Australian Government
Inspector-General of Taxation

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GPO Box 551
Sydney NSW 2001

Our reference number: [redacted]

19 October 2018

Ms Helen Petaia
[redacted]

By email only to: [redacted]

Dear Ms Petaia,

RE: IGT VIEWS

1. I refer to the above matter in which you had raised a complaint with our office for investigation concerning:

   - the Commissioner of Taxation's opening statement in the 30 May 2018 Senate Estimates hearing;
   - the Deputy Commissioner of Small Business' 1 June 2018 email to you that was sent in response to an email that you had sent to the Commissioner regarding his opening statement; and
   - the potential for the ATO's General Counsel to have a conflict of interest in this complaint.

2. In making your complaint, I understand that you have sought, as specific outcomes, retractions of the Commissioner and Deputy Commissioner's statements and apologies as well as the IGT's view on the potential for the General Counsel to have a conflict of interest in this matter.

3. To assist with the expedited resolution of this matter, the IGT's views regarding the Commissioner's opening statement and the role of the ATO's General Counsel are set out separately in Attachment A. The ATO has already provided its response to these views. Its response is set out in Attachment B to allow its comments to be read in the full context in which they were presented.

4. To provide transparency of the investigatory process, we have set out below an outline of the steps taken in our investigation. A summary of relevant events is set out next which

provides context for specific statements made by the Deputy Commissioner in her 1 June 2018 email as well as the IGT's views on these statements.

BACKGROUND

5. By way of background, your experience with the ATO was referenced in the media and featured in an ABC television program, *Four Corners*, in April 2018. While the Commissioner did not appear on that program, he did make comment regarding it in his opening statement during Senate Estimates on 30 May 2018. You had responded to these comments via correspondence sent to the Commissioner directly and the Deputy Commissioner replied to you on the Commissioner's behalf via an email sent on 1 June 2018.

6. You approached the ATO, our office and Parliament to formally raise complaint. The IGT commenced a complaint investigation on 6 July 2018. As part of the process for the investigation, a meeting was scheduled for 18 July 2018 with ATO officers who were responsible for assisting IGT officers with their inquiries.[1] At the meeting, our understanding of your concerns was explained, the ATO's views were discussed and the IGT's process for the investigation was set out. As part of this process, ATO officers were also asked to provide the IGT with pre-existing documents, and/or details of such documents on the ATO's systems, so that such material could be independently verified, regarding three statements made by the Deputy Commissioner in her 1 June 2018 email to you. These three statements are identified in the following extract from the Deputy Commissioner's email:

> … The Commissioner has asked me to respond to you, as the Deputy Commissioner Small Business, in relation to the concerns you have raised about his opening statement at the recent Senate Estimates hearing.
>
> … the ATO absolutely stands by the statements the Commissioner made.
>
> … As you would be aware, there are aspects of your case that have not been covered in the media. For example, [Statement 1:] the fact that your R&D claim was originally rejected due to lack of substantiation; [Statement 2:] that the ATO had asked for documents substantiating your R&D claims; and, [Statement 3:] that the substantiation was only obtained when ATO officers visited your premises…

7. In response to the IGT's information request, on 24 July 2018, the ATO provided Siebel case notes and reference IDs to documents that were held on the ATO's systems. IGT officers accessed the ATO's systems to independently verify the documents and analyse the factual material. As part of this process, on 10 August 2018, we provided the ATO with the IGT's views (as set out in Attachment A) and gave opportunity to consider the facts before the views were finalised.

8. The ATO provided a response on 28 August 2018 (set out in Attachment B) and suggested that the IGT consider the issues in light of the broad range of events in this matter as the "Deputy Commissioner … statements in her email to Ms Petaia … were merely a very small part of those many interactions, and with respect we consider that you are putting too much stock in them."[2] In fairness to this response, the IGT considered

[1] Note: Prior to that meeting, the ATO's General Counsel advised in writing that parliamentary privilege would apply to the Commissioner's opening statement on 30 May 2018 (see Attachment B for more details).
[2] See Attachment B, p 7

that regard should be had to the wider range of relevant interactions to ensure that views were formed with an appreciation of the range of interactions, that were relevant to the subject matter of the Deputy Commissioner's identified statements, as well as the context in which those interactions took place.

