

JOINT SUBMISSION BY

The Institute of Chartered Accountants in Australia, The Tax Institute,
The Institute of Public Accountants, CPA Australia
and Taxpayers Australia

Draft Taxation Determination TD 20011/D4

Tax administration: what is a general administrative practice for the purposes of protection from administrative penalties and interest charges?

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The Professional Bodies welcome the opportunity to comment on Draft Taxation Determination TD 2011/D4 ("the Draft TD").

GENERAL COMMENTS

The Professional Bodies are disappointed that the Draft TD has not adopted all of the actions in Chapter 5 of the 2009 report by the Inspector-General of Taxation ("IGT") entitled *Review of the Tax Office's administration of public binding advice* ("the IGT Report").

As a consequence, we do not believe that the Draft TD will provide an acceptable level of:

- certainty
- efficiency, and
- confidence in the tax system.

We submit that the ATO should reconsider its decision not to publicly confirm that all documents which the ATO refers to as 'precedential ATO views' in PS LA 2003/3, together with all its publicly available practice statements, represent its 'general administrative practice' for the purposes of the income tax laws.

SPECIFIC COMMENTS

1.1 The IGT Report

The IGT Report states that:

... the post 2006 rulings law changes which refer to the concept of a 'general administrative practice' offer considerable opportunity for increasing certainty, efficiency and community confidence in the tax system.

5.6 Acknowledgement by the Tax Office that a particular document embodies its general administrative practice (GAP) will have the following effects under the present rulings regime:

- *any change to that practice will protect taxpayers who have relied on the Tax Office's previous practice against the levy of any penalty for prior tax periods;*
- *any change to that practice will protect taxpayers who have reasonably relied in good faith on the Tax Office's previous practice against the levy of interest on tax that was not paid for prior periods; and*

- *any change to that practice that is made by a public ruling, will practically operate on a prospective basis only.*

5.7 *In addition, under the Tax Office's current administrative practice, any change to such a practice that is made otherwise than by a public ruling will, under the Tax Office's Practice Statement PS LA 2008/3 (paragraph 32), generally operate on a prospective basis, unless the practice has been exploited or been the subject of tax avoidance.*

5.8 *These consequences are largely equivalent to giving the relevant document legally binding status. The only difference is that where a document is a general administrative practice the Tax Office will be able to change that with retrospective effect where the practice has been exploited or been the subject of tax avoidance.*

The IGT then went on to make the following recommendation:

Key recommendation 4

The Inspector-General recommends that the Tax Office:

- *seeks independent legal advice on the meaning of the term 'general administrative practice';*
- *ensures that this advice also deals directly with the types of documents the Inspector-General has raised with the Tax Office during the course of this review as being potential candidates for 'general administrative practice', as well as situations where no formal ATO document refers to the alleged practice;*
- *issues further guidance to its staff on the meaning of the term 'general administrative practice' following the receipt of the independent legal advice; and*
- ***publicly confirms in this guidance that, subject to the independent legal advice, all documents which the Tax Office refers to as 'precedential ATO views' in PS LA 2003/3, together with all its publicly available practice statements, represent its 'general administrative practice' for the purposes of the income tax laws. [our emphasis]***

We note that the ATO only agreed to the first three bullet points in its response to the IGT report.

The Professional Bodies consider that, absent an acknowledgement by the ATO in the Draft TD along the lines of bullet point 4 above, the Draft TD will not provide the requisite level of certainty needed by taxpayers and their advisers.

This is because the lack of clear guidelines on the meaning of the phrase 'general administrative practice' as evidenced in the Draft TD creates uncertainty and additional compliance costs for taxpayers, especially in the SME sector. These costs would arise for instance from seeking to establish whether a general administrative practice exists or not (if indeed possible on the information available to the taxpayer and/or its advisers) or whether the taxpayer should seek a private binding ruling ("PBR") on a particular issue (thereby incurring further costs).

This is because, as the IGT correctly notes in the IGT Report:

... if there is a Tax Office document dealing with this issue which is not a public ruling but is something which amounts to a 'general administrative practice', this document will give the taxpayer benefits (in the form of protection against the payment of penalties, interest and possibly prior year tax) that will in many cases be almost as

good as that of a private binding ruling. Hence the taxpayer may not actually need to incur the costs in terms of time and money of obtaining a private binding ruling on the relevant topic.

