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Submission presented to the Joint Standing Committee on Public Accounts and Audit for Inquiry into Taxation Issues Within Australia:

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Terms of Reference.

- **The impact of the interaction between self-assessment and complex legislation and rulings;**
- **The application of common standards of practice by the ATO across Australia;**
- **The level and application of penalties, and the application and rate of the General Interest Charge and Shortfall Interest Charge;**

Introduction

Since at least 1998, a large number of MPs and Senators have been involved in assisting constituents who have been caught in the conflicts and confusion caused by the self-assessment system and the ATO inefficiency and inconsistency in administering the tax legislation.

Over this period of time we have become aware of a culture within the ATO that can only be described as bloody minded and we have seen numerous inquiries, reviews, assessments and submissions to Government about these matters. Some of the reviews have resulted in legislation (e.g. the ROSA Bills) and others in settlement arrangements. However, while all have identified numerous system-wide faults that require attention, none of the remedies has fully rectified the outstanding issues or held the ATO accountable for the mismanagement that created these problems. As a consequence, the individual taxpayer, sitting at home or in the office continues to drown in inequity and uncertainty, while trying to cope with an administration that is basically a shambles.

It is an unfortunate truth that in the present system, the ATO as administrator of the tax system and the professions that derive large amounts of income from providing advice to taxpayers do not bear any responsibility for getting it wrong, only the taxpayer carries that burden.

I recently addressed the House on the introduction of the proposed promoter penalties legislation and was interested to subsequently read the comments of John de Wijn Queens Counsel and National President of the Taxation Institute of Australia on the issue. In his column in the Taxation magazine on page 395 of Vol 40/8 March 2006, Mr de Wijn states: 'We should appreciate that this legislation is very much a reaction to the undoubted excesses of the most recent

tax scheme era. **We as practitioners, together with the ATO, must accept some responsibility for that era.'** (my emphasis). I totally agree with Mr de Wijn's comments, but I must ask if this is just another empty statement? These practitioners and the ATO gave advice, provided written opinions and rulings and advised on the structure of these arrangements, but neither the practitioners nor the ATO stepped forward to accept responsibility or alleviate the tax, penalties or interest imposed upon the ill-advised taxpayers. In my humble submission it is time the position is changed. Tax practitioners such as accountants, tax agents and the legal professions reap countless amounts of income from tax matters. The more complex the legislation the more income they can expect. The more disputes that occur because of conflicting or incorrect advice results in more income generated.

Apart from one obscure and rarely used provision in the Tax Act, hidden away at section 251M and costly civil action in negligence, there is no recourse for taxpayers who become liable to additional tax, penalties and interest as a result of wrongful or incorrect advice. It is time that these professions and the ATO are made more accountable so that they will act more carefully in protecting the revenue or become personally liable to the cost.

In the body of the submission, before I address the specific terms of reference, I wanted to highlight certain general areas of concern and have therefore raised these issues under separate headings as follows:

Administration

One of the major issues facing taxpayers and their representatives including their elected representatives is the inability to speak directly with decision makers within the Australian Taxation Office (ATO). Self-assessment places the responsibility on the taxpayer to understand how legislation which is invariably complex, applies to the taxpayer's circumstances. However, taxpayers who have difficulty in understanding or applying the legislation receive little or no assistance of any value from the ATO. Furthermore, the ATO does not bear any responsibility for incorrect advice, rulings or general administrative practice. In fact taxpayers who act in reliance upon the ATO's general administrative practice run the very real risk of having the ATO change position at anytime in the future and imposing tax and interest upon the taxpayer as a result of the ATO's change of position. This inequity and uncertainty in the tax system that has prevailed in the past has unfortunately received support from the legislators by the introduction of section 361-5 of Tax Laws Amendment (Improvements to Self Assessment) Bill No 2.

Where the Commissioner of Taxation has treated the tax legislation as applying in a particular way for any period of time to the extent that that application is accepted as a general administrative practice, section 361-5 allows the

Commissioner to alter position at any time in the future so that those taxpayers who have followed the past administrative practice are liable to pay tax that was not payable due to the previous application of the law. These taxpayers will have twenty-one days to pay the tax or will be subject to the tax plus the general interest charge at the applicable rate (currently 12.63%)

The end result is that taxpayers are at risk if they act in reliance upon a general administrative practice and can only obtain a measure of certainty if they apply for private rulings. For reasons that will be provided later, the private rulings system is generally inadequate for taxpayers, but more importantly this committee should consider whether this legislation is likely to result in more or even every taxpayer seeking to obtain rulings so as to have certainty in their tax affairs. The issue of how the ATO will resource and administer such an increase in demand and the cost to the revenue compared to the benefits should also be considered.

In seeking to understand the complex legislation or issues that arise, taxpayers or elected representatives who make enquiries on their behalf are generally unable to contact or speak directly with anyone in the ATO who either has direct knowledge or "ownership" of the issue or who has the authority to make a decision on the matter.

Taxpayers have to comply with statutory time limits when lodging tax returns or otherwise complying with their tax obligations. Generally, when a contentious issue arises there is insufficient time to obtain rulings from the ATO and finalise any appeal process. For example, I have been made aware of a situation where the taxpayers sold their home near the end of the 2005 financial year. The question of whether the capital gain is assessable or not is in issue and the taxpayer sought a ruling from the ATO. The ATO ruled that the capital gain is assessable, as in the ATO view the home did not qualify for the principal residence exemption because the taxpayer did not "sufficiently" reside in the home, but was resident in rented premises while the home was being renovated. The taxpayer and legal advisors are of the view that the principal residence exemption is properly available to the taxpayer as this was the only home owned by the taxpayer, the taxpayer had purchased the home as the sole and principal residence and the only reason for non-occupancy from the date of purchase was that the house contained large amounts of asbestos which required removal for safety before the taxpayer and family moved into the house. Importantly, the sale of the house was forced upon the taxpayer as a result of being transferred to another part of the State.

