



Submission

Draft PS LA: When the Australian Taxation Office will not take action to apply its view of the law in past years or periods

Issue date: 09 August 2010

Taxpayers Australia (TA) responses to Consultation Issue 1 and Consultation Issue 2, as detailed on pages 8 and 14 of the draft PS LA respectively, are set out below.

Consultation Issue 1

In relation to Consultation Issue 1, TA submit that “the extent to which the Tax Office has relied on material not available to taxpayers generally (for example Treasury files and discussions) with respect to its new/clarified view” is a relevant criterion for the Commissioner to consider in determining whether to only take action to apply the Tax Office’s view of the law prospectively.

Our detailed comments in relation to Issue 1 are contained in Appendix 1.

Consultation Issue 2

In relation to Consultation Issue 2, TA submit that additional examples should be included in the final PSLA:

- Examples which clearly illustrate circumstances which entail a changed view and circumstances which entail a mere clarification of an established view.
- The impact of a landmark court decision on the Commissioners approach; for example: refer to comments regarding the application of the “Bamford principles” in practice statement PSLA 2010/1.
- Examples illustrating what constitutes “general administrative practice” (general administrative practice), including illustrations of what might not constitute general administrative practice.
- Examples of deviations from a general administrative practice which would warrant retrospective application.
- Examples of deviations from a general administrative practice which would not warrant retrospective application.
- Specific examples regarding what constitutes a “reasonable timeframe”.

Our detailed comments in relation to Issue 2 are contained in Appendix 2.

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Appendix 1

1. TA submit that “the extent to which the Tax Office has relied on material not available to taxpayers generally (for example Treasury files and discussions) with respect to its new/clarified view” is a relevant criterion for the Commissioner to consider in determining whether to only take action to apply the Tax Office’s view of the law prospectively.
2. We have set out below detailed commentary in support of this contention.

Application of the purposive approach

3. In the comments accompanying Issue 1, the Tax Office contends that it applies “the **purposive approach** to the interpretation of the law which has regard primarily to the words of the relevant provisions read in the light of the scheme of the Act and the objects of the provisions [emphasis added]”.
4. *Commissioner for Railways (NSW) v. Agalianos* (1955) 92 CLR 390 established judicial authority in respect of the purposive approach. In the judgement, Dixon CJ noted that “the context, the general purpose and policy of a provision and its consistency and fairness are surer guides to its meaning than the logic with which it is constructed”.
5. The Tax Office has recently demonstrated a reliance on the *Agalianos* guidance, in its draft Taxation Determination TD 2010/D2 (citing the High Court in *Project Blue Sky Inc v. Australian Broadcasting Authority* [1998] HCA 28). If the Tax Office agrees that the context, purpose and policy of a provision are fundamental to the correct interpretation of the provision in question, then the extent of its reliance on anything that contributes to the Tax Office’s understanding of that context, purpose and policy, even if it is confidential in nature, is integral to its final view of the law.
6. Treasury advice on the purpose and object of the provisions would necessarily be an integral part of the purposive interpretation process.
7. On this basis, the Tax Office’s assertion that it “does not consider that this is a matter that is relevant in determining whether to only take action to apply its view of the law on a prospective basis” cannot be supported. The extent to which relevant confidential material was relied upon does contribute, whether by taking action based on the material or by omitting to act on the material, to the Tax Office’s final view. It is therefore a relevant matter in determining whether the Tax Office’s publicised view of the law has changed to an extent that necessitates prospective-only application.

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For example, if the change in viewpoint is significantly due to confidential Treasury information regarding the purpose of a provision, then the Commissioner is obliged to take into account the fact that taxpayers did not have access to the same information.

8. If the Tax Office does not rely on the confidential information, then that non-reliance should also be taken into account. For example, retrospective application may be justified for a position that is changed based only on publicly available information. A “perceived” change, where the perception is due to taxpayers not knowing of the existence of certain information, may not warrant retrospective application even if the change is perceived rather than actual.