We are disappointed therefore, that the ATO has not decided to accept that all the following types of documents represent the ATO's 'general administrative practice':

- publicly issued practice statements;
- publicly issued binding rulings;
- draft public rulings and other publicly issued rulings;
- ATO Interpretative Decisions;
- decision impact statements; and
- documents listed in the ATO's Schedule of documents containing precedential ATO views.

<http://law.ato.gov.au/atolaw/htmlfile.htm?fileid=atoviewsch1&title=Schedule%20of%20Documents>

If accepted this would alleviate a considerable amount of uncertainty around whether a general administrative practice existed or not.

1.2 IGT second report

More recently, the IGT revisited the difficulties for taxpayers and their advisers in establishing whether a 'general administrative practice' exists or not in his report entitled "Review into delayed or changed Australian Taxation Office views on significant issues" of March 2010 ("IGT second report"). In particular:

4.14 *The ATO's position is that a GAP generally requires a habitual or customary adoption of a view in multiple cases of which the Commissioner is aware and accepts by administering the law consistently with that practice. This means that:*

- *establishing ATO acceptance of a GAP requires consideration of all relevant circumstances. At the very least, existence of the practice needs to be made clear to the ATO (and made with a purpose of eliciting a response from the ATO with respect to the asserted practice) and the ATO continued to administer the relevant law consistently with the relevant practice.*
- *public statements of how the Commissioner intends to administer the law may help to evidence a GAP, but are not enough in themselves to establish a GAP (notwithstanding potential indications to the contrary in paragraph 3.130 of the explanatory memorandum to the Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005 — as set out above). What is needed is evidence that the view has been serially applied — that is, a repeated application of the view to taxpayers' affairs needs to be established.*

4.15 *This view is confirmed by the AGS legal advice.*

4.16 This view raises significant practical difficulties in establishing whether a GAP exists or not.

4.17 *Firstly, on the above view, it is extremely difficult for taxpayers to definitively determine whether a GAP exists or not. They may not know if that practice has been applied by the ATO widely or not. Even if their adviser may be aware, their adviser is prevented by the secrecy provisions from adducing the requisite evidence. Also, the ATO itself may not know if a GAP exists because the IGT has observed in other reviews that the ATO does not consistently record which precedential decision it applies in making interpretative decisions in advice products, audits and disputes (see for example, agreed action item in Chapter 4 of the IGT's report on the Review*

into Aspects of the Tax Office's Settlement of Active Compliance Activities: Report to the Assistant Treasurer).

- 4.18 *Secondly, the above view requires a relatively high hurdle to be cleared in establishing whether the ATO is aware of, and accepted, a practice adopted by taxpayers. For example, the AGS legal advice indicates that a GAP could be established where senior ATO officers are made aware of the industry practice on successive occasions with the purpose of eliciting a response as to whether the ATO accepts the industry practice. However, a GAP will not be established where the ATO is aware of the practice, but does not agree with the practice. **On the face of it, this view may appear to give clear guidance on whether a GAP exists or not. This ATO view raises significant practical difficulties in determining whether a GAP exists, and if so, at what point in time it does.** [our emphasis]*

The Professional Bodies consider that the Draft TD does not assist taxpayers and their advisers in determining whether these hurdles have been cleared and providing a level-playing field in many circumstances. As submitted above, this situation would be improved if the ATO decided to accept that the types of documents listed in section 1.1 represented the ATO's general administrative practice.

1.3 Perception of inconsistency between paragraphs 4 and 34

Paragraph 4 in the Ruling section of the Draft TD states that a:

... general administrative practice is not established by mere silence by the Commissioner, a failure to issue a ruling or provide other public advice or guidance in relation to an issue, or delay in providing such advice or guidance where a taxpayer practice is under review.