9. On 31 August 2018, IGT and ATO officers discussed the issues and IGT officers asked for clarification of certain facts, including that the ATO confirm whether the facts that the ATO had provided on 24 July 2018 were the facts that the Deputy Commissioner had relied upon in making the three identified statements and that the ATO provide the contemporaneous records/documents which contained those facts.

10. A response to this request was provided to the IGT on 4 September 2018. However, the ATO's response did not provide the confirmation that had been requested. The request was re-iterated on 5 September 2018. On 7 September 2018, the ATO responded by identifying an email, which was sent by a tax agent to an ATO officer in October 2014, that was referred to by officers in briefing the Deputy Commissioner. Relevant extracts of these written communications are set out in Attachment C.

11. As part of the investigation process, IGT officers also reviewed the ATO systems for information that evidenced the range of interactions that were relevant to the subject matter of the three identified statements, for independent assurance purposes. IGT officers also contacted you to provide you with opportunity to comment on particular interactions and to provide corroborating documentation. Accordingly, a more expansive chronology of relevant events and interactions (which is set out in Attachment C) was compiled and analysed.

12. On 26 September 2018, the IGT provided the ATO with opportunity to comment on its updated view and more expansive chronology, as a matter of procedural fairness in ensuring all of the relevant facts regarding your complaint were identified and considered. At the request of the ATO, on 4 October 2018, senior IGT and ATO officers discussed the matter to better understand the updated view and its basis as it had provided facts regarding the audits, and related analysis, which had not been previously raised to the attention of more senior ATO officers. The ATO intended to provide the IGT with a further response and would conduct its own forensic analysis to verify the facts set out in Attachment C.

13. The ATO provided its further response (reproduced in Attachment D) on 10 October 2018, together with an amended version of Attachment C which included ATO representations and comments regarding the events and interactions to allow the IGT to finalise the complaint with "a full appreciation of all of the circumstances associated with the matter" as "much of this information [was] not previously accessed by" IGT officers. These representations and comments have been reproduced in a separate document for readability purposes (Attachment E). The IGT asked the ATO to provide the relevant source documents or ATO system reference numbers for its representations and comments for IGT verification purposes. Such source material was provided and accessible to IGT officers on 15 October 2018, who then independently accessed ATO systems and documents to verify the ATO's representations and comments. The IGT's consideration of these representations and comments is provided in Attachment E and any resulting inclusions to Attachment C are identified as "tracked changes" for transparency purposes.

14. The following summary is drawn from the facts and representations that are set out in Attachment C and provides the context for the IGT's final views that follow. For a full and complete appreciation of the relevant events in support of the IGT's conclusions and views, regard should also be had to Attachment C, together with the cited evidence from which the facts are drawn.

SUMMARY OF RELEVANT EVENTS

15. After a life threatening experience for both yourself and your son, you established Safe Family Cards Australia Pty Ltd (SFC) in 2004 and developed an emergency contact device known as "Emergency Scan ID". It involved a method to safely store vital personal information that may be needed in an emergency situation. This included medical information and emergency contact details to alert medical staff to pre-existing medical conditions before they started stabilising the patient.

16. With a view to maximising profit by being the first to market with such a device, Vital One Technologies Pty Ltd (VOT) was established in May 2010 to attract investors as well as to complete the needed research and development (R&D) before commercialising the product. SFC initially held the shares of VOT and moved its business premises to Loganholme in Queensland after VOT was established. By March 2011 both companies had moved to business premises in Murrajong Street, Springwood. SFC had also sold 30% of its shares to investors and then remained as a holding company of VOT.

17. Both companies had engaged registered tax agents who specialised in the R&D Tax Concession (R&D Consultants) to ensure that the companies held the appropriate documentation that was needed to appropriately support R&D registration with AusIndustry as well as the records to substantiate tax offset claims, including those made in the 2009–10 and 2010–11 financial years. These R&D Consultants were engaged in addition to the accountants who acted as tax agents for the companies. Although VOT initially engaged the same tax agent as SFC, it engaged a different tax agent from June 2012.

18. In early 2011, VOT had attracted investors, established a Board with an independent Chairman and retained an operations manager. You continued to focus on intellectual property, IT and business development activities. Towards the end of 2011, a plan was formulated to launch the product and raise capital from the market in 2013 which would be used to fund staff needed for further growth in Australia and market the device overseas.