The taxpayer as at March 2006 is required to lodge a tax return. The ATO ruling has been appealed to the Administrative Appeals Tribunal and that process may take several months or years to finalise. In the meantime the taxpayer must either declare the capital gain and pay a significant amount of tax or ignore the ruling and not declare the capital gain. If the taxpayer does not declare the

capital gain the ATO will amend the taxpayers return and impose penalties and general interest at the rate of 12.63% for the period that the amount is unpaid. If the taxpayer pays the tax and succeeds with the appeal, the ATO will pay interest on the tax payment at around 4%, which is less than the taxpayer could obtain from a bank. This is clearly a situation where the taxpayer is in a no win position. The taxpayer sought a ruling to obtain certainty, however the taxpayer's honesty and quest for certainty has created this problem. It is most likely that if the taxpayer had not drawn attention to himself, the ATO would never have queried the matter, as this was the sole residence owned by the taxpayer. In my view, taxpayers must be encouraged to be open with the ATO and not disadvantaged by honesty.

In my submission the ruling system is potentially resource and time consuming and does not provide a timely resolution of disputes. To be more equitable and effective, the interest paid to taxpayers on overpayments should at least be equal to the general interest charge imposed by the ATO on tax that remains outstanding.

I am also advised that it is ATO practice that taxpayers who discover a mistake in their tax affairs and self-amend receive a 5% penalty plus interest at 12.63% over the period that the amendment applies. When a taxpayer discovers a mistake they are thus placed in a position of weighing up the cost of honesty compared with the risk of the mistake being discovered. I have no doubt that the vast majority of taxpayers and especially those whose mistakes are nearing the time limit after which the ATO is prevented from making amendments take the risk that the ATO may never discover the mistake. My concern is that the Commissioner's imposition of penalties and interest in these circumstances is a disincentive to taxpayers to correct genuine mistakes and consequently a large amount of revenue is lost.

Tax Counsel Network

I understand that Mr Kevin Fitzpatrick has been appointed Chief Tax Counsel for the ATO. I have had occasion to raise issues with Mr Fitzpatrick and I must say that his appointment as Chief Tax Counsel causes concern. Mr Fitzpatrick has on several occasions made it clear that he does not accept Court decisions and it seems a dangerous move to place someone with so little regard for the decisions of the Court in the position of Chief legal advisor to the Commissioner and ATO administration.

In a speech to the Institute of Chartered Accountants and National Australia Bank Gala Luncheon on 14 March 2003 the former Commissioner Mr Michael Carmody, stated '..... we do not accept the Court's comments in Essenbourne on both Part IVA and Fringe Benefits Tax were correct .....I see no reason to

change our current position on these schemes. The appropriate venue for people wishing to contest our decisions is in the Courts.'

Despite criticism of the Commissioner's position by Members of Parliament and the Inspector General of Taxation, the ATO held out and refused to withdraw FBT assessments issued to taxpayers in arrangements identical to Essenbourne. Earlier this month, the ATO finally announced that the FBT assessments would be withdrawn. So after nearly 3 years the ATO has finally decided to follow a very clear Court decision. In that time taxpayers have in many cases had multi-million dollar FBT tax bills hanging over their heads. The impact of having these additional tax bills has incorrectly placed all of these businesses in the position of breaching ASIC provisions. Because these businesses were given tax bills that they were unable to pay, they were legally insolvent and should have ceased trading. As you can see the position these businesses were placed in by the ATO's actions was untenable and this situation continued for an excessive period because the ATO were using their power to intimidate and force taxpayers to settle or lose everything. Even the Inspector-General of Taxation recognised that the ATO's actions were damaging to these businesses and this was one of the criteria for offering a remission of interest to taxpayers who had received these multiple assessments.

This is just one example, I am told there are many, of the Commissioner and his senior staff becoming entrenched and acting to the detriment of taxpayers. I am afraid that with Mr Fitzpatrick as the chief legal advisor this culture of refusal to act in compliance with Court decisions and in the best interests of taxpayers and the country will not change.

Superannuation Guarantee Payments by Employers.

There is an anomaly in the pursuit of non-payment of Superannuation Guarantee Payments by employers. The superannuation liaison contact within the ATO confirmed that employers who do not make the payment do not have a debt raised against them payable to the tax office.

Under the present system the ATO is the only authority that can pursue the employer for payment from the time a complaint is lodged by an eligible employee but recent events have demonstrated that although employees have lodged complaints as long ago as about 2003 the ATO have done absolutely nothing to make the employer pay and have not contacted the complainant to advise that payment has not been collected. The non-paying employer is liable for the amount of un-paid Super plus interest to their employee for the period of non-payment. This interest is calculated at an average market rate of return plus a percent or so. The employer is also liable for penalties.

The complainant is never advised of the figure or told if the employer is making payments to the ATO for dispatch to the employee's fund. The only way the complainant will know if the employer is repaying the money owed is by perusing their half yearly superannuation statements.

If the ATO and the employer do not agree on the money owing the ATO virtually does nothing. It relies on the employer to verify the income of the employee and why they have not made the payments. It is not proactive in seeking a resolution to the outstanding debt. I am puzzled as to why the ATO relies on the employer to verify the income. The employee should have received a group certificate in accordance with tax regulations and that document should be primary evidence of the employee's income. In addition, the employer is required to lodge an income tax return for the business in which the wages and the superannuation guarantee payments paid in respect of employees is generally claimed as a deduction. It should be a simple task for the ATO to match the information. In my view it is unacceptable to allow the employer entity to claim a deduction for super guarantee payments in respect of employees, where those payments have not been made to the employees' superannuation funds. It would seem that where a deduction has been claimed but payments have not been made the employer entity is guilty of making a false claim and should be subject to penalties and additional tax. This does not appear to be a complex issue to resolve and the ATO's failure to deal with even such a simple issue as this raises serious concerns about the ATO administration.

