. Very reminiscent of Gerardgate with its sham insurance company explanations, the Lowys claimed that the money was a capital injection from an unknown investor. The tax office though claimed it was income. The total for tax, penalties and interest outstanding for Cordera was estimated within the tax office to be \$50 million to \$51 million.

Elements of the dispute went before the Administrative Appeals Tribunal and several days later the case was settled. The hearing centered on the confidentiality of three key documents held by the tax office who did not want to disclose the nature of them before questioning the Lowys'. ATO's counsel argued that if the Lowys were given advance warning of adverse material then evidence might be tailored to accommodate the material. The documents related to transactions with a Liechtenstein-based entity, Yelnarf, which the ATO believed may have been linked to the Lowys, who have a number of companies with the word Franley (Frank and Shirley Lowy). "Yelnarf" is "Franley" spelt backwards.

The AAT decided that the Lowys should be shown the documents in advance. However, a settlement was reached a few days later and no further litigation ensued after the Lowy family reached a settlement with the ATO to pay a total of \$25 million. The settlement caused consternation among tax office staff. Two investigators involved in the case took stress leave after the decision. They were apparently upset primarily on equity grounds. They saw the settlement as an example of the tax office having one rule for ordinary people and another for the big boys.

They claim that if the case had involved a coffee shop owner or some other small-business operator, the ATO would pursue interest and penalties without hesitation.

From my point of view I would have been upset as well if I had worked on the case which kept auditors busy for three years. The question I would ask is why settle a case when the ATO were demonstrably on the front foot with a strong case (remember "Yelnarf" is "Franley" spelt backwards) nudge nudge wink wink!

Later that year Victorian MP Mr Ken Aldred unloaded on the Lowys and the ATO under parliamentary privilege. He divulged details of the secret settlement and declared, "Mr Lowy claimed the money was a capital injection from unknown international sources ... how lucky can you get? He didn't stop there, "If the money paid to Mr Lowy was from unknown international sources, as he claimed, why was he willing to pay \$20 million if it was not his money?"

Mr Aldred also asked: "Who authorised the reduction of Mr Lowy's tax bill from \$50 million to \$25 million? Mr Lowy is one of Australia's richest men. He has a net worth of \$860 million and a reported annual salary of \$3.1 million. Yet he had his tax obligation halved and avoided tax investigation of his affairs." Mr Lowy declined to make any comment at the time. Michael Carmody, the Tax Commissioner at the time of the settlement, also declined to comment.

The other shady settlement belongs to Gerard Industries. As this was a more recent case I will not go into the full details of the case as most committee members would be aware of its broad contents. The embarrassing details of the Gerard Industries fiasco had been sitting in the files of the South Australian Supreme Court, which is where the Tax Office's 2001 tax "sham" ruling against the company has been a matter of public record after Gerard himself challenged the ruling by taking it to court but then hiding the detail behind an out-of-court settlement in 2003 after two years of negotiation. If this case had not been plucked from the Supreme Court Registry by an *Australian Financial Review* reporter then we would be none the wiser today.

I have read the ATO audit report of this case. In a nutshell how did a company that was allegedly involved in the following,

- international tax avoidance with sham companies set up in tax havens deliberately contrived to deceive the commissioner of taxation
- false and misleading statements made to tax officers
- false accounting records deliberately contrived to deceive the commissioner of taxation
- the hindering of tax officers in the performance of their duties,

not be subject to any penalties or indeed prosecution? All these offences are indictable so why wasn't it referred to the DPP which was normal protocol under both the ATO and DPP guidelines. Why did Michael Carmody provide Rob Gerard with a dodgy comfort letter which facilitated his promotion to the Reserve Bank Board? Are you getting the same feeling I am?