19. In November 2011, the ATO had identified SFC's R&D tax offset claim during a compliance risk project as a large amount of this tax offset had been claimed and there was little reported income. The ATO's project team posted a letter to SFC asking for its R&D documentation so that they could assess whether there was a risk of non-compliance. The letter was sent to SFC's old business address and not the postal address that had been nominated by SFC and recorded on the ATO's systems at that time. As no response was received from SFC, the ATO selected it for audit.

20. Initial ATO inquiries commenced in August 2012 and an ATO auditor (accompanied by a second auditor) attended the premises of SFC's tax agent in September 2012. The auditor also requested documents by email and telephone. These documents were provided to him. Following analysis of the documents, the auditor informed SFC and

VOT that the ATO had decided to audit both companies' R&D tax offset claims by verifying transactions for the 2010–11 financial year. An interview was scheduled to take place on 18 December 2012 at 'the taxpayer's premises' which the auditor had thought was located on Pacific Highway in Loganholme. The operations manager for VOT alerted the auditor to the fact that he had the wrong address and this was noted by the auditor on the ATO's audit files. The business was located on Murrajong Road in Springwood.

21. Before the 18 December 2012 interview, VOT's operations manager asked to meet the auditor to advise him of VOT's plans. The ATO auditor recorded on the ATO's systems that the operations manager's "concern was that the potential buyers may be 'put off' by the prospect of an ATO audit on the [company]". Leading up to the 18 December 2012 interview, VOT's operations manager engaged with the ATO auditor to understand what was needed and prepared the relevant documents in anticipation of that meeting. During this process, an error was identified with a line item on SFC's tax return regarding your superannuation, which was salary sacrificed. SFC intended to lodge an amendment to correct the error and SFC's tax agent asked that the audit of SFC be postponed. The auditor agreed to do so.

22. Five hours before the interview on 18 December 2012, the auditor sent an email that specified particular documents that he needed, including the companies' R&D Plans as well as their R&D and income tax working papers. The interview was conducted by the auditor, accompanied by a Case Leader (an experienced compliance officer who provided oversight on audits for technical issues), and he obtained a number of documents and samples of the product being developed. His file note of that interview included:

> I proceeded to ask for copies of documents relevant to the case. The documents were produced. There was some questioning about business set up and operating processes. The responses given were detailed….

23. At the end of the meeting, it was understood that if the auditor needed any further documentation from VOT he would ask and that he would be in contact to recommence the SFC audit once he was ready to do so. There is no record on the ATO systems that identifies which documents the auditor had viewed and/or taken. A number of documents relating to VOT's R&D activities was uploaded onto the ATO's system some seven months later in June 2013. However, it cannot be verified that these were the total sum of documents that had been obtained by the auditor at the interview. There is also no record that the auditor had asked for any further information from VOT or that he had recommenced the SFC audit.

24. The auditor did not do any further work on the audit after this interview as he took leave. He also failed to attach to the two audit case files any of the documents he had obtained at the interview at that time. VOT's representatives left messages on his voicemail. He only responded once, which was in February 2013 to advise VOT that it could lodge its current year income tax return. As a result, VOT lodged its 2011–12 income tax return which included an approximate [redacted] R&D tax offset claim. The ATO paid the full amount as a refund.

25. An ATO Case Leader did send an email to VOT in April 2013 to advise that the audit finalisation date was extended. VOT replied to this email and stated that unanswered messages had been left on the auditor's voicemail. There is no record that the Case Leader

responded or alerted VOT to the auditor's unavailability or the fact that she had been asking for the audit to be re-allocated. The records show that ATO management had declined to reallocate the audit at that time (April 2013). No notification of this was made to VOT by the ATO.

26. More than six months after the auditor's interview with VOT, the ATO re-allocated the audit to a second auditor. Letters were posted to notify SFC and VOT of the new auditor and her contact details in July 2013. However, once again, the ATO's letters had been sent to the old business addresses of the companies. These addresses were used despite the ATO systems having a record of the correct addresses at the time and despite the first auditor's file note that the old business addresses were incorrect. These letters, posted by the ATO, were not received by VOT or SFC.

27. Meanwhile, VOT's representatives continued their attempts to contact the first auditor, however, their messages were left unanswered. When they did get in contact with someone from the audit area, VOT's representatives were told that they did not work in the same office as the first auditor and to leave him a message.