I am aware of cases lasting over 2 years where the complainants have contacted the ATO on a number of occasions only to be told "that the matter is still being investigated". This is more than two years down the line, no wonder these employees feel that they will never receive the money, and that it is a waste of time to pursue the matter further.

A staff member suggested to the ATO that they raise a debt to the employer for the outstanding amount when it is calculated and pay the employee so that they have a resolution and so it just affects 2 parties, the ATO and the employer, into the future. However he was told that this is not possible as the ATO did not want to be responsible for pursuing these outstanding debts as debts to themselves.

He was further informed that as SGC is considered akin to salary and wages it rates ahead of the ATO in liquidation of employers' assets in the event of the employer claiming bankruptcy. This does not resolve the issue for the employee if the employer has for a number of years failed to make payments, even though required to by law, as there are no real consequences for the employer for non payment except a raising debt to the employee and if they have a strategy to claim bankruptcy the employee will in most cases never see their entitlements.

This is just another example of administrative failure by the ATO.

Inspector-General of Taxation

The Office of Inspector-General of Taxation (IGT) was created as a result of the Prime Minister Mr Howard, expressing the view that taxpayers needed a Taxpayer Advocate. Unfortunately, at some stage between the announcement by the Prime Minister and the implementation of the position, the function changed from Taxpayer Advocate to Advisor to the Minister.

Although the role of Advisor to the Minister could encompass the role of Taxpayer Advocate, a significant restriction has been placed on the IGT so that the IGT is prevented from enquiring into individual taxpayer complaints and is only authorised to examine systemic issues. Put another way, the IGT is not able to represent the concerns of individual taxpayers unless the concern is part of a systemic problem in the ATO.

A further restriction is the extremely low level of funding available to the IGT, I understand somewhere in the region of 2 million dollars. Compare this to the billions of dollars allocated to the ATO and it becomes apparent that the watchdog is a Chihuahua trying to keep a rabid bullmastiff under control. The final straw to this picture of hopelessness is that the IGT is not empowered to make findings, recommendations or instruct the ATO as a result of any enquiry. The most the IGT can do is report to the Minister, who is also prevented from instructing the ATO.

The concept of the IGT has great promise and as announced by the Prime Minister as a Taxpayer Advocate provided a strong ray of hope for all taxpayers. In the current form however, the Office of the IGT is a farce and a waste of resources, as little as they are.

In June 2005 I attended a meeting with the IGT in Melbourne to discuss outstanding matters relating to Employee Benefit Arrangements. In the course of that meeting I became aware that after the IGT concluded his Inquiry concerning Employee Benefit Arrangements, the IGT met with the then Commissioner Mr Carmody and certain agreements were reached. As at June 2005 the IGT Mr Vos was of the view that the ATO had not complied with the agreements and Mr Vos had been seeking further meetings with the ATO to resolve the matters without success. In my humble view, it is a serious indictment of Mr Carmody and his administration that Mr Vos should be of the view that the ATO has not upheld agreements made by the Commissioner Mr Carmody. It is also a serious indictment of the system that the IGT has to rely on verbal agreements to rectify findings of unfairness and inequity and then when the Commissioner breaches those agreements the IGT is powerless to take any action.

To be effective the IGT must be funded adequately and I recommend that the allocation to the Office of the IGT should be increased. Funding alone however,

is worthless unless the powers of the IGT are increased. The IGT must be required to make findings and draw conclusions after enquiries. The IGT must be empowered to make recommendations or instruct the ATO Commissioner. In the present system the ATO Commissioner is able to and often does ignore Court rulings, the IGT and even the Minister and this must be changed or the ATO will continue to act without control.

Term of Reference 1 – Part A

The impact of the interaction between self-assessment and complex legislation and rulings;

Although the committee is reviewing generic issues that impact on taxpayers broadly, in my view we as legislators cannot afford to be divorced from real, human experiences where the system of government is found wanting. In particular, I would ask committee members to allow themselves to be placed in the specific position of one of my constituents as an example, as they consider this submission in relation to the first 3 terms of reference in Part A. In fairness, I will endeavor to identify incorrect decisions and bad planning on my constituent's part that contributed to the dispute, which continues to suffocate both he and his family and has paralysed his future planning.

Firstly, his position is not as catastrophic as it is for many others. However, if we by habit feel we have to set thresholds before bad conduct needs to be dealt with, we might as well not bother to change anything – those thresholds will change in time as relentless bureaucratic pressure is applied to normalize the abnormal.

I invite the committee to put aside the obstacles of an institutional view and consider what is simply right or wrong. The process of rectifying past injustices and preventing them in the future then becomes a task founded on correct principles instead of a futile succession of excuses and buck-passing, along with existing bureaucratic and legal limitations.

I have been relatively close to the disputes that have been running now for nearly a decade. As I have a strong aversion to the misuse of powers vested in Public officials by the Parliament, I acknowledge that my interest in this issue has been more than one of merely assisting others. My constituent invested in a mass

marketed arrangement in 1997 and 1998, I am told, without the slightest doubt that he was, a) involved in a dynamic enterprise and, b) secure that the best available tax professional in Perth, Robert O'Connor QC had written a detailed analysis of the investment arrangement and how it complied with the provisions of tax legislation. Additionally, in his considered, but layman's view, the manager of the arrangement had done all that it could to verify that the claims in the investment documentation concerning tax deductibility were accurate.