In my view Michael Carmody has a lot to answer for public perception going into overdrive. As he was the Commissioner when both these settlements were done he should have the opportunity to clear the air before your committee. I know he will try and hide behind the secrecy provisions of the tax act and say he can't talk about individual cases but you should ask him whether he received any help from politicians because that is what the hearsay evidence from auditors close to the cases suggest. Restricting the talk to political interference or who contacted Carmody about those cases does not breach section 16 of the tax act as he is not talking about the taxpayer's tax affairs. The Keating government were in power at the time of the Lowy settlement and, of course, the Gerard settlement happened under the current Howard government

ATO DEFYING PARLIAMENTARY COMMITTEES:

What are we to make of the effectiveness of parliamentary committees when the ATO defies parliamentary committee recommendations regarding the publicising of settlement statistics and other matters over a period of 5 years? In 2000 the Senate Economics Committee http://www.aph.gov.au/Senate/committee/economics_ctte/completed_inquiries/1999-02/ato/report/c07.doc conducted an inquiry into the ATO after serious allegations were made about their administration (including client settlement guidelines) on Channel Nine's Sunday program.

The following recommendations were never taken up by the ATO,

Recommendation

7.1 The Committee recommends that the Commissioner include in his annual report statistics that show:

- **numbers of cases settled per annum;**
- **cases identified by business line;**
- **the difference between tax assessed and paid (by business line); and**
- **an explanation of why there are differences between the amounts assessed and paid.**

Recommendation

7.2 The Committee recommends that, to promote transparency and provide assurance about the administration of tax settlements, the ATO report the findings of the forthcoming audit of the new Code of Settlement Practice in the Commissioner's annual report to the Parliament.

Recommendation

7.3 The Committee recommends that the ATO consider formulating advice to the Government on legislative measures necessary to empower it to tape settlement negotiations, particularly in cases involving significant amounts of revenue and/or persistent tax avoiders, tax debtors and aggressive scheme promoters.

I recommend members of the committee read the Senate Economics Committee report as it has some good historical information on ATO client settlement guidelines.

If you go back to 1993 the Joint Committee of Public Accounts, in a report titled "An Assessment of Tax", the committee made similar recommendations particularly relating to the audio taping of settlements. This was also never acted upon.

ACCOUNTABILITY AND SECRECY:

At present the ATO are not accounting to parliament information relating to these large case settlements. The propaganda coming out of the Commissioner's office about the big stick being applied to Corporate Australia is misleading. The ATO come out with figures that suggest they are screwing their fair share out of Corporate Australia and it all sounds very impressive but what he doesn't tell you (the Parliament) me and the public is how much he is giving away in "settlements".

The former taxation ombudsman Peter Haggstrom has said in previous commentary "The big problem with giving a balanced view of tax administration to the parliament and the public is the secrecy provisions of the tax act."

"One area I particularly wanted to look at closely was settlements and we got a complaint that actually demonstrated the flaws of the system. To say that the ATO was unenthusiastic about having its settlement processes picked over is an understatement. It had external Senior Counsel riding 'shotgun' on the investigation," says Haggstrom.

Haggstrom tried valiantly to make the settlement process more accountable but it fell on deaf ears. "My suggestion that videotaping of settlements be mandatory (at least for amounts over a certain level) was not greeted warmly by the ATO or the tax industry."

So who is accountable to the Australian people regarding big company settlements (BCS)? Is it the Commissioner? He doesn't even bother to tell Parliament in his annual report of anything relating to BCS, even the simplest statistics. Under the secrecy provisions he can't tell anyone about specific cases; not even the Treasurer.

So is the Treasurer accountable to the Australian people about BCS? Well I suppose he is but he can only get his information from the ATO and the Commissioner and they can't or won't tell him anything. This is the farcical situation which we saw unfolding during the Gerard fiasco last month. The flick passes from the treasurer to the commissioner and then both hiding behind the stonewall of the secrecy provisions of the tax act.

If you thought that the appointment of a new tax commissioner Michael D'Ascenzo would change things you are sadly mistaken. In preparing an article for publication recently I asked Mr D'Ascenzo for the same information that parliamentary committees had recommended be made public to the Australian people about the ATO's Code of Settlement Practice and their settlement register <http://www.ato.gov.au/atp/content.asp?doc=/content/8249.htm&page=1&H1>. He refused to provide me with the information. Refer to annexure 'A' which are the questions Mr D'Ascenzo wouldn't answer for me.