28. When the second auditor did attempt to contact VOT's representatives in late August 2013, the ATO files indicate that she attempted to contact SFC's tax agent to seek information regarding SFC's proposed amendment and details of the sale/transfer of information to VOT. The file notes indicate that two days after this attempt she got a hold of SFC's tax agent to advise them that the previously requested information was required urgently. A file note of the third call to SFC's tax agent was made on the ATO audit files, advising SFC's tax agent that a determination would be made in the case if the information was not provided within 6 days. There is no record that these requests were confirmed in writing. A senior ATO officer later advised that only 2 voicemail messages were left and a brief phone conversation was conducted with SFC's tax agent. There is no record that the second auditor attempted to contact VOT or its representatives.

29. SFC's tax agent had believed that the audit of its 2010–11 R&D tax offset claim had been postponed until further notice and, therefore, thought that the caller had confused SFC with VOT. The ATO records indicate that, notwithstanding the fact that the audit cases were linked to the same Case Leader since its commencement, any auditor confusion may be explainable by reference to the audit case notes (e.g. entered on 7 August 2013). These case notes indicate that the second ATO auditor would have had only two business days to review the case files for the two audits before attempting the phone calls. An internal ATO 'case review' of the auditor's progress in the cases was also scheduled to take place on the day that the auditor's first call was made to SFC's tax agent.

30. SFC's tax agent told VOT's operations manager of the call when the latter had returned from leave. VOT believed that all information that the ATO had requested had already been provided. In any event, VOT's operations manager left unanswered messages on the first auditor's voicemail as no contact details were provided by the second ATO auditor during her call.

31. The second auditor, then, also went on leave and the case was allocated to a third auditor. The auditor's manager (the Case Manager, an officer who manages the 'flow' of work that a team of auditors conduct) completed the finalisation letter for the SFC audit, which was based on a position paper that had been started by the second auditor but without the benefit of testing her views with the taxpayer. The audit conclusions in this letter were,

generally, that all R&D tax offsets were 'disallowed' on the basis that the taxpayers had 'failed to provide adequate and sufficient evidence'. The third ATO auditor had used substantially the same wording in the finalisation letter for SFC, despite both companies having different arrangements and representatives. Based on the wording of the relevant documents, their editing times as well as their timing relative to other events, it appears that the third auditor did not adequately check the wording provided to him by the Case Manager against the records in the audit files to ensure their accuracy. The third auditor also disallowed SFC's total R&D tax offset for the 2009–10 financial year which was a period that was outside of the communicated scope of the audit. There is no record on the ATO audit files that indicates any decision to expand and/or recommence the scope of the SFC audit. In fact, the ATO's systems continue to show that the scope of SFC's audit was for the 2010–11 financial year.

32. VOT, SFC or their representatives were not given any notice of the ATO's views before the amended assessments. These amendments raised an approximate total amount of [redacted] in tax liabilities against VOT and SFC. Although the ATO may issue amended assessments to taxpayers without notice, where it has reasonable grounds to do so, for example a reasonably based apprehension that the taxpayer will dissipate assets, there is no suggestion that the auditors believed that there was any such risk in this case.

33. When VOT's tax agent became aware of the amended assessments in mid-November 2013 and the basis on which they were made, they immediately contacted officers in the ATO audit area to request review of the decisions on the basis that VOT had not been asked to provide further documentation and had not been provided opportunity to respond to the ATO's position before amendments were issued, which was contrary to the ATO's stated practice. SFC also asked for review as it had not been notified that any audit had recommenced and was surprised that amendments had issued for the 2009–10 financial year which was not previously identified by the auditors as being subject to review. VOT and SFC's requests for review were declined and, as you explained to us, so were their requests to discuss the matter with more senior officers.

34. In November 2013, VOT had reached a critical stage in its plan to raise capital. When VOT became aware of the ATO's amendments, its capital raising partner (Tauro Capital) believed there was no possibility of raising capital until the matter with the ATO could be resolved—'The risk to investors was too great and the [proposed capital raising] offer was tainted.' You explained that you had assured VOT's Board that the appropriate advice had been received and relied upon in obtaining the relevant government registration and in complying with the relevant reporting of R&D Tax Concession obligations. For weeks after receiving the amended assessments, you unsuccessfully attempted to secure the ATO's agreement to review the audit decisions and escalate the matter to more senior officers. In response, the ATO's audit area told you to lodge objections instead.