The taxpayer now acknowledges that he could and should have applied for a private binding ruling (PBR) – indeed that is the first (and only) retort of ATO staff when investors claim, "I did all that I could". The consequences of Private Rulings have been endlessly debated during these disputes, however in real-life terms I pose these questions for the committee:

At what stage does a layman decide that the published advice of a recognized professional, expressed in writing and under the spotlight of public scrutiny, is of insufficient value? Where does a non-tax professional set the bar? Why wouldn't a taxpayer apply for a PBR for claims for mobile telephone expenses incurred in their business activities, which are not expressly referred to in the legislation?

Of course, phone expenses can be justified as part of earning income and fall under broad provisions of the act. But most taxpayers rely entirely on their tax agent to advise them that this is indeed the case and submit their returns on that basis. In the case of this taxpayer's Franchise investment, franchise fees are deductible expenditure under the legislation (explicitly stated in the QC's opinion). I accept, and I think any reasonable person would also accept, that there was simply no need at that time to repeatedly put the deductibility question to the test. Furthermore, with the then ATO practice to a) pay refunds for the previous 3 years on the investment, b) issue no warnings that the investment didn't measure up and, c) conduct audits on taxpayers who had invested and allow their deductions, is it reasonable to blithely state now that the necessity for a PBR was obvious?

This is precisely where the system lets taxpayer's (our constituents) down and falls into the ATO's neverland of "it's your problem". Unfortunately, so far it also seems to remain in the "too hard" realm for too many of our legislators.

This brings into question the social legitimacy of an ATO that has clearly changed it's view, hides behind self-assessment and applies what it now claims (falsely) was always it's view of the law, then applies tax, penalties and grossly inflated interest to ruin the financial future of taxpayers.

I am confident that all committee members are aware that the ATO frequently doesn't know the correct interpretation of tax law. The fact that tax legislation, up until 2 years ago at least, was developed and drafted by ATO staff, then

analysed by them after passing into law, taught to staff with explanatory documents, explained to the tax profession via interpretative decisions or administrative guidelines, and they still get it wrong and have to issue new interpretations, indicates what a basket case of uncertainty the current system is. In fact, I am sure that some members of the committee have personal knowledge of their constituents who have suffered as a result of loose regulations and a discretionary power that is out of control.

And at the end of all this, self-assessment says the taxpayer must get it right. Perhaps I can be clearer - the consequences of a taxpayer failing to personally assemble a comprehension of tax law more complete than highly paid ATO business section executives, prominent lawyers, Federal and High Court judges, plus the supposedly overarching understanding of the Federal Treasurer, are that he is taxed (found guilty), penalized (judged as being deliberately culpable), further penalized with interest (because the ATO requires the time), and then forced to pay (the executioner) by the very entity who has miserably failed him and before he can have any appeal dealt with. If none of these highly educated, highly experienced and highly paid experts can agree, what is the hope for the taxpayer?

A study of tax cases that have plodded through the judicial system, from the Administrative Appeals Tribunal through to the High Court will reveal a succession of decisions that have been overturned, or upheld then overturned etc sometimes in favour of the Commissioner and sometimes not. I shake my head in disbelief when I read repeated examples of successful appeals where the opinion of the primary judge is described as "my learned colleague's view" or words to that effect. If that is not a polite way of referring to professional failure, it is a ringing endorsement for the view that we have failed the community by cloaking the tax administration with incomprehensible legislation.

If the parliament continues to avoid this issue by blandly advising people to "get a PBR" for certainty, the ATO will grind to a halt within weeks. How on earth can a taxpayer realistically do much more than use advice available in the community, recognized advice at that? Surely, if a professional entity is a registered tax agent of the ATO, the ATO should be investing a healthy measure of support and trust in that agent so that taxpayers can be protected against punitive charges for doing nothing other than getting advice.

Because of my involvement with a broad range of people affected by these anomalies, I have been a close quarter witness of the anguish, trauma and raging frustration felt by taxpayers against the ATO, flowing on to the government that supports it and fails to keep it within correct boundaries.

Much of this anger has been based on a lack of understanding of the law and the self-assessment system itself. Given the non-legal orientation of the vast majority of taxpayers, plus the now recognized failure of government and the

ATO to educate the public about self-assessment, this is entirely understandable. Nonetheless, both government and the ATO have defaulted to laying the blame for this lack of understanding entirely at the taxpayer's feet, and in fact have supported summary judgment by public servants, penalizing taxpayers with costs that have far exceeded civil or criminal penalties applicable to those found guilty (through due process and without having to bear the burden of proof), of serious transgression against persons or property.

Additionally, some of this anger has stemmed from reliance on overly ambitious, or, in some cases, blatantly false statements about investment returns available, or application of investment funds, resulting in a quest to identify a common enemy.

Furthermore, a key misunderstanding of almost every person attacked has been the circumstances that surround Part IVA of the legislation, the anti-avoidance provisions. Put in place to act as a measure of last resort for the Commissioner, enabling him to deal with false and contrived arrangements, this provision has been systematically abused to transport the culpability of the developers of the investment structures across to the investor. In the case of my constituent for example, as a financial planner with a basic understanding of tax as it affects personal income, the background arrangements that the ATO allege were used by the manager to distribute receipts with minimal or no tax were not discussed outside the directors of the company. Yet it is these arrangements that the ATO has used to justify not only assessing him for tax but also penalizing him for activities of which he had no knowledge and over which he had no control.[1]

It is important to note that the ATO did not admit that Part IVA was used because of the manager's conduct rather the investors, until they were subject to overwhelming public criticism and condemnation. The claim then became an exercise in self-justification. I note that in subsequent inquiries, a common conclusion has been the inequity of a taxpayer being penalized for the actions of another. As yet, nothing has been done to ameliorate this significant flaw.

But by far the most prevalent reason for taxpayer discontent has been the arrogant, incompetent and sometimes just plain stupid action of ATO management and staff. As you will see from my submission, this conduct unfolds into a dangerous threat to the legitimate expectation of citizens that the government and its instrumentalities exist for the good order or the community, and the rights and freedoms of all individuals.

