# CHAPTER 3

# SELF-ASSESSMENT, CERTAINTY AND REASONABLY ARGUABLE POSITIONS

## Self-assessment and expert advice

3.1 It is by now well-established that many of those who invested in tax effective schemes did so relying on 'expert' opinions which assured them of the legality of the arrangements. The following testimony, taken in Kalgoorlie from Mr Michael Burns, is representative of much of the evidence before the Committee. Mr Burns said:

> I tried to seek the best advice available to me at the time. I did not go to any Kalgoorlie people. I went to a Perth financial adviser in order to get separate advice on this. Many of my friends and work colleagues are in the same boat as me. They all say that the financial advisers, accountants and lawyers that they talked to all said the same thing: these schemes seemed above board and quite safe and sound. They could not find anything wrong with them. I thought I would do something a little bit different and go and see a financial adviser in Perth, and he said exactly the same thing. He said the schemes were quite good; there was nothing wrong with it that he could see, and he said he was actually in it himself.
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> With respect to the scheme, I got a prospectus. In that prospectus were two signed documents from two separate QCs saying that they were above board and they could not see anything wrong with them whatsoever, including from the tax department's point of view, so everything should be spot on.[1]

3.2 Faced with testimony of this sort, the Committee was at first inclined to think that investors such as Mr Burns had been the victims of a deliberately misleading sales pitch, if not of professionally negligent advice on the part of the relevant accountants and lawyers. Those who promoted and advised on these schemes, however, dispute this conclusion.

3.3 For example, one of the salesmen who marketed the schemes aggressively in Kalgoorlie and elsewhere in Western Australia told the Committee that he himself had been convinced of the legality of the schemes. Mr Rick Shenton said:

> I am a professional salesman. I used to be a state manager of a branch of AMP and I have some background legal qualifications. I felt, and still do feel, that these schemes were legal and I promoted them as such. I believed they were legal because I had, when I was selling, a Queen's Counsel opinion, a solicitor's opinion, an accountant's opinion and usually Coopers and Lybrand – or one of the top three accountants in the world – giving

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1 Evidence, p.225.

> opinions to say that these things were legal … As I understood it, the taxation department had clearly known of these schemes and had not done anything about them.[2]

3.4 The Committee also received evidence from lawyers and accountants who provided favourable opinions in relation to schemes whose deductions have been disallowed by the ATO, and who stand by their original opinions.

3.5 For example, the Committee received a submission from the law firm, Blake Dawson Waldron, which is acting for Cabonne Management Ltd on behalf of participants in the Central Highlands Wine Grape Projects (CHWGP) 1-4. While Blake Dawson Waldron did not themselves provide the taxation opinion in the Central Highlands prospectuses, the firm argued that the favourable opinions that were provided were soundly based on existing case law. The submission stated:

> Prospectuses in relation to projects of this nature are required to contain a taxation opinion. In relation to Central Highlands Wine Grape Project No. 1 ('Project 1'), a taxation opinion was obtained from Court & Co, Chartered Accountants. In relation to Project 2, Project 3 and Project 4 a taxation opinion was obtained from Lear & Co. … We note that projects of this nature typically contain taxation opinions from 'Big 5' accounting firms. These firms have typically given a similar taxation opinion to the opinions contained in the prospectuses for CHWGP 1, 2, 3 and 4 and rely on the same income tax principles as were relied upon in the opinions for CHWGP.[3]

3.6 Both in their submission and in subsequent oral evidence to the Committee, Blake Dawson Waldron emphasised that the relevant taxation opinions relied on case law that was relevant at the time, and that 'the ATO had no published position that was contrary to these decided cases'.[4]

3.7 Mr Colin Thomas of the accounting firm, Hudson Croft Thomas, commenting on the position 'as I recall it' in 1998, told the Committee:

> In my view, no tax professional with specialist knowledge in this area believed that part IVA would apply to genuine business transactions where limited recourse or indemnified loans were used to finance these transactions … The existing rulings and tax cases gave a clear indication. It therefore follows that in some schemes participants had no reason to believe that they were entering into a scheme that did not comply with the law.[5]

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2 In-camera evidence, 21 August 2001, p.2.