35. It is important to understand that the usual tax objection process does not apply to audit adjustments that reduce refunds for R&D tax offsets claimed in the 2009–10 and 2010–11 financial years. The ATO must issue a 'section 73IA(1) notice' to provide a taxpayer with the right to object to such adjustments. If no such notice is issued, the only means to reverse such ATO audit adjustments is through informal review. In this case, no section 73IA(1) notices were issued and the companies' requests for informal review were declined.

36. Also, you were initially advised that an objection had to be lodged within 60 days of the amended assessment and that the companies would 'only get one shot' at the objection. Specialist advice was needed for the R&D issue. However, at that time, the R&D consultant they had previously used was unavailable and her former business partner (also an R&D specialist) was on holiday until the end of January 2014. Then, just before Christmas, the third auditor confirmed that the companies would have two years in which to lodge objections and that the objections would also stay any ATO debt collection action. Forms were lodged in December 2013 and again in February 2014 in an attempt to start the objection process, as it was thought that further information could be provided once the R&D consultant was available.

37. In any event, you considered that, according to the ATO's expected timeframe for determining objection decisions (56 days), an objection decision would take too long to reverse the effects that the amended assessments had on the company. VOT would need to generate cash flow through other means than capital raised. Having started the objection process, you explained that you then focused your energy on 'crisis control' and generating revenue to retain VOT's contractors as it was considered critical to VOT's survival.

38. In late January 2014, the ATO rejected VOT and SFC's objection application. The application was considered invalid as it only sought an extension of time. Some assistance was obtained from the R&D consultant when he returned from overseas, however, VOT would be unable to engage him to do the work until April 2014. VOT lodged an objection in February 2014 and 27 days later the ATO asked for further information. Throughout this period, you had persisted in seeking an informal review of the audit decisions. On 28 March 2014, these requests were also declined. As a result, work was started to collate documents for an objection. Over the next 18 days, VOT's operations manager worked to pull together documentation and provided regular updates to the ATO's objections officer. However, the officer declined requests to extend the time-frame past mid-April 2014. Although it was initially resisted by you, VOT and SFC agreed to withdraw their objection and re-lodge at a later time.

39. You have explained that at this time that, in addition to efforts to generate cash flow for the business, efforts were focused on the threatened legal action [redacted]

40. The ATO recommenced active debt recovery and, in July 2014, issued a garnishee notice on VOT's bank account. The ATO's debt area was advised that the amended assessments were in dispute and that objections would be lodged when they could do so, as they had 2 years in which to lodge it. VOT could not afford to hire an R&D specialist at that time. VOT's tax agent had agreed to work pro bono but, as she was not a specialist in R&D claims, she needed time to better inform herself about the requirements.

41. The ATO personally served on you in October 2014 a statutory creditor's demand that required payment of SFC's debt of [redacted] within 31 days. As a result, you once again began contacting officers in the ATO audit area. You managed to establish contact with the second auditor who had now returned to work. You requested all the audit documentation and expressed dissatisfaction with how the audit was conducted.

42. The second auditor raised your request with a Director in the Small Business and Individual Taxpayers business line (the SBIT Director). Within days, the SBIT Director had made some internal inquiries and considered that there may have been shortcomings with the audit process. He quickly made arrangements to suspend the ATO's debt recovery action, pending an informal review. He instructed a Case Leader (the same one that had attended the December 2012 interview) and an auditor (the 'ATO reviewers') to verify VOT and SFC's documentation for the 2010–11 financial year.

43. The ATO reviewers attended the companies' business premises on 20 November 2014, verified the companies' documentation and concluded that VOT and SFC had sufficient documentation to substantiate the amount that the companies had originally claimed in their 2010–11 income tax returns, minus an approximate [redacted] which was due to an 'inadvertent error' made by one of the tax advisers. Although you expressed your willingness to have SFC's documentation for the 2009–10 financial year reviewed, you were concerned with the time that such a review would take as SFC's electronic records for that year were stored on a laptop which had since crashed, many archived items had gone missing in the office moves and office gear stored in your garage was damaged by flooding in January 2011. However, the invoices of many of the consultants that the ATO reviewers had already verified in their review of the 2010–11 year were used by SFC in that year and SFC had also relied on the same R&D Consultant that VOT had used in 2010–11. You explained that had the ATO communicated to you that the 2009–10 year was subject to audit before the 18 December 2012 audit meeting, then the preparation of those documents would have been actioned when the companies were resourced to do that, alongside the preparation of the 2010–11 records for both companies.