Addressing taxpayer perceptions of unfairness

9. The Inspector General of Taxation (IGOT) concludes in his report (para 5.7) that:

.....the overarching aim of the Commissioner’s exercise of his power of general administration should be the fair and reasonable treatment of taxpayers by striking an appropriate balance between:

- *protection for taxpayers where the Tax Office has facilitated or contributed to formation of taxpayer views which are inconsistent with subsequent Tax Office views; and*
- *preventing a laissez-faire situation where any position could be arguably justified on a particular area of uncertainty before the Tax Office releases its formal view.*

10. The IGOT report more generally advocates for the exercise of the Commissioner’s power to be subject to improved processes that “instils greater public confidence” (see para 5.9).

11. The IGOT report (for example, para 5.6) identifies “**perceptions** of unfair Tax Office treatment [emphasis added]” as a key problem for the Tax Office in respect of its retrospective application of a changed (or clarified) view of the law.

12. Regardless of whether there is any **actual** unfairness, so long as unfairness has been perceived, public confidence in the Tax Office’s due process is diminished. From the taxpayer perspective, the “overarching aim” of “the fair and reasonable treatment of taxpayers” as identified by the IGOT is compromised by the presence of perceived unfairness. Therefore, the Tax Office should seek to mitigate the perception of unfairness in its design of the process for deciding whether the Tax Office view of the law should only be applied prospectively.



13. TA contend that the identified problem of perceived unfairness would be addressed, at least in part, if the Tax Office indicates (through the PS LA) that it will seek to support its future positions with its use of confidential information (where relevant) even if the nature of the information cannot be revealed.
14. It would also improve the transparency of the Tax Office's decision-making process if it is revealed that confidential material was relied upon (or not relied upon) in making the decision. The IGOT identifies transparency as a desired characteristic of the decision-making process in relation to retrospective application (para 5.9). Arguably, transparency is not optimised if a key aspect of the Tax Office's change of view or clarification of an existing view is omitted from the decision-making process in relation to the retrospective application of that changed or clarified view.
15. If the extent of reliance on confidential information is listed as a criterion for the consideration of Tax Office officers, then taxpayers may have comfort that the Tax Office will take into consideration the fact that taxpayers did not have access to the same information and also that the Tax Office may have a credible (even if unidentified) basis for a perceived change in viewpoint.
16. The draft PS LA (para 13) reiterates the Tax Office position, first expressed in PS LA 2008/3, that if the Tax Office departs from a precedent administratively binding advice for reasons other than legislative change, its default position is to apply the view on a prospective-only basis unless "particular circumstances warrant another approach". This suggests that the Tax Office bears the onus of justifying retrospective application of a view of the law. If the Tax Office decides not to take the default position, such a decision should be made with regard to all relevant factors, including the extent to which confidential information was relied upon. For example, significant reliance on information that was not available to the general public may mean that the circumstances do not "warrant another approach" if it is deemed unreasonable that taxpayers could have interpreted the law in the same way.

The extent of reliance on confidential information is integral to forming a view

17. If the use or non-use of certain material had been instrumental to the change or clarification of the Tax Office's view of the law in a particular matter, then the extent of reliance on that material should be a factor in deciding whether retrospective application of the Tax Office's revised stance is necessary.
18. It is a factor of no less importance than, for example, the Tax Office not previously challenging an established industry practice (see subpara 31(a)(i)), the existence of a previous general administrative practice (see subpara 31(a)(iii)) or whether affected taxpayers have taken reasonable care in adopting a legally meritorious view of the law (see subpara 31(b)).

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19. Therefore, it should be taken into consideration that taxpayers would not have had access to the confidential information. To take this into consideration would necessarily entail the inclusion of the extent of Tax Office reliance on that information in the Tax Office's decision-making process in relation to whether to apply the current view of the law prospectively only. Otherwise, taxpayer awareness or ignorance of relevant matters would not be taken into account.
20. The IGOT report (at para 5.9) believes more action should be taken to ensure that decisions involving the exercise of the Commissioner's power of general administration "are guided by clearly stated principles, with reference to considerations that are clearly relevant". It is beyond contention that the extent to which the Tax Office relied upon pertinent material is a "consideration" that is "clearly relevant" in deciding whether to apply the current view of the law retrospectively. This consideration should be included in the factors listed at para 31 of the draft PS LA which represents the "clearly stated principles" with regard to which a decision in respect of retrospective application is to be made.