3 Blake Dawson Waldron, Submission No. 852, p.3.

4 Blake Dawson Waldron, Submission No. 852, p.3; Evidence, pp.515-518.

5 Evidence, p.536.

3.8 When asked by the Committee whether 'with the benefit of hindsight' he would not have given positive opinions on schemes which have since been disallowed by the ATO, Mr Thomas said:

> With the benefit of hindsight, knowing now what I know, I still believe the tax office is wrong, and consequently I would have been advising people to go into these types of investments because, at the time, and believing the directors had done their due diligence in preparing the prospectuses, and that they believed the investments would work, consequently that they were sound investments.[6]

3.9 Fletcher Securities expressed the view that the ATO's position is not 'supported by case law or tested in the courts'.[7] For that reason:

> It is far too premature for the ATO and even the Committee's final report to consider and/or discuss the use of penalties for promoters and designers of prospectus-based schemes as the ATO's view on limited recourse funding arrangements that underpinned them is yet to be tested before the courts … Schemes that were based on real business activities … contained independent taxation opinions often provided by the same large accounting firms that the government had paid tens of millions of dollars each year for taxation advice that it relied upon. Securities advisers had a reasonable basis … for relying upon these taxation opinions in satisfying themselves and their clients that the taxation deductions outlined could be claimed to help fund their investments.[8]

3.10 One of the large accounting firms that provided taxation opinions for some mass marketed schemes was Deloitte Touche Tohmatsu. In its submission to the Committee, Deloitte Touche Tohmatsu commented that it is relatively easy to identify the extreme ends of the schemes market, but 'much more difficult to comment on the whole spectrum. This is so given the variety of arrangements, the complexity of our taxation laws and the uncertainty of their administration from time to time'.[9]

3.11 Deloitte Touche Tohmatsu informed the Committee that, while the firm never promoted schemes, it provided taxation opinions for inclusion in a number of prospectuses including Connect the World, Budplan A Series 1, Personal Budplan 4, Tracknet, and Tentas.[10]

3.12 The Committee emphasises that the point of this discussion is not to determine the merits, at law, of the ATO's decision to disallow deductions and to apply Part IVA to many of the so-called mass marketed schemes. The point, rather, is

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6 Evidence, p.548.

7 Fletcher Securities, Submission No. 652A, p.5.

8 Fletcher Securities, Submission No. 652A, p.8.

9 Deloitte Touche Tohmatsu, Submission No. 894, p.2.

10 Deloitte Touche Tohmatsu, Submission No. 894, p.7.

to show that some taxation advisers who provided advice in relation to mass marketed schemes continue to maintain that their advice was correct, notwithstanding the views of the ATO.

3.13 By way of contrast to this approach, Mr Mark Leibler, of Arnold Bloch Leibler – Lawyers and Advisers, noted that it would have been prudent for advisers to inform potential investors of the risk of the ATO taking a different view even if they considered the scheme arrangements acceptable. In other words, he advocated that advisers should take a pragmatic rather than an 'academic' approach to the question of the possible application of Part IVA, saying:

> How would you feel if I gave you advice that on balance it ought to be okay under the anti-avoidance provisions and you ended up getting an assessment from the commissioner with very heavy penalties and then, seven years later, you won your case in the High Court? I do not think you would consider that a very productive course of action.[11]

3.14 A solicitor from McKenzie Lalor in Kalgoorlie, Miss Lisa McLean, told the Committee that when potential investors *were* advised of these risks, they usually chose not to invest. She said:

> We actually do see people on occasion who have been given the opportunity to get legal advice … When they do, we give them the full picture, the possibilities of what could happen and we have not had anybody that has left our office and has actually signed up to a scheme if they have been given that opportunity.[12]

3.15 The Committee is concerned that many advisers do not seem to have taken responsibility for advising their clients of the full extent of the risks involved in investing in schemes, particularly the risk of the ATO taking a different view of the arrangements.