It seems that BCS are something the government does not want Australians to find out about. They are happy for the secret details to disappear into some black hole or abyss to never reappear. So what is the ATO hiding? I suspect a number of things

including corruption, political interference and sloppy administration. If you think that's a bit far fetched then I ask you: How would you know otherwise?

CONCLUSION AND RECOMMENDATIONS:

It is clear from the limited number of settlements on the public record that controversy seems to follow. How many other Adsteams, Lowys or Gerards have slipped down the black hole never to be seen or heard of again without any parliamentary scrutiny? How many millions or billions of dollars is Australia losing because of these settlements? How much corruption, political interference and sloppy administration is the ATO hiding from parliament and the Australian people? We don't know because the ATO doesn't tell you and you don't ask the hard questions.

Because of the secrecy provisions we have seen public perception of the tax administration go into overdrive. We have seen evidence of the ATO thumbing their nose at parliamentary committee recommendations to be more accountable.

At the moment the ATO is an unaccountable rabble with respect to BCS and parliament has allowed this to happen under their collective noses. Is this committee going to become another toothless tiger and allow the ATO to go on its merry way and allow the tax system and the tax administration to fall further into disrepute?

I believe that a bi-partisan parliamentary committee be formed to oversee BCS. I don't want tax experts from outside the ATO. They have too many vested interests. Any settlement over \$10M would have to be approved by the committee and these decisions should be videotaped and reported to parliament in the commissioner's annual report without identifying the taxpayers. To facilitate this the committee should recommend changes to the tax secrecy laws.

Christopher Seage

ANNEXURE 'A'

QUESTIONS THAT MICHAEL D'ASCENZO WOULD NOT ANSWER

CODE OF SETTLEMENT PRACTICE – LARGE BUSINESS AND INTERNATIONAL

- 1 How many cases were settled in the 2004-05 financial year and recorded in the ATO's Settlement Register?
- 2 How many cases have been settled in the 2005-06 financial year and recorded in the ATO's Settlement Register?
- 3 How many cases in 1 and 2 have been subject to Technical Quality Reviews under the ATO Practice Statement Law Administration PS LA 2001/11?
- 4 What issues have been identified by these Technical Quality Reviews?
- 5 Please provide the names and positions of any external consultants that have sat on any Technical Quality Reviews in relation to 1 and 2?
- 6 How many of these cases in 1 and 2 have been settled at the Commissioner level?
- 7 Is the Settlement Register maintained on a computer or is it in a hard copy format, or both?
- 8 Who inputs information onto the Settlement Register after the ATO has settled an audit with a taxpayer?
- 9 Who can access the Settlement Register?
- 10 Has the Settlement Register been subject to any scrutiny by any authority outside the ATO such as the Inspector General of Taxation, Auditor General or Parliamentary Committee?
- 11 Why aren't statistics, such as the number of settlements, the amount settled and the issues settled, recorded in the Settlement Register included in the ATO Annual Report?

12 Does the Commissioner believe that those statistics in 11 should be supplied to Parliament and in turn the Australian people?

13 Does the Commissioner believe there is adequate transparency in the settlement process in view of the lack of accountability to Parliament at the present time about settling large case audits?

14 Why has the ATO defied recommendations from the Senate Economics Committee in 2000 and the former Public Accounts Committee in 1993 relating to improving the accountability of their settlement guidelines?

ANNEXURE 'B'

Comments by Fitton, Haggstrom and Coleman can be found here

<http://www.crikey.com.au/articles/2005/12/12-1031-3497.html>

ATO prosecution guidelines

<http://law.ato.gov.au/atolaw/browse.htm?toc=03%3AATO%20Guidelines%20and%20Policy%3AATO%20Prosecution%20Policy>

DPP Prosecution Policy of the Commonwealth

<http://www.cdpp.gov.au/Prosecutions/Policy/>

ATO Code of Settlement Practice

<http://www.ato.gov.au/atp/content.asp?doc=/content/8249.htm&page=1&H1>

Link to ATO technical quality reviews

<http://law.ato.gov.au/atolaw/print.htm?DocID=PSR%2FPS200111%2FNAT%2FATO%2F00001>