44. The Case Leader also recalled later that at the time they:

> therefore worked on limited records provided for 2010 and based on findings of records provided for VOT which was the continuation of SFC. We decided that on examination of the records we did have, looking at the relevant accounts and our overall satisfaction with VOT records that we would accept the claims for SFC. We were comfortable that the project [Ms Petaia] was pursuing was genuine so it became a judgement call on whether to accept the extent of the R&D claims declared which we did. To some extent this was concessionary but we felt justified in making our decision based on all the factors we had to consider and the documents we had seen.[3]

45. SBIT Director agreed and by February 2015, the ATO had reversed the auditor's adjustments to give effect to the ATO reviewers' conclusions, with the exception of the approximate [redacted] that was due to an inadvertent error.

46. In 2016, VOT also sought and received informal 'approval' from AusIndustry and the ATO for VOT to lodge its R&D tax offset claim for the 2012–13 financial year. The resulting [redacted] refund had the effect of extinguishing the approximate [redacted] that had remained from the review adjustments.

47. An ATO Assistant Commissioner has provided you with an oral and written apology. He has also telephoned the Board of VOT directors to assure them that the amended assessments did not reflect on your integrity but were a result of shortcomings with the ATO's audit process.

[3] Reviewing Case Leader email to the SBIT Director, 29/09/2015

48. Compensation for defective administration was claimed under the CDDA scheme. The initial ATO CDDA decision maker, in June 2015, concluded that the audit delay and auditors' failure to realise that significant information had already been provided to the ATO amounted to defective administration:

> 67…. Based on this, the audit outcome was flawed and resulted in a taxation debt of [redacted] being added to the SFC account and [redacted] to the VOT account.
>
> 68. Absent the errors, the most likely audit outcome would have seen SFC's R&D claims accepted in full and VOT's R&D claims adjusted from [redacted] to [redacted] (difference of [redacted]) and a penalty of 25% for lack of reasonable care [redacted]
>
> 69. That is, your adjusted assessments would have had you owing [redacted] instead of [redacted]

49. However, this initial decision maker also considered that SFC had difficulties in substantiating the R&D claims for the 2010–11 year:

> Given the email exchange between [VOT's operations manager and the ATO's objections officer] …, it is clear that you had difficulties substantiating your SFC R&D claims for the 2010-11 Financial year…. My understanding from talking to the audit area is that because of the issues you incurred from the audit process, as a 'good faith gesture', they did not insist on the evidence normally required. They used the documents provided for the alternate audited financial year as support for your claims.
>
> 100 …We accepted the R&D claims for SFC for the 2010-11 financial year, even though you had no documentation to support these claims.[4]

50. It should be noted that there is no record that the review did not verify the documentation for the 2010–11 year. However, you did not request IGT investigation of the ATO's CDDA decisions or actions relating to settlement discussions. Accordingly, these matters were not considered.

IGT VIEW

51. Based on the above understanding of the many interactions between you and the ATO, we provide our view on the identified three statements that were made by the Deputy Commissioner in her 1 June 2018 email. For clarity, these statements are reproduced below:

> [Statement 1] the fact that your R&D claim was originally rejected due to lack of substantiation;
>
> [Statement 2] that the ATO had asked for documents substantiating your R&D claims; and,
>
> [Statement 3] that the substantiation was only obtained when ATO officers visited your premises.

52. The ATO had advised the IGT that, in making the above statements, the Deputy Commissioner had relied on an email that was referred to by ATO officers in briefing her following the ABC television program. This email was sent by VOT's second tax agent on 22 October 2014 to an ATO officer who was the Case Leader for the relevant audits that were conducted over the August/September 2012 – December 2013 period. The email purports to "demonstrate that information to substantiate the claim was outstanding in 2014 …. The email demonstrates that substantiation occurred post-2012."