3.16 The difficulty for individual taxpayers is that the ATO can levy penalties against them for acting on that sometimes incomplete advice and investing in schemes whose deductions the ATO deems to be not allowable. In other words, it is the individual taxpayer rather than the adviser who ultimately bears any risk associated with the ATO taking a different view of the tax effectiveness of particular schemes.

3.17 This matter may be of less importance following the introduction of the product ruling system, which gives the investor comfort that the deduction will be available, providing the schemes is implemented in accordance with the information provided to the ATO. The issue of ATO rulings is discussed in the next section.

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11 Evidence, p.145.

12 Evidence, p.264.

## ATO rulings

*Self-assessment*

3.18 The Committee notes that there is mechanism which is expressly designed to mitigate the risk borne by the individual under the self assessment system. This mechanism is the ATO's ruling system.

3.19 Prior to 1 July 1986, tax returns were individually examined by the ATO, the tax calculated and an assessment issued. After that date, a minimalist self-assessment system was introduced, which meant that taxpayers were required to calculate their own tax liability. The ATO accepted that calculation at face value, but retained under law the right to audit returns for up to four years in ordinary circumstances and for up to six years if it determined that Part IVA applies.[13]

3.20 The Taxation Institute of Australia (TIA) noted that the decision to move to a self-assessment system 'reflected the reality that in many ATO branches assessors were being asked to process 1,000 individual returns in a standard day. Excessive manpower requirements and quality assurance were both issues under the old system'.[14] The Australian National Audit Office explained the background to the introduction of the self-assessment system in the following terms:

> Before the 1986-87 financial year, the ATO had the role of assessing every tax return submitted by every tax payer … However, in reality the assessment process was little more than *tick and flick*. With approximately 10 million income tax returns to assess annually and with quotas applying to assessors, it had been calculated that, on average, an individual taxpayer's return would have received less than 2.5 minutes of scrutiny by the ATO.[15]

3.21 As the TIA explained, however, with the introduction of a self-assessment system, there were concerns about whether taxpayers could be certain they had assessed themselves correctly, and about their exposure to penalty and interest charges in the event of mistakes which were subsequently identified by the ATO. In response to this concern, modifications to the self-assessment system were introduced in 1992. Among other things, these provided for the introduction of a rulings system through which the Commissioner could communicate how, on his view, the law would apply to particular arrangements.

3.22 Further, in response to the problems of taxpayers achieving certainty in relation to mass marketed tax effective scheme arrangements, the ATO introduced a new class of rulings in 1998. These 'product rulings' aim to give certainty about the

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13 See also Mr Ian Phillips's witty summary of this change in his Submission No. 890, p.2.

14 Taxation Institute of Australia, Submission No. 898, p.2.

15 Australian National Audit Office, *Risk Management: Australian Taxation Office*, Audit Report No. 37 1996-97, p.9.

tax effectiveness of a scheme, not just to an individual applicant but to any participating investor.

3.23 As mentioned in Chapter 1, the product ruling system has helped reduce the risk of investing in arrangements with tax benefits. However, product rulings do not provide complete protection for taxpayers. There are still some circumstances which could leave taxpayers, who have invested in a scheme with a product ruling, exposed to tax penalties. Of concern is the question of investor control over the implementation of schemes in conformity with ATO product rulings.

*Conformity with a ruling and the application of Part IVA*

3.24 In a speech on 15 May 2001 to the Taxation Institute of Australia, Brisbane, Mr Michael O'Neill, Assistant Commissioner of Taxation, discussed the use of the ATO's rulings in terms of investor certainty. He warned, however, of two respects in which the existence of rulings would not necessarily guarantee an investor's immunity from ATO action. First, he said:

> Where the facts presented to the ATO are not implemented on the ground then no comfort can be drawn. (This issue is particularly important for product rulings where prudent investors may seek written undertakings from the promoter that the arrangement is fully implemented).[16]

3.25 Second, Mr O'Neill observed:

> While the ATO can rule on the application of Part IVA, silence on this issue cannot be taken as consent. On complex schemes yet to be implemented it may be impossible to rule on Part IVA because some of the eight requisite factors are yet to happen.[17]

3.26 The Committee notes that, from the ATO's point of view, both these hedges seem necessary. A ruling given for one set of arrangements should not be able to be used to protect a materially different set of arrangements for which, perhaps, no ruling would have been given. Further, a ruling given in advance should not be able to prevent the ATO from determining that the anti-avoidance provisions apply to unlawful subsequent action on the part of the promoter or operator.