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[1] The ATO allege in this case that he invested for the sole or dominant purpose of obtaining tax deduction. Had that been true, it is unlikely that he would have invested in the product that he did. There were other products available in the marketplace that my constituent was well aware of, that offered nearly twice the deduction that he initially received, for the same outlay. The ATO have refused to even acknowledge this point and simply deferred to the purpose of the manager.

Recommendations

Prescriptions for the value of varying types of ATO advice are not enough. The system is too complex to rely on this alone. There needs to be an additional investment in the front-line tax administrators of the country – tax agents. Not so much in training and education, but in acceptance of risk.

The ATO already manages its compliance activity by establishing risk levels and directing resources accordingly. It should do the same with tax agents & tax lawyers.

Written advice by these agents and recognised legal taxation specialists should be able to be relied on without penalty or interest consequences if subsequent review finds it to be incorrect. Fraudulent advice would be corrected by civil penalties. Exploitation of such a system is not the smoking gun that many think it to be. Carefully written legislation, plus the value of a current tax agency to a professional firm are powerful inducements to effective self-regulation.

Where doubt exists, and yet the reasonable view of the Tax Professional is that the matter is in favour of the taxpayer, there should be an amnesty period during which the taxpayer can also self-amend without penalty and interest costs. The costs of this feature to the revenue would be limited to the real cost of money for the period and avoid extensive ATO resources being tied up in conducting audit level enquiries.

A decision by a Tax Agent not to lodge a return because of concerns about the taxpayer's position will clearly require the taxpayer to review their intentions before the declaration is made.

The ATO has already successfully exported its responsibility to assess each taxpayer for the correct tax by virtue of the self-assessment system. Unless it wants to take that individual assessment role back again, it also needs to accompany that with the tools and protections for tax professionals to self-regulate.

The ATO cannot be trusted, regardless of the goodness of its intentions, to independently review instances of incorrect treatment and administrative abuse. At present the objection and appeal process starts with an internal review. However, even before this, the decisions made by ATO staff in the process of issuing an amended assessment (now including an original assessment) are excluded from review under the Administrative Decisions (Judicial Review) Act (ADJR).

In the absence of immediate comprehensive change to the Commissioner's powers in the existing tax legislation, a tax dispute court where taxpayers can represent themselves at absolute minimal cost is necessary, and this entity

needs to be able to consider some of the matters of abuse of process (indicated later in this submission). Decisions of the court should be able to eliminate penalty tax and interest beyond the real value of money without the prospect of appeal by the Commissioner. This would minimise the possibility of intimidatory practices that are becoming the rule as far as ATO disputes are concerned.

The Taxpayer's Charter needs to be revised by non-ATO personnel, preferably a joint committee of the parliament who can take the concerns of the taxpaying community into proper account, give the Charter the force of law and hand it to another body to administer who will have the ability to enforce it's provisions.

Term of Reference 2 – Part A

The application of common standards of practice by the ATO across Australia;

In many significant ways, this term is addressed in part by the comments in the previous section, however, this issue can also be considered from 3 aspects; firstly, the need for reliable interpretations and advice on tax law, secondly, the issue of discrimination against individual or certain groups of taxpayers and, thirdly, the practice of the ATO to source letters, advice and demands from different offices across Australia without adequate correlation.

1. The need for reliable interpretations and advice on tax law.

There have been many recommendations flowing from Senate Committees, Treasury reviews and the Inspector-General of Taxation that have identified the need for change concerning this matter within the ATO's systems. Largely these have focused on purely administrative issues, including IT development and access to internal information. The system of rulings and advice has also been exhaustedly canvassed.

However, turning once again to the human impact of this matter on my constituent and others, it opens up another level of critique.

When the Petroulias matter developed into a protracted legal battle, an internal ATO 'protected' document became available via The Australian newspaper to many taxpayers[2]. Dated 18 March 1999 and written by Michael O'Neill, a senior tax officer who it seems participated in the internal ructions against Petroulias and took over the section he used to manage, it documents the extent of positive rulings and opinions provided by the ATO to marketers of Employee Benefits Arrangements.

[2] Copy available to the committee on request.

Significantly, the author of several positive advices is Ms Marina Dolevski, a tax officer who presently heads up the EBA taskforce and is the person enforcing recovery of tax, penalties and interest from taxpayers who followed those rulings.

Once again, there has been much written about the conflict between rulings and the Commissioner's decision to act against the advice his office provided.

Perhaps for this submission though, it is useful to consider that the Commissioner's public explanation for his office disallowing taxpayers their deductions after the rulings were relied on, was that the taxpayers concerned did not comply fully with the rulings, or that the rulings were not applicable to them, because they were specifically for another taxpayer, despite the arrangement being identical.

This claim has proved to be false, as, shortly following the internal memo referred to above, the Commissioner withdrew the rulings already issued. If he claims that taxpayer contravened the rulings, it can only be assumed had they complied with the rulings, the ATO would have allowed their deductions. But the Commissioner withdrew the rulings and disavowed them, supporting the Federal Police claim that Petroulias had constructed, or caused to be constructed, rulings in favour of taxpayers for which he received some form of financial benefit.

In my view, the ATO cannot and indeed should not be able to avoid its role as the primary interpreter of the tax legislation and must bear the cost of getting it wrong. Whether from its own staff or through its network of tax agents and recognized tax legal professionals, it should communicate its views in a manner that taxpayers can rely on without being penalized for the inadequacy of the view.

2. The issue of discrimination against individual or certain groups of taxpayers.

Once again, I invite committee members to place themselves in this scenario – you receive a letter of intention to audit, concerning your investment in a tax effective product. You have invested along with nearly 1200 other taxpayers. But each of the other taxpayers receives a different letter, merely advising that their deductions will be disallowed.