Paragraph 34 in the Explanation section of the Draft TD however, states that:

... the Commissioner could not simply avoid responding to relevant matters drawn to the ATO's attention and then argue that the practice is therefore not accepted. If, for example, a practice was drawn to the attention of the ATO's most senior employees on successive occasions with the purpose of eliciting a response from the Commissioner as to his/her acceptance of the practice, the Commissioner might be found to have accepted the practice if he/she failed to respond in any way but continued to administer the relevant tax laws consistently with the relevant taxpayer practice.

On first reading these paragraphs a perception of inconsistency arises - for example, in paragraph 4 "silence" by the Commissioner" is stated as not being capable of establishing a general administrative practice whereas in paragraph 34 a failure "to respond in any way" (i.e. silence) is acknowledged to be a possible way in which a general administrative practice can arise.

We believe that any perceptions of inconsistency between these paragraphs could be dispelled if paragraph 4 was revised along the following lines:

4. *A general administrative practice is not established by:*
- (a) mere silence by the Commissioner;*
 - (b) the mere failure to issue a ruling or provide other public advice or guidance in relation to an issue; or*
 - (c) a mere delay in providing advice or guidance where a taxpayer practice is under review.*

1.4 More Examples are needed

We believe that more Examples are needed, preferably in the Ruling section of the Draft TD, to show advisers and taxpayers when the ATO will/will not regard a general administrative practice as having being established.

Drawing from the IGT second report, further Examples might include the ATO's view on the following situation:

- 4.19 *Take the following scenario for example (which is based on conduct seen in the examples raised with the IGT). New law may have been enacted and a small number of taxpayers applied for private rulings on particular arrangements that involved this new law. ATO officers follow the technical decision-making requirements of escalating the applications to the ATO's Centres of Expertise because there is no ATO precedential view. A precedential ATO view is formed and documented in a published ATOID and favourable rulings are issued. Other taxpayers entered arrangements on the basis of this view also; however, they did not apply for rulings given the time and costs involved. They relied on the view in the ATOID. They thought that until the ATO withdrew the ATOID, ATO officers would continue to be directed by the Commissioner to apply that view in materially similar circumstances. Several years later one of the taxpayers sought to enter a materially similar arrangement and sought another private ruling. This time the ATO escalated the ruling application to the tax counsel network (TCN) realising that a different conclusion may likely be reached this time, largely because of a new ATO view in another area of the law which impacted its thinking on how the relevant provision should apply. The ATO alerted the relevant industry to its potentially adverse view during a consultative forum meeting and sought community input. Months later the ATO advised that it was involved in discussions with Treasury seeking policy clarification. A year after alerting the industry to a potential new view, the ATO advised the industry that a draft public ruling was to issue shortly.*
- 4.20 *In examining the certainty that taxpayers have in relation to subsequent ATO active compliance action, on one view one could argue that a GAP existed up until the time the ATO advised the industry of its potentially adverse view. The ATO has arguably accepted the taxpayer practice because the ATO was made repeatedly aware of the practice in private rulings and was expected to respond as to whether the ATO accepted that practice. The ATO gave favourable private rulings and did not alert taxpayers to its potential adverse view until several years later.*
- 4.21 *On an alternative view, one could also argue that the ATO never accepted the practice. Firstly, according to the ATO's legal advice, public statements about how the ATO intends to administer the tax laws (such as ATOIDs) do not establish a GAP unless there is other evidence that indicates customary or habitual ATO administration consistent with the view expressed in the public statement. Secondly, 'senior officers' were not made repeatedly aware of the practice, only the relatively lower level officers (the Centres of Expertise) received and considered the ruling applications — once the relatively more senior TCN officers were made aware of the practice they were involved in an internal dialog on the technical issue and once they concluded that their view was likely to be adverse (albeit taking some time) it was communicated to the community. Thirdly, the explanatory memorandum to the Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005 indicates that a small number of single private rulings will not evidence a GAP (this is likely due to the risk framework that the legislation provides for the private ruling system — a trade-off between providing timely certainty on the application of the tax laws to a private ruling applicant while at the same time limiting the ATO's risk of giving incorrect advice to a single case). However, evidence of a significant number of uncontradicted private rulings on an issue over time may evidence a GAP.*

4.22 *On this alternative view, therefore, there was no GAP. This means that those who obtained private rulings would be protected under the binding advice framework. However, those that relied on the ATOID would be exposed to subsequent adverse compliance action.*

1.5 Lack of clarity on core concepts remains

For the sake of completeness, the Professional Bodies wish to flag that the relationship between concepts such as “general administrative practice”, “general guidance” and “legally binding advice” continue to be not as clear as they should be.