3.27 However, from the point of view of the individual taxpayer, these caveats make the certainty attainable through the ruling system seem highly provisional. It is questionable whether an individual investor in, say, an agribusiness scheme would have any knowledge of, let alone influence over, actions by the scheme promoter or operator which might fall foul of the scheme's product ruling or of the Part IVA

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16 Michael O'Neill, 'Taxes, Death & Civilisation: A look at year end "tax effective products"', 15 May 2001, http://www.ato.gov.au/content.asp?doc=/content/corporate/sp200103.htm (6 June 2001), p.5.

17 Michael O'Neill, 'Taxes, Death & Civilisation: A look at year end "tax effective products"', 15 May 2001, http://www.ato.gov.au/content.asp?doc=/content/corporate/sp200103.htm (6 June 2001), p.5.

provisions. Yet, if these provisions are contravened, then it is still the individual investor who is exposed to ATO recovery action.

3.28 The ATO has acknowledged the vulnerability of investors in cases where promoters 'recklessly or knowingly' fail to implement the scheme in accordance with the terms of the product ruling. It has advised that, 'in these cases, it might be appropriate for a reduced tax shortfall penalty to fall on the unwitting investors'.[18]

**Matters for consideration**

3.29 Based on the points raised so far in this Chapter, the Committee wishes to flag a number of suggestions or recommendations for consideration by the Government and the ATO. The Committee will discuss these suggestions under the following headings:

- increasing taxpayer understanding of self-assessment; and
- judicial resolution of differing interpretations of law.

*Increasing taxpayer understanding of self-assessment*

3.30 That the majority of taxpayers do not understand the implications of the self-assessment system became clearly apparent during the inquiry. Many witnesses accused the ATO of acting retrospectively by issuing amended assessments for previous tax years, despite the fact, as stated earlier, that the law explicitly allows for the ATO to amend assessments for up to four years in ordinary circumstances and for up to six years if it determines that Part IVA applies.[19]

3.31 The Committee thus considers that there is an urgent need for taxpayers to be made aware of the implications of the self-assessment system and, in particular, that 'just because they have treated an item in a particular way last year and the year before without demur by the ATO, that practice is not to be assumed to be correct or tolerated or irreversible'.[20] Indeed, as Mr Ian Phillips, a taxation consultant and former representative on the Commissioner's Self Assessment Task Force, warned:

> If the matter is at all contentious, no surety is gained for a long time and no precedents are set unless, exceptionally, the ATO is specifically bound by a ruling or other determination.[21]

3.32 Both Mr Phillips and the Taxation Institute of Australia made a number of suggestions aimed at making the self-assessment system more transparent to

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18 ATO Additional Information, 31 October 2001, p.5.

19 This was true not only of individuals, but of organisations with professional involvement in the financial area. See, for example, Van Eyk Capital, Submission No. 691, Appendix A, p.10; and, Financial Planning Association, Submission No. 705, p.3.

20 Mr Ian Phillips, Submission No. 890, p.3.

21 Mr Ian Phillips, Submission No. 890, p.3.

taxpayers. The Committee believes that these suggestions warrant careful consideration by the ATO.

3.33 First, Mr Phillips and the TIA expressed the view that the use of the word 'assessment' may itself be misleading. In Australian taxation law, 'assessment' is defined as the 'ascertainment' of the amount of taxable income and the tax payable.[22] But, as the TIA, observed:

> If the taxpayer's word is accepted without review it is difficult to see in the self-assessment environment [that] the Commissioner has 'ascertained' anything in issuing a 'Notice of Assessment'. At best a 'Notice of Assessment' is no more than a notification of liability in a self-assessment environment.[23]