You and all investors are invited to submit a form known as a voluntary disclosure form, detailing your investment. This is despite the ATO having all the details on the investor list already supplied by the manager.

Taxpayers who return the voluntary disclosure form by a nominated deadline receive a reduction in penalty from 50% to 10%. However, because you have received a different letter, which refers to an audit, your penalty will only be reduced from 50% to 40%, (in the case of my constituent) **$17,607 more** than if you had your penalty reduced to 10%.

You contact your tax agent who checks with the tax office. They advise that the reason you got the audit letter is because "you should have known better". Nothing to do with an audit process, or lack of information on your circumstances – just this arbitrary opinion of an individual who has clicked a different box on the mail merge and charged you nearly **$18,000 dollars more.**

The ATO refuses to reply to correspondence from you requesting an explanation about this aspect. 4 months later, you obtain documentation from your tax file under Freedom of Information. You discover that there was no audit report and therefore no audit was performed. There are no documents evidencing that an audit was ever contemplated. You request that the ATO adjust the penalties down to 10%, in line with other taxpayers. The ATO never bother to reply to you.

This is the personal discrimination that has been applied against my constituent and it has been achieved through blatant abuse of the administrative process. A tax officer should be identified and disciplined for doing this. However, the ATO is immune to such inquiry and, when it suits, simply refuses to respond to correspondence.

On a wider basis, taxpayers in the mass marketed arrangements, classed as promoters because they sold the investments, are denied the full terms of the settlement arrangement. This is because, according to the ATO, they had a greater knowledge of the tax legislation and should have known that what they were doing was incorrect. The reality of the situation is that the ATO wish to penalise those who received commissions, even though the actual architects of the arrangements, the real promoters who received the majority of the income have walked free. The ATO's view of this group of taxpayers is further unsustainable for the following reasons:

a). The proposed promoter legislation draws a distinction between the architects of a scheme as promoters and the mere agents of promoters and does not impose penalties on the latter.
b). Taxpayers who sold the products and received fees for investor participation, or even planned and developed them, but didn't invest themselves, have not been dealt with by the ATO at all. Because the ATO have failed or been unable to hold the actual promoters responsible they are classing these taxpayers who were essentially employees as promoters.
c). It suggests that all taxpayers who were not in this 'special' category were just plain stupid and were all duped by slick sales campaigns. This is demonstrably false, as, despite the early noise raised by taxpayers in regional mining cities such as Kalgoorlie in WA, a large proportion of investors were professional individuals including doctors, accountants, legal professionals at various levels, architects and business individuals. All of these made decisions to invest after reading promotional and background material and studying the tax opinions.

d). The selection of a certain group of taxpayers for 'special' punishment because of their profession, even though their tax conduct was identical, is a dangerous stretch of the Commissioner's discretionary powers. It would not be permitted in circumstances outside the tax administration.

Further evidence of the convenient way the Commissioner acts against different classes of taxpayers when it suits him, becomes evident when the Employee Benefits Arrangements dispute is considered.

In early ATO correspondence and even in submission to the first Senate Inquiry into Mass Marketed Arrangements, the ATO referred to EBAs as Mass Marketed Arrangements. In fact, in the internal memo by Michael O'Neill referred to earlier, it was noted that Sydney tax lawyer Chris Batten was marketing his EBA arrangement via faxstream.[3]

However after announcing the settlement offer for Mass Marketed taxpayers, the previous Commissioner Michael Carmody decided that EBA's were not Mass Marketed any more and therefore were not entitled to the settlement terms. A recent report by the Inspector-General of Taxation, Mr David Voss noted this anomaly:

> "2.185 The ATO publicly de-grouped EBAs from other forms of MMTEI from at least 26 April 2001 when it announced that it would reduce the interest on tax debts for some MMTEIs, which did not include EBAs.
> 2.186 However, the ATO's own internal guidelines for settling MMTEIs continued to apply to EBAs after both this date and even after the date of its no penalty and no GIC offer to MMTEIs. These guidelines were only withdrawn by the ATO on 29 October 2002.
> 2.187 There is further evidence which supports a view that the ATO continues to regard EBAs as a form of MMTEI, even though they have indicated to this office and others that EBAs are not now part of MMTEIs. For example, in an organisational sense, the ATO staff which are responsible for EBA arrangements are also responsible for MMTEI
> arrangements."
> *(A report to the Minister for Revenue and Assistant Treasurer, Inspector-General of Taxation 5 August 2004)*

I am firmly of the view that the removal of EBAs from under the previous Mass Marketed 'umbrella' was a deliberate ATO management decision to reduce the impact of the settlement and maintain pressure on EBA taxpayers. To perpetuate this, they have constructed a disgraceful strategy to stain the character and integrity of these taxpayers, thus supposedly justifying them being denied access to the settlement. I also note that in the same report by the

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[3] Michael O'Neill, Commissioner's EBA Briefing – SIA Task 1 dated 18 March 1999 page 17/78 ". . . Chris Batten had instituted a faxstream campaign and was reportedly selling a number of plans which in the short space of time in which they were sold, suggested they were unlikely to be implemented appropriately. Furthermore, the tax agent brother of a senior ATO manager was approached by a Chris Batten representative with a round robin financing structure."

Inspector-General of Taxation, Mr Vos noted that he could see no justifiable reason why EBA taxpayers should be treated differently to MMTEI taxpayers.

As can be seen from this report, the ATO is quite prepared to adjust it's own rules to suit it's objectives in maximizing revenue, be that from primary tax which is disputably payable, or from penalty and inflated interest amounts that are applied ostensibly in accordance with the provisions of the act, but are able to be totally eliminated at the Commissioner's discretion in the case of certain classes of Mass Marketed taxpayers.

