

JOINT SUBMISSION BY

The Taxation Institute of Australia, National Institute of Accountants, the
Institute of Chartered Accountants in Australia, CPA Australia
and Taxpayers Australia

Draft Miscellaneous Tax Ruling MT 2008/D1, D2 & D3

“Penalty relating to statements: meaning of reasonable care, recklessness and intentional disregard”; “Shortfall Penalties: administrative penalty for taking a position that is not reasonably arguable”; and “Shortfall Penalties: voluntary disclosures” (respectively)

Date: 11 July 2008

GENERAL COMMENTS

The Professional Bodies welcome the opportunity to comment on Draft Miscellaneous Tax Rulings MT 2008/D1, D2 and D3 (“the Draft Rulings”).

In light of the ATO’s intention to consult further with stakeholders on 5 August 2008, the views expressed in this submission should be regarded as preliminary in nature. The Professional Bodies reserve the right to amend this submission, if necessary, in light of the outcomes of further consultation with the ATO and to raise and comment on any further issues that may arise during the course of any additional consultations with the ATO.

SPECIFIC COMMENTS

1. MT 2008/D1 - penalty relating to statements: meaning of reasonable care, recklessness and intentional disregard

1.1 Existence of reasonable care where reasonably arguable position is achieved

It is acknowledged at paragraph 39 of MT 2008/D1 that the reasonably arguable position test imposes a higher standard than that required to demonstrate reasonable care.

It is submitted that the ruling should clarify that the Commissioner will not seek to argue a lack of reasonable care in relation to the application of a taxation law where a reasonably arguable position has been adopted.

This point should also be clarified in relation to paragraph 29 of MT 2008/D2

1.2 Applying for a private ruling in reaching the reasonable care threshold

The wording in paragraph 64 implicitly overstates the importance of applying for a private ruling in achieving the reasonable care threshold.

It is submitted that the words “failing to do so does not inevitably lead to a failure to take reasonable care” should be substituted with “in some situations, failing to apply for a private ruling or to pursue other channels, such as obtaining appropriate advice from a qualified advisor, may lead to a failure to take reasonable care”.

1.3 Relying on third party information

It is suggested that a further example should be included after example 7 of MT 2008/D1, covering the position where an individual obtains a tax statement from a third party, which is reasonable on its face, relied upon but proves to be incorrect. This may include a statement from the bank about annual interest on an account, a trust distribution statement or some other similar statement.

1.4 Recklessness and intentional disregard

It is suggested that some examples be included in relation to situations where the Commissioner considers that there might be recklessness or intentional disregard.

1.5 Mismatch between paragraph 40 and ATO practice

There seems to be an inconsistency between paragraph 40 (i.e. no presumption of a lack of reasonable care just because there is a tax shortfall) and what almost invariably seems to happen in practice - i.e. that the ATO automatically imposes a penalty if there is a shortfall amount(s). The ATO needs to stress in the Ruling and any Practice Statements that officers must have a reasonable case before imposing penalties

2. MT 2008/D2 - shortfall penalties: administrative penalty for taking a position that is not reasonably arguable

2.1 Reasonably arguable position and initial comments

It is suggested that it be emphasised in MT 2008/D2 that, by definition, the question as to whether a position is "reasonably arguable" will only initially arise where the ATO adopts a view that the position adopted is incorrect. As such, the fact that the position is incorrect is not of itself a factor in determining whether there is a reasonably arguable position.

2.2 Reasonably arguable position and lower Court / dissenting decisions

It is submitted that the ruling should acknowledge a "reasonably arguable position" where there is a decision in favour of the taxpayer in the course of litigation, including for example a decision of a single judge at first instance or a dissenting judgment at a higher level.

2.3 Reasonably arguable position and absence of authority

It is submitted that the words "will not be fatal to" in paragraph 41 of MT 2008/D2 provide an unnecessarily negative connotation. We suggest that they be replaced with words such as "will not prevent or be detrimental".

2.4 Relevant authorities and advice

It is suggested that paragraph 49 should be recast in light of comments by the Joint Committee of Public Accounts and Audit (JCPAA) in *Report 410* on the issue of 'reasonably arguable'. The JCPAA noted:

4.25 Section 284-15 defines a position as reasonably arguable when, having regard to the relevant authorities, it is 'about as likely to be correct as incorrect.' Without limitation, the relevant authorities are tax laws, statutory interpretation materials, court and AAT decisions, and public rulings. Some commentators have expressed concern that independent legal opinions are not relevant authorities. If the area is grey because there are no court decisions, then the concern is that a court will only examine the public ruling in determining whether a taxpayer has taken a reasonable position.¹⁶

4.26 The Federal Court examined this issue in *Walstern v FCT*.¹⁷ The Court considered the previous section 222C of the *Income Tax Assessment Act 1936*, which is very similar to the new section under discussion.¹⁸ There, the ATO argued that legal opinions could not constitute relevant authorities. However, Justice Hill stated:

It is true that opinions of counsel are not referred to in the definition of 'authority'. On the other hand it may be said that the definition is inclusive so that recourse to the opinions of counsel is not necessarily ruled out by the definition. It is unnecessary in the present case to decide this question, although I am inclined to think that the opinion of eminent counsel practising in the field,... if directed at the actual facts of a case, might well fall within the definition.¹⁹

4.27 In other words, the list of authorities relevant to determining whether a taxpayer has taken a reasonably arguable position can include legal opinions. This is a fair approach. The ATO does not have a monopoly on legal tax advice. Taxpayers are entitled to approach private sector advisors as a means of demonstrating that they have acted reasonably. If they could not, this would be an unreasonable restriction on taxpayers' personal liberties. It would also potentially breach competition policy.