3.34 The TIA suggested that the word 'assessment' be reserved for occasions where the Commissioner actually has determined a taxpayer's final liability. For example, an 'assessment' could be issued following an audit. Otherwise, the existing document named 'Notice of Assessment' should be renamed to make it clear to the taxpayer that the notice 'is merely a confirmation of the information supplied by the taxpayer'.[24] The TIA suggested the adoption of names such as 'Interim tax calculation' or 'Tax calculation sheet' while, in a similar vein, Mr Phillips suggested the use of phrases such as 'payment requirement based on your return' or 'interim payment obligation'.[25]

3.35 Similarly, the TIA was of the view that all ATO correspondence processing taxpayer instalment variations and amendment requests should 'make it plain that no actual review of the taxpayer's facts and circumstances has taken place'.[26] A positive response does not mean that the ATO agrees with the taxpayer's claim: it simply means that the taxpayer's claim has been taken at face value. Since the response may be reversed in later years, the TIA suggested that the correspondence carry a prominent 'health warning' to that effect.[27]

**Recommendation**

3.36 The Committee recommends that the ATO, in consultation with the Taxation Institute of Australia, the Commonwealth Ombudsman and other relevant bodies, develop measures to educate taxpayers about their obligations and rights in the self-assessment environment. Particular attention should be given to ensuring that taxpayers are made aware of the period over which the ATO may review their returns

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22 Taxation Institute of Australia, Submission No. 898, p.4.

23 Taxation Institute of Australia, Submission No. 898, p.5.

24 Taxation Institute of Australia, Submission No. 898, p.5.

25 Mr Ian Phillips, Submission No. 890, p.3.

26 Taxation Institute of Australia, Submission No. 898, p.5.

27 Taxation Institute of Australia, Submission No. 898, pp.5, 8.

and amend their assessments. Further to the recommendation at paragraph 1.59, information about the ATO's power to review and amend assessments, and the time periods that apply, should be clearly stated in the *TaxPack* and on notices of assessment sent to taxpayers.

*Judicial resolution of differing interpretations of law*

3.37 The Committee notes that increasing taxpayers' understanding of the self-assessment system does not do anything to provide them with greater certainty that taxation advice upon which they act will be acceptable to the Commissioner. All it does, is to make them more fully aware of the risk to which they are exposed.

3.38 The Committee received very little evidence which addressed the question of how judicial resolution of differences of interpretation of taxation law might be more comprehensively and swiftly obtained. Such resolution, however, was seen as desirable by witnesses, particularly in relation to the scope of the Part IVA provisions.

3.39 An important means of achieving judicial resolution on disputed interpretations of taxation law is via the ATO's test case program. This program provides funds to individuals or organisations to test a point of tax law in court, where a case raises issues that will affect a significant section of the tax-paying public.[28] A number of witnesses, however, were critical of the ATO's selection of cases for test case funding.

3.40 For example, the Taxation Institute of Australia was critical of the ATO's 'long-standing ban on the funding of Part IVA cases, and its reluctance to issue Part IVA assessments [in] the first place'.[29] The result of that reluctance, claimed the TIA, has been that the power of Part IVA has not been fully exposed to the community. In the TIA's view, however, 'Part IVA is a part of the tax law like any other, and artificial contracts [on] its use and testing are detrimental'.[30] Notwithstanding that criticism, the TIA noted that the ATO has won most Part IVA cases it has contested in recent times. These decisions have confirmed that the provision 'does work', and have provided some guidance to its meaning.[31]

3.41 Deloitte Touche Tohmatsu also commented upon the ATO's seeming reluctance to clarify the scope of the Part IVA provisions. Mr Michael de Palo, National Managing Partner – Tax, wrote:

> … it has been a generally held view in the tax profession that from the time when Part IVA was first introduced in 1981, and until recently the ATO has

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28 'ATO Test Case Program', http://www.ato.gov.au/printcontent.asp?doc=/content/Professionals/test_case_program… (10 October 2001), p.1.