This practice can do nothing but sap confidence in the tax administration and lead to further uncertainty.

The Inspector-General went on to state:

> "A4.80 This review also found that, in conducting the above ATO processes, considerations of the extent to which taxpayers were members of a particular group or shared certain other characteristics overshadowed considerations of the conduct and circumstances of each individual.
> However, the ATO has not stated in any of its MMTEI settlement offers, that uncertainty in the law is a ground for applying a reduced rate of interest. As will be seen in the next appendix, uncertainty in the relevant law has been one factor leading to an interest
> rate reduction for one form of EBA. MMTEIs and EBAs have therefore received different treatment in this regard."

Finally, I am alarmed at the public statements of the new Commissioner, Michael D'Ascenzo, who has signaled his intention to use more discretion and rely less on the rule of law. This drift from application of the statutes must be arrested and then reversed by strong executive management by the Minister.

3. The practice of the ATO to source letters, advice and demands from different offices across Australia without adequate correlation.

Once again, my constituent's present experience is very recent with this concern. Last week he received a letter from a Mr Peter Geraghty of the Brisbane office of the ATO advising him that he was required to pay a large sum of money towards his disputed tax debt. The officer advised that if he did not pay 50% of the disputed primary tax within 14 days, legal action for recovery could be commenced. He also advised that interest would continue to accrue on his account at the full GIC rate.

The amount cited as owing was incorrect as, firstly, it did not take into account the deduction for cash that had been offered under settlement and, secondly, it ignored payments made by the taxpayer 15 months previously that amounted to the full primary tax debt required if the calculation was done correctly.

Since October 2002 the taxpayer has been waiting for a decision on his application for a review of the ATO's decision to exclude him from the full terms of the Mass Marketed settlement. This application was sent to the Canberra office. After 17 months silence, in March 2004, the Perth Office sent him notices disallowing his objections, (initially lodged in January 2001) with no reference to his settlement application. He was then forced to protect his position by appealing to the Administrative Appeals Tribunal. In August 2004 the ATO requested a stay of the hearing because of another similar application already before the tribunal. The ATO advised the taxpayer's accountant that interest would be stayed as this delay was at the ATO's request.

Then out of the blue came the letter from Brisbane.

Perhaps tabulating this insanity would be helpful:

Date	Item	ATO Office and Contact
June 2002	Application for settlement	Commissioner - Albury NSW
September 2002	Rejection as eligible taxpayer	C Field - Northbridge WA
October 2002	Application for Review of decision	R L Bruce – Canberra ACT
November 2002	Additional information for review supplied	R L Bruce – Canberra ACT
December 2002	Additional information for review supplied	R L Bruce – Canberra ACT
March 2004	Disallowance of Objections	K Fitzpatrick – Northbridge WA
August 2004	Stay of proceedings, interest stopped	ATO Legal Practice, Perth WA
March 2006	Demand for payment, interest continuing	Peter Geraghty – Brisbane QLD

As I'm sure the committee would agree, this army of supposedly competent people, none of whom have the facts right, have done nothing to bring the dispute to an end. I have met with my constituent and I am ashamed at the enormous personal stress and anxiety he and his wife are suffering over this incompetence, particularly in this last week when the ATO has so blatantly got his position wrong, but nonetheless hung the sword over his neck.

In the same report by the Inspector-General of Taxation referred to earlier, Mr David Vos stated:

> "A4.62 Three different areas of the ATO were responsible for the calculations of the interest, penalty and primary tax amounts which ineligible MMTEI investors had to pay. Submissions to this review have pointed out that this meant that, when finalising their MMTEI dispute, taxpayers may have had to deal with up to three or more different ATO staff. This process lengthened the time taken to finalise the dispute."

Recommendations.

The Taxpayer's Charter is a good starting point for reform of the ATO's practices concerning individual and groups of taxpayers. However, it needs to be reviewed, given the force of law as stated earlier, and placed in the hands of an external person or body that is also covered by the section 16 secrecy provisions and can therefore access any and all data available to the ATO.
The settlement offer made to investors in Mass Marketed Arrangements has to be available to all investors in these products. To allow the Commissioner to discriminate against a class of taxpayers for any purpose is improper, but where those purposes appear to include some form of revenge treatment for marketing products that the ATO itself failed to guide the community on, then that abuse of power demands intervention by the parliament.
Individual Members of Parliament are ostensibly the representatives of the people in the legislature. The previous Commissioner, Michael Carmody was well known for telling MPs to "but out" of tax matters. In the case of WA Labor MP Jan MacFarlane, this included a telephone contact to her office by a senior tax officer advising her that she shouldn't ask a particular question during question time! Thankfully, most MPs are resilient enough to give suggestions like that short shrift. However, MPs should be permitted an open and transparent connection with a senior ATO team, to bring specific matters that are clearly being lost in the system or are instances of abuse to the attention of the Commissioner and require him to intervene, taking the MPs recommendations into account.
The Inspector-General of Taxation has reviewed the Commissioner's discrimination against certain mass marketed investors however, his charter only allows him to comment on the improper processes attached to a decision, not the decision itself. As the ATO has surrounded the application and review process with a set of rules and procedures, the only conclusion to be reached was that the process was followed. There is no ability it seems for the Inspector-General to determine whether the decision was itself discriminatory and should be changed. This is the essence of effective review as the contention of taxpayers has never been that the process was flawed, rather, the practice is just plain wrong – unfair and discriminatory. The powers of the Inspector-General need to be reviewed to take these necessary inputs into account.