4.28 If a court were to subsequently rule that such opinions are not relevant authorities, then the Committee's view is that this matter should be corrected through legislation. The Committee also expects there would need to be exceptional circumstances for the ATO to challenge Justice Hill's comments.

16 Scolaro D, 'Tax Rulings: Opinion or Law? The Need for an Independent 'Rule-Maker'' (2006) *Revenue Law Journal*, vol 16, pp 119-20, Corporate Tax Association and Ernst & Young, RoSA submission 27, p 17, viewed on 9 May 2007 at http://selfassessment.treasury.gov.au/content/_download/Submissions/27_cta_ey.pdf.

17 [2003] FCA 1428.

18 In section 284-15, the list of authorities operates without limitation. In section 222C, the authorities include those listed. Both sections list the same authorities.

19 *Walstern v FCT* [2003] FCA 1428, para 112.

2.5 Reasonably arguable position and documentation

It is suggested to expand paragraph 52 of MT 2008/D2 to include the Commissioner's view as to whether, given the objective nature of the test, it is necessary for the taxpayer to have actually had regard to the relevant authorities, or whether it is merely necessary that they existed.

2.6 Reasonably arguable position and errors of fact

It is suggested that the Commissioner include a comment after paragraph 69 that where there is an error of fact, it will be necessary to consider whether reasonable care has been taken.

3. MT 2008/D3 - Shortfall penalties: voluntary disclosures

3.1 Caveat

Although the Professional Bodies have been advised that there is a draft Practice Statement being prepared to deal with remission, the absence of that document makes it extremely difficult to comment on this draft Ruling. This arises as the draft Ruling in isolation seems to contain a major reversal in ATO practice and interpretation in the context of risk reviews. With that caveat, our comments are as follows.

3.2 Scope of the definition of “tax audit”

In paragraph 49 of MT 2008/D3, a risk review is being treated as a “tax audit” on the basis of the very wide definition of that term under s 995-1. However, like many of the taxation administration amendments introduced in 2000, the wording does seem to limit the scope of the definition to a position which is narrower than that which previously operated.

A “tax audit” is in s 995-1 deemed to mean “**an examination by the Commissioner of an entity’s financial affairs** for the purposes of a taxation law” (emphasis added). So where the Commissioner identifies risk and requests a taxpayer to conduct a review, it cannot be said that the “Commissioner is examining an entity’s financial affairs”. Therefore, paragraph 49 needs to be amended to reflect that qualification.

The view is also consistent with the ATO’s former approach where client risk reviews were not treated as a tax audit. This former view is illustrated in the recent publication “Wealthy and wise: A tax guide for Australia’s wealthiest people”. The Guide states:

Risk review outcomes

At the end of a risk review we will discuss the outcomes with you or your adviser, to advise whether we are satisfied with your compliance or consider further action is warranted.

Where further action such as an audit is anticipated it may not commence immediately after a risk assessment has been completed. The risk may be monitored for some time, with the timing of further action depending on our overall priorities.

Where it is likely we will undertake an audit, we will discuss how we can keep you informed about progress. Depending on the nature of the risks, the discussions may also cover possible mitigation strategies you can use to reduce the likelihood or impacts of an audit.

We encourage you to advise us of any changes in your position or of any errors in your tax affairs when they are detected. If you notify us of the resultant tax shortfall before we notify you of an audit, any penalty is reduced by 80%.

If a disclosure is made after we notify of an audit the penalty is reduced by 20%, except where the disclosure relates to an issue outside the scope of the audit, in which case the penalty is reduced by 80%.

The distinction between the risk review and audit processes also appears in a number of publications including the Compliance Program and the Taxpayer’s Charter.

We submit that the current treatment of voluntary disclosures during a risk review should be continued through an explicit comment in the Draft Ruling that a risk review is not a tax audit as defined.

3.3 Timing of voluntary disclosure

In respect of the timing of voluntary disclosure the Draft Ruling fails to reflect scope of the views expressed by the JCPAA in *Report 410* on the issue of ‘commencing audits’. The JCPAA noted:

5.72 . . . The penalties and interest report recommended that the ATO provide clearer guidance on when an audit starts and give taxpayers an opportunity to make voluntary disclosures prior to an audit formally commencing. . . .

It is suggested that the draft Ruling should be recast in light of comments by JCPAA.