29 Taxation Institute of Australia, Submission No. 898, p.9.

30 Taxation Institute of Australia, Submission No. 898, p.9.

31 Taxation Institute of Australia, Submission No. 898, p.8.

> evinced a clear reluctance to have the scope of the provision clarified, either by public or private rulings or decided cases. Rather, the ATO strategy seemed to have been to keep the provision hanging over taxpayers and advisers.[32]

3.42 Similar criticisms were expressed about the selection of test cases in the mass marketed schemes arena. For example, Mr Robert O'Connor QC told the Committee that test case funding for the Budplan litigation was initially refused by the ATO 'presumably because the case involved Part IVA'. The ATO finally agreed to fund the case in April 2001 but, according to Mr O'Connor, 'that decision should have been made three years ago'.[33]

3.43 On the other hand, Mr Richard Gelski, Blake Dawson Waldron, took issue with the ATO's decision to fund test cases for Budplan rather than for the Central Highlands Wine Grape Project. He said:

> … they have chosen to fund Budplan, which is a case that I would respectfully submit does not have the merits that Central Highlands does. That is not to say that Budplan should not obtain test case financing; it is to say that Central Highlands and Frankland Valley should.
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> Here are cases which, we would submit, are completely deserving of obtaining finance, and the only reason that the Commissioner might choose to reject, as he has done at this stage – or at least not to accede to the request at this stage – in our view can only be that he is concerned that he might actually lose.[34]

3.44 The Committee notes that although the ATO's Deputy Chief Tax Counsel makes the final decision on whether to fund the case, the decision is made after consultation with a 'Litigation Panel' comprised of taxation experts from within and outside the ATO. Currently, the ATO's Litigation Panel consists of six members, four of whom come from the wider taxation profession. The ATO has said that the panel was established 'to ensure that the Tax Office has community input into the Test Case Program'.[35]

3.45 The Committee further notes that criticisms of the ATO's selection of test cases for funding should be seen in the context of the large number of schemes for which claimed deductions have been disallowed. Participants in more than 200 schemes have been subject to ATO recovery action. It is not necessary, for the purpose of establishing general principles concerning the application of the law to

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32 Deloitte Touche Tohmatsu, Submission No. 894, p.4.

33 Mr Robert O'Connor QC, Submission No. 891, p.7.

34 Evidence, p.517.

35 'ATO Test Case Program', http://www.ato.gov.au/printcontent.asp?doc=/content/Professionals/test_case_program… (10 October 2001), p.1.

broadly similar arrangements, to fund test cases in relation to each scheme. Moreover, the broader tax paying community would be disadvantaged by a decision to fund any more cases than are required to establish the relevant legal precedents.

3.46 There may, of course, be disagreement over whether the appropriate cases really have been selected for funding. The Committee considers that the Litigation Panel should help to ensure that cases selected are representative, not only from the point of view of the ATO but also of the broader taxation profession.

3.47 As an additional measure, the Committee considers that it may assist the tax profession and the wider community if the reasoning behind the selection of cases for test case funding were published. This would make transparent the reasons for the choice of some cases for funding and the rejection of others.

**Recommendation**

3.48 For this reason, the Committee recommends that the test case Litigation Panel publish the criteria in the light of which it will recommend cases for funding and publish the reasons for its recommendations in particular cases.

3.49 A second issue to be addressed in relation to the litigation of test cases is the often extensive delay in the court process, while a third concerns the expertise of different courts in taxation matters and the need for consistent interpretation of taxation law. The Committee notes that a measure relevant to both these issues was raised in evidence by Mrs Jennifer Batrouney SC. She commented that:

> From time to time, the spectre of a federal tax court has been raised. I am very much in favour of the idea of a federal tax court.[36]

3.50 On the other hand, the Committee notes that the whole test case model relies on the preparedness of a taxpayer to challenge the ATO through a full litigation process. This entails, among other things, that the ATO will never be able to drive this process quickly nor in such a way as to provide it with judicial certainty *before* it issues a determination in relation to a particular matter.

**Recommendation**

3.51 The Committee recommends that the Government undertake an analysis of the adequacy of current mechanisms for obtaining judicial resolution of disputed or contentious tax law interpretation. This analysis should include consideration of whether and how the ATO might obtain a legal judgement without having to be taken to court by a taxpayer objecting to an ATO determination, and consideration of the merits of establishing a specialist federal tax court.

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[36] Evidence, p.679.