As a summary of these issues, we have included in the Appendix an excerpt from the submission by the Institute of Chartered Accountants in Australia to the IGT’s *Review of the Tax Office’s administration of public binding advice* dated 19 December 2007.

APPENDIX

Excerpt from submission by the Institute of Chartered Accountants in Australia to the IGT's *Review of the Tax Office's administration of public binding advice* dated 19 December 2007 (footnotes omitted)

The relationship between concepts such as “general administrative practice”, “general guidance” and “legally binding advice”

Only public rulings confer legal protection on taxpayers who choose to rely upon them and these are the only form of “legally binding advice”. However, somewhat confusingly, the Commissioner extends this protection to taxpayers who rely on other publicly issued rulings to which he regards himself as administratively bound.

Advice in other products and publications is not legally binding. However, taxpayers who apply the law in accordance with the Commissioner's general administrative practice or a publication in writing approved by the Commissioner (unless labelled non-binding) should be legally protected from penalties and interest. Such taxpayers do not need to rely on the Commissioner's discretion to remit all or part of the penalties or interest that might otherwise be imposed. Accordingly, knowing when something falls within either of these categories is important for taxpayers.

What constitutes the Commissioner's general administrative practice is also relevant as a public ruling that relates to a scheme does not apply to a taxpayer if a scheme has begun to be carried out when the ruling is published and the ruling changes the Commissioner's general administrative practice (section 358-10 of Schedule 1 of the TA Act).

Statements contained in a publication approved in writing by the Commissioner (unless labelled non-binding)

There is a myriad of information published on the Tax Office website, other than public rulings and other publicly issued rulings which are legally or administratively binding on the Commissioner. Some of that information clearly outlines the level of protection it is intended to confer.

For example, the recent fact sheet entitled “Share capital tainting” makes clear that it is intended to be binding. It states “The status of this fact sheet will provide users with protection from interest and penalties where a person reasonably relies in good faith on the statements in the publication.”

Similarly, draft public rulings usually carry the following or similar words:

You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the way explained below. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

In a similar vein, ATO Interpretative Decisions (ATO IDs) say:

If you reasonably apply this decision in good faith to your own circumstances (which are not materially different from those described in the decision), and the decision is later found to be incorrect you will not be liable to pay any penalty or interest. However, you will be required to pay any underpaid tax (or repay any over-claimed credit, grant or benefit), provided the time limits under the law allow it. If you do intend to apply this decision to your own circumstances, you will need to ensure that the relevant provisions referred to in the decision have not been amended or repealed. You may wish to obtain further advice from the Tax Office or from a professional adviser.

To the extent that publications on the Tax Office website are silent as to the level of protection they provide, such publications should protect taxpayers who rely upon them from penalties and interest under sections 284-215 and 361-5 of Schedule 1 of the TA Act. This should be the case notwithstanding that such publications may predate the ROSA changes.

We would like to see the Commissioner publicly confirm our interpretation in this regard. This is particularly desirable as PS LA 2001/4 "Provision of written advice by the Australian Taxation Office" indicates that income tax publications are general guidance only (see paragraph 49). We assume that, despite this practice statement being described as rewritten in TR 2006/1011, a rewrite is in progress (presumably as ID 1300 on the Law Administration Practice Statements Program) as the practice statement is clearly out of date.

It would be helpful to stakeholders for the Commissioner to publish one document that clearly indicates what particular documents represent and what level of protection they afford taxpayers who rely upon them. This should include general publications on its website which are currently silent as to the level of protection they afford. In addition, existing documents should be updated as a matter of priority to eliminate existing confusion.