Consistency in approach

21. The IGOT recommendation for the Tax Office to include the extent of its reliance on material not available to taxpayers generally in its consideration of whether retrospective application of its new or clarified view is warranted is accompanied by a non-exclusive example of "Treasury files and discussions".
22. Using the example of confidential Treasury advice relating to a statutory provision's purpose or object, the Tax Office choosing to use this information (or choosing not to use this information) in applying the purposive approach to interpretation is, in substance, no different to the Tax Office relying on (or not relying on) the contents of publicly available information such as ExplanTax Officery Memoranda.
23. A recent example is the Taxation Ruling TR 2010/3 relating to unpaid present entitlements. The taxpayer community considered that the views expressed by the Tax Office in this ruling constituted, in large, a significant "u-turn" on previously established positions. The ruling entailed what was widely perceived to be a change of viewpoint and included retrospective application in some aspects, it is incumbent upon the Tax Office to identify the sources of its revised position.
24. In para 31 of the ruling, the Tax Office refers to a statement of the purpose of Division 7A contained in an ExplanTax Officery Memorandum in support of its view. Presumably, had the legislative object been contained in a confidential Treasury document and not in a publicly available ExplanTax Officery Memorandum and the Tax Office had relied on the Treasury document to formulate its view, the public

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should be made aware that the Tax Office used this information in the same way that TR 2010/3 advised of the information contained in the ExplanTax Officery Memorandum.

Further, the Tax Office have apparently placed little or no emphasis on the report of the Board of Taxation ("Taxation of Discretionary Trusts") which was adopted by the government of the day, when the Tax Office approach to TR2010/3 was finalised. It is submitted that this information should be made clear to taxpayers.

25. Presumably, the extent to which the Tax Office relied on or did not rely on publicly available information such as statements contained in ExplanTax Officery Memoranda would be taken into account in considering the other relevant factors in para 31 of the draft PS LA. For example, the incorporation of publicly available information in previously issued Tax Office statements on how to apply the law (see subpara 31(a)(ii)), the influence of such information in forming a general administrative practice (see subpara 31(a)(iii)) or in deciding whether affected taxpayers have taken reasonable care in adopting their view of the law (see subpara 31(b)).



Appendix 2

1. Other examples that TA recommend should be included in the final PS LA are outlined below.

2. Recommendation: that the PS LA includes examples which clearly illustrate circumstances which entail a changed view and circumstances which entail a mere clarification of an established view.
 - 2.1. The IGOT report para 5.6 identifies that the overarching problem comprises the “tensions that underlie the perceptions of unfair Tax Office treatment”, being taxpayer reliance on the Tax Office’s administration of the law at the time that taxpayers relied on that Tax Office conduct.
 - 2.2. Examples included in the PS LA should address these perceptions. This would include clearly illustrating circumstances which constitute the Tax Office changing its view and differentiating from circumstances which constitute a mere clarification of a previously and publicly established view.
 - 2.3. The inclusions of such examples would assist in treating the perception problem identified in the IGOT report. Strengthening taxpayer awareness regarding what are “clarified views” that are likely to warrant retrospective application and what are “changed views” that may not warrant retrospective application would improve taxpayer certainty in relation to the perceived fairness of the Tax Office’s chosen approach to the particular issue.

3. Recommendation: that the PS LA includes examples which illustrate the impact that a landmark court decision has on the retrospective application of a revised interpretation of the law.
 - 3.1. The High Court decision in *Bamford* is a recent example.
 - 3.2. The Tax Office issued its intention to withdraw a number of public rulings and determinations as a result of its view of the *Bamford* decision. In particular, the Tax Office has withdrawn pronouncements upon which taxpayer’s have typically relied in prior years, including the PS LA 2009/7: Taxation of capital gains of a trust and Taxation Ruling TR 92/13: Income tax: distribution by trustees of dividend income under the imputation system.
 - 3.3. The respective withdrawals of the pronouncements officially take effect from the beginning of the 2010-11 income year.