Term of Reference 3 – Part A

The level and application of penalties, and the application and rate of the General Interest Charge and Shortfall Interest Charge;

Recent legislative changes arising from the ROSA report have made certain changes to the interest and penalty regime. A commonly held view has been

that had these changes been in place several years ago, much of the angst surrounding the major tax disputes would have been completely avoided. That is not quite true. For a start, the changes only reduced the impact of additional costs the Commissioner can impose and tinkered with the interest regime by adding another interest charge, 4 points below that of the GIC. The old GIC remains and both rates are now available for use by the Commissioner, within certain guidelines.

Penalties are by nature a consequence of wrong, deceitful, fraudulent or reckless conduct. The use by the Commissioner recently of these provisions to induce settlements, force retreat from legal avenues and generally to maximize revenue is well known, despite the implacable denials of ATO staff.

The old GIC still applies, as the legislation will not have effect on any amendments made to returns up to the 2004/05 year. Furthermore, other ROSA law now means that where the Commissioner amends an assessment for past conduct, the full GIC will start to accrue 21 days after the assessment is issued and for as long as the assessment remains unpaid. So the pressure of a punitive interest bill still applies.

Fundamentally, there should be no interest uplift from the prevailing bank rate. If, as indicated in the legislation, the interest is designed to compensate the revenue for the loss of access to funds to which it is entitled, any rate beyond the prevailing bank rate constitutes a penalty, and should be pursued by the Commissioner through the penalty provisions if appropriate.

I have already illustrated the case of my constituent, where a penalty was applied at 40% instead of 10% by nothing other than the manipulation of correspondence. I can assure committee members, that however outraged you would be to have that imposed on you, it achieves nothing to simply claim "they can't do that".

Perhaps one explanation of the ATO's seemingly mindless insistence of maintaining penalties and interest at all costs is the ATO's Executive Performance Bonus Scheme. Criteria for the award of the bonus is linked to certain performance standards and it may be necessary to enquire whether revenue collections form part of that measure. Although, not specifically referred to in the scheme documentation, the level of tax raised does impact on the success rates of various ATO business units. If there is a connection, there must be an immediate and complete disconnection of revenue considerations from this management bonus program.

In the current system as I understand it, the ATO automatically imposes a penalty where there is a tax shortfall. Where a penalty is imposed it may range from 5% to 75% depending on the alleged culpability of the taxpayer for the shortfall. The Commissioner has the discretion to remit the penalty to nil, but

rarely does so. A taxpayer may request a remission and the Commissioner is obliged to consider that request, but again seldom grants remission, unless it would appear from recent examples, there are other influences. It is apparent that the penalty structure is adequate to impose appropriate penalties on taxpayers who either deliberately flout the legislation or make an honest mistake. The problem lies in the Commissioner's administration and use or perhaps more correctly misuse of discretion to remit penalties or apply the appropriate rate of penalty. The Commissioner as identified by the IGT uses a "one cap fits all approach" and this is improper and unfair. Additionally, the Commissioner in his one-size fits all approach sets the penalty rate at the highest level and this is a gross abuse of power. The principles of natural justice require that the Commissioner must consider each taxpayer's individual circumstances before imposing the penalty and the discretion to remit penalties should also be a mandatory requirement.

It is apparent from the penalty structure that taxpayers can be adequately penalised when appropriate. The inequity arises in the shortfall and general interest charge (GIC) provisions. In both the shortfall and GIC provisions the applicable rate includes an uplift factor, which is clearly a penalty component. When the shortfall and GIC amounts are calculated they are applied to the primary tax as well as the penalty. In other words, penalties are imposed on penalties. For example a taxpayer has a primary tax shortfall of $100,000. The penalty applied is 50%. Total tax plus penalty is thus $150,000. Shortfall interest at 8.63% over two years on $150,000 amounts to a further $28,255. As the uplift factor in the SIC is 4%, the penalty component of the SIC is $13,703. This means that if the ATO takes two years to make the amendments, the taxpayer penalty is effectively increased by 14% and the total penalty imposed is now 64%. Lets say this taxpayer appeals the matter and it takes a further two years during which GIC is applied at 12.63%. The GIC amount is $51,215 and the uplift or penalty component is $33,921, which is a further 34% of the original tax shortfall. The total penalty is now 98%. The total tax payable in this example is $229,470.

It is apparent from the above that while the inclusion of the uplift factors in the SIC and GIC are there to stop taxpayers using the revenue as a source of borrowing, the practical effect is that the uplift factors are a penalty component which when imposed on top of the culpability penalty has the effect of steadily increasing the penalty rate.

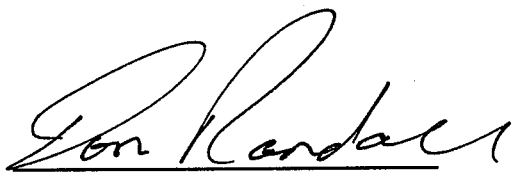
In my view, the penalty imposed must reflect the culpability of the taxpayer as established by the facts of the case and must not be variable depending on time factors, especially when those timing factors are mainly outside the taxpayer's control. During the period taken by the ATO to raise a challenge to the taxpayer's tax return or during the period when the taxpayer is appealing the matter, the taxpayer should only have to pay interest on the primary tax amount, not the penalty amount and the rate of interest should be the prevailing bank

rate. Where a taxpayer has exhausted all legitimate appeals but continues to refuse to pay, then the ATO should immediately take collection action and a penalty rate of interest could be justified during this latter period. However, the ATO must bear responsibility for taking immediate collection action and must not be allowed to simply ignore collection while a tax bill accumulates interest and increases to the extent that ultimate collection is jeopardised.

In offering their submission to the Committee, I trust that members examine the recommendations and examinations that I have made in the serious context that I have presented them.

On behalf of all tax payers and those that I represent, I would be disappointed if the genuine concerns expressed and solutions offered were not given the important priority for which they were recorded.

Should the Committee wish me to further clarify or expand on matters contained in this Submission, I am willing to appear in person to address the Committee.



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Federal Member for Canning