The Commissioner's general administrative practice

The EM to Tax Laws Amendment (Improvements to Self Assessment) Act (No 2) 2005 describes what constitutes general administrative practice as follows:

- 3.130 General administrative practice will usually be established by the ATO having communicated consistently to a wide range of taxpayers on a particular issue. A general administrative practice is usually adopted for the efficient administration of the taxation system and will often be documented in a Law Administration Practice Statement, General Administration Law Administration Practice Statement, an ATO policy document (eg, the ATO Receivables Policy), or other precedential material (such as an ATO Interpretive Decision). An example is Law Administration Practice Statement PS LA 2003/8 which sets out the rules developed to lessen the cost of accounting for low cost assets for taxpayers carrying on a business. Where a draft public ruling represents the Commissioner's only public statement on an issue, the draft ruling will usually represent the Commissioner's general administrative practice.
- 3.131 A general administrative practice is not established merely because there are several similar private rulings on a matter, although evidence of a significant number of uncontradicted private rulings on a matter over time will tend to support such a conclusion. Similarly, a bare failure by the Commissioner to take some action within his power does not establish a general administrative practice, but a repeated failure to exercise that power after the issue is drawn to the Commissioner's attention will tend to do so. Again, mere silence or failure to issue a public ruling on a matter does not constitute general administrative practice, but it will be established where, following identification of an issue, ATO officers have accepted it as the basis on which taxpayers should treat the issue in a range of situations.

It is worth noting that the EM indicates that precedential material, such as ATO IDs and draft rulings, may reflect the Tax Office's general administrative practice. However, precedential material also represents statements in publications approved in writing by the Commissioner.

In the context of protection from penalties and interest, nothing turns on this distinction. Protection is afforded to taxpayers who rely on statements in approved publications or the Commissioner's general administrative practice.

However, whether a statement in a publication approved in writing by the Commissioner also represents the Commissioner's general administrative practice is relevant in the context of section 358-10 of Schedule 1 of the TA Act. This is because if a public ruling is published which changes a general administrative practice relied upon by a taxpayer, the ruling cannot

apply retrospectively to the taxpayer's detriment. In effect, a taxpayer would obtain de facto protection from primary tax as a result of relying on the Commissioner's general administrative practice.

In TR 2006/10 dealing with the public ruling system, the Tax Office adopts the view that precedential material, such as ATO IDs and draft rulings, represents the Commissioner's general administrative practice - but only if the view contained therein is supported by other evidence of a pattern of Tax Office treatment of the issue. We do not agree that the words in the EM support the Commissioner's view in respect of published information that, by its nature, amounts to consistent communication to a range of taxpayers on a particular issue. This is particularly the case where the published information is precedential material tax officers are generally required to follow. Indeed, there is a clear statement in the EM that if a draft public ruling represents the Commissioner's only public statement on an issue, it will usually represent the Commissioner's general administrative practice.

Curiously, an earlier version of PS LA 2003/3 dealing with precedential ATO view 12 described ATO IDs and draft rulings for penalty protection purposes as reflecting the Commissioner's general administrative practice but the current version describes them as publications approved in writing by the Commissioner. This suggests that the Commissioner has himself changed his views on whether these precedential documents reflect his general administrative practice.

Even if the Commissioner's interpretation of what constitutes general administrative practice as set out in TR 2006/10 is correct, we are concerned at how it has been applied in practice. Perhaps the most cogent example of this is the Tax Office's refusal to accept that TR 2006/2 "Income tax: deductibility of service fees paid to associated service entities: Phillips arrangements" and the associated guidance booklet does no more than supplement IT 276 "Payments to service companies: splitting of professional income".

The Institute remains of the view that this is not the case and that the general administrative practice of the Commissioner was to accept arrangements where a mark up was determined in line with Phillips case. As a consequence, TR 2006/2 and the guidance booklet should have applied prospectively for all taxpayers.

We are aware from the Inspector-General's "Review of Tax Office's management of complex issues – Case study on service entity arrangements" that the Inspector-General agrees with this view and disapproves of the methods employed by the Commissioner to "sidestep" this issue by denying that he has changed his general administrative practice and, in any event contending that as any change is contained in the guidance booklet as opposed to TR 2006/2, section 358-10 does not apply.

We predict that this will continue to be a fruitful area for dispute between the Tax Office and stakeholders unless something is done to address what the Inspector-General describes as "the systemic weakness in relying on Tax Office fairness and objectivity to provide access to the principle, protections and provisions of a changed general administrative practice".