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- 3.4. However, the new PS LA 2010/1 clearly states that, in respect of prior year assessments, where there is “a deliberate attempt to exploit Division 6..... or cases are selected for other reasons (for example, because there is a dispute about the quantum of the [tax] net income), and adjustments are to be made, **the adjustments must be made on the basis of the law as explained in Bamford** [emphasis added]”.
- 3.5. This directive from the Commissioner is provided in PSLA 2010/1 notwithstanding an instruction that Tax Office staff should not select cases from the 2009-10 or earlier income years for active compliance just on the basis that taxpayers may have complied with their income tax obligations on the basis of views that may be considered “wrong” in light of the High Court *Bamford* decision.
- 3.6. The latter directive that active compliance actions should only be taken on a prospective basis indicates that the Commissioner considers the Tax Office views formed post-*Bamford* to be significantly “changed” from its previously held views that retrospective application on a default basis is not warranted.
- 3.7. Yet, where prior year cases are selected for “other reasons”, Tax Office compliance officers are permitted to make adjustments that adopt the post-*Bamford* view of the law even where the taxpayer’s position was previously an acceptable interpretation of the law. The approval of retrospective application suggests that the outcome of the Court decision and the withdrawals of public rulings are tantamount to a “mere clarification” of the Tax Office view of the law. The assertion that there has been a “mere clarification” of the Tax Office view is not credible.
- 3.8. This submission does not consider the validity or otherwise of retrospective application of the Tax Office’s post-*Bamford* interpretation of the law. Rather, the concern is that the inconsistent approaches allowed will add unnecessary taxpayer uncertainty at a time during which taxpayers already must adapt their tax and financial affairs to the post-*Bamford* view of the law.
- 3.9. The PS LA should include pertinent examples to illustrate how (and whether) such a situation is consistent with the directives provided in the PS LA.



4. Recommendation: that the PS LA includes examples illustrating situations which constitute “general administrative practice” and the various outcomes that may arise from a deviation from a general administrative practice.

- 4.1. A proposed “relevant factor” for Tax Office officers to consider whether the Tax Office’s current view of the law should only be applied prospectively is:

*The extent to which the Tax Office has facilitated or contributed to taxpayers’ adopting a view of the law (which may result from an industry practice or position), including whether..... a **general administrative practice** supporting the taxpayer or industry practice or position can be deduced from other Tax Office conduct (draft PSLA subpara 31(a)(iii)) [emphasis added].*

- 4.2. The term “general administrative practice” is not defined in the draft PS LA. Given that the concept is fundamental to the relevant factor noted at subpara 31(a)(iii), it is important that the finalised PS LA includes examples that illustrate the facts and circumstances that may form a general administrative practice.

- 4.3. The examples should also illustrate the types of deviations from the general administrative practice which would warrant retrospective application of the Tax Office’s current view of the law and the types of deviations from the general administrative practice which would not warrant retrospective application.

- 4.4. TA note that paras 73 and 74 of Taxation Ruling TR 2006/10 provides some principles for identifying situations where a general administrative practice is not necessarily established. Examples to be included in the PS LA may be based on these principles, using practical case studies.



5. Recommendation: that the PS LA includes more specific examples regarding what constitutes a “reasonable timeframe”.

- 5.1. A proposed “relevant factor” for Tax Office officers to consider whether the Tax Office’s current view of the law should only be applied prospectively is:

*The extent to which the Tax Office has facilitated or contributed to taxpayers’ adopting a view of the law (which may result from an industry practice or position), including whether the Tax Office became aware of the taxpayer or industry practice or position (eg. through compliance activity) but **did not challenge it within a reasonable timeframe** (draft PSLA subpara 31(a)(i)) [emphasis added].*

- 5.2. Example 4 in the draft PS LA provides one practical example in relation to a “reasonable timeframe”.

While this example is useful, it would be constructive to include more illustrations of what may constitute a “reasonable timeframe” in differing contexts. For instance, Example 4 denotes that a period of 5 years is not considered to be within a reasonable timeframe. In the fact scenario used in Example 4, what period of time would not constitute a reasonable timeframe? What would be reasonable timeframes under other circumstances?