[4] ATO, CDDA decision letter for SFC, 17/06/15, para 67-68, 90, 100

The ATO referred to the following statement that was made by VOT's tax agent in the email:

> I met with [Ms Petaia] and [VOT's operations manager] and it was clear almost immediately that one of the most important pieces of information we need to be able to provide in the Objection is substantiation as to how the R&D claim has been calculated. This information was not supplied to your officers during the audit and [Ms Petaia] and [VOT's operations manager] simply do not have these details as they are part of the working papers of the R&D Consultants used for this process.

53. When the email is read in its entirety, in the IGT's view, it is clear that the tax agent's reference to 'substantiation' in the email is a reference to a particular calculation in the R&D Consultants' working papers. This calculation was conducted by using an ATO "approved calculation spread sheet relating back to the 2011 year" which is no longer available on the ATO's website.

54. The tax agent ends the email by asking the ATO for assistance — ie. to provide the ATO "spread sheet" or "calculator" as they were unable to obtain the working papers from the R&D Consultants due to their dissolution, amongst other things. There was urgency in doing so as the tax agent had stated that "we still need to be in a position to lodge the Objection by 31 October 2014" which was understood to be the date that the ATO's debt collection action would recommence if an objection was not lodged.

55. A copy of the ATO's 'spread sheet' was requested because the calculation that was conducted by VOT's tax agent (using figures drawn from the companies' source documents which had been used in the income tax return's preparation) had resulted in a figure which was approximately [redacted] different to that calculated by the R&D Consultants in 2011. It was thought that the R&D Consultants' figure may have resulted from an error embedded in a formula within the ATO's 'spread sheet', hence the request. We have not identified any record that the ATO had provided a copy of that 'spread sheet' in response to the tax agent's request.

56. Later in this email, the tax agent states that there is a "clear paper trail to support this process but [that they] need the details on the calculations used at the time to identify what breakdown was used to calculate the claim". The 'breakdown' was the apportionment percentage that was applied to certain expenses and represents the proportion of employees' work activities that are attributable to R&D activities, based on taxpayers' records of such activities. The percentage applied to employees' salary expenses is applied to administrative expenses.

57. In this case, when the ATO reviewers later verified the companies' documentation, they confirmed that the apportionment percentage applied to salary expenses was correct, however, for an inexplicable reason, the same percentage had not been applied to the administrative expenses. This 'inadvertent error' had resulted in an approximate [redacted] difference in the amount of the R&D tax offset that was claimed from what the ATO reviewers had concluded.

58. Importantly, the email indicates that all documentation regarding the substantiation of expenses was available. On this basis, in the IGT's view, the 22 October 2014 email was seeking to identify the cause of the 'inadvertent error', and was not an admission that no documents could substantiate any of the claims.

59. The ATO has also offered other material in support of the Deputy Commissioner's statements, however, it has declined to confirm that the material was relied upon in making those statements. Some of that material is set out below:

> … Notices of audit dated 7 November 2012 to [redacted] [who acted as both VOT's operations manager and SFC's General Manager] outline the records that would be required for the audits into both companies. Please refer to document ids [redacted] for VOT and [redacted] for SFC.
>
> Some documents were obtained by the ATO at the 18 December 2012 interview, but not all that was required.
>
> In late August 2013 file notes were created for both companies. The most complete version is attached to SFC. The notes indicate that an auditor spoke with the agent for SFC on 22 and 26 August 2013 regarding the requirement to provide to the ATO the outstanding information relating to both companies. The auditor was advised that [redacted], the director of both companies, had the information and was then on leave. Our records indicate that the agent was advised that if the information was not received by 29 August 2013 a determination would be provided on the basis of the information already held by the ATO.
>
> … The reasons for decisions attached to the 29 October 2013 and the 7 November 2013 notices of the finalisation of the audits indicate that at the time of the decisions, the ATO did not consider that the companies had provided 'adequate and sufficient evidence' to support the R&D claims. Please refer to document ids [redacted] for SFC and [redacted] for VOT.
>
> An email chain indicates that an objection officer advised [redacted] on 18 March 2014 that the ATO did not have enough information to adequately address the objections for both companies, and further information was requested. Extensions to the time frame for providing the requested information were sought by [redacted] on 27 March 2014, 9 April 2014 and 14 April 2014. On 15 April 2014 the objection officer advised that he was unable to provide further time, but instead suggested that the companies withdraw the objections and resubmit when they had 'the required substantiation'. [redacted], after consulting with Ms Petaia, indicated that they would adopt this suggestion 'to take a little more time to ensure that it is completed correctly', and referred to 'both [VOT and SFC]'. Please refer to document ids [redacted] for SFC and [redacted] for VOT.[5]
>
> … Emails between an objection officer and [redacted] in March and April 2014 indicate that, at that time, information to substantiate the relevant claims had been requested, but had not been received. Whilst the objection stage post-dates the audit stage, the latter information is relevant to what information was available to the ATO when the audits were finalised.
>
> … [The] Deputy Commissioner … was not referring to the earlier meeting on 18 December 2012, [but was referring to a meeting between ATO officers and the companies on company premises on or about Thursday 20 November 2014, during the 'review' of the audits]. We acknowledged in our earlier response to you on 24 July 2018 that the companies provided 'some' documents to the ATO at the 18 December 2012 interview, 'but not all that was required'. At this stage, the claims had not been substantiated.
>
> We are of the view that a comment to the effect that substantiation for the R&D claims was only obtained around about the time of a meeting between the ATO and company representatives in November 2014, when the audits were being reviewed, is in no way inconsistent with a file note indicating that some information was provided to the ATO in December 2012. If the claims had been fully substantiated in December 2012, the audits would have concluded then or shortly thereafter. The fact that the audits continued and resulted in amended assessments further suggests that the R&D claims had not been substantiated at the time of the conclusion of the audits. Any comment to the effect that substantiation for the R&D claims was only obtained at a later date than December

[5] ATO letter to VOT, 12/11/15, para 4

> 2012, where the earlier meeting took place, is neither unreasonable nor in all of the circumstances wrong.
>
> … In paragraph 33 you refer to the fact that the companies were not afforded the opportunity to respond to a position paper that had been produced prior to the finalisation of the audits. As we indicated in a previous IGT investigation, we do not resile from the fact that this was a departure from normal audit practices and procedures. In any event, we do not see the relevance of the position paper issue to your investigation into [the] Deputy Commissioner['s] ... comments.
>
> … It is also important to note however that [the] Assistant Commissioner['s] … apology post-dates November 2014, when the companies provided the ATO with sufficient documentation to, in the ATO's view at that time, substantiate the R&D claims. Whilst we agree that the apology makes it clear that a full examination of source documents did not occur during the audit process, it does not follow from the apology that the ATO was provided with sufficient documentation to substantiate the R&D claims during the audit process. It is the ATO's view that this did not occur until November 2014, and this is consistent with the words in the apology 'the results of the review confirm the legitimacy of making the claim for the Research and Development concession'. Prior to this time, the claims had not been substantiated.

60. The above ATO response outlines the ATO's position and the facts on which they are based. However, these facts do not reflect the weight of evidence that is set out in Attachment C. For example, the above ATO response states that [redacted] was a director of both SFC and VOT, however, ASIC records show [redacted] was not a director of VOT or SFC during or after the ATO's audit. The above ATO response infers that the amended assessments were due to a failure to substantiate the R&D claims 'at the time of the conclusion of the audits'. However, a senior ATO officer had previously concluded that the audit outcome was "flawed" due to his view that "the new officer did not realise that [SFC] had already provided significant information relevant to the audit, even though this information was available to her in the case notes." Furthermore, he was of the view that the auditor had "made an erroneous assumption that the ATO had provided clear and consistent requests for additional evidence to support the R&D claims, but received no response from SFC. This assumption was incorrect. The ATO had never requested additional information." "Absent the errors… the adjusted amendments would have had (SFC) owing [redacted] instead of [redacted]."

61. In the IGT's view, the accuracy and appropriateness of the three identified statements should be considered in the context of the range of interactions between the companies' representatives and the ATO, particularly the following:

    a. At the time of the lodgement of the relevant tax returns, SFC and VOT had engaged a registered tax agent who specialised in R&D tax claims (the R&D Consultants) to ensure that the companies complied with their obligations in making R&D tax offset claims, including the substantiation requirements for such claims. This engagement was in addition to the tax agents that the companies had already retained and who lodged the income tax returns on the companies' behalf.

    b. In December 2012, the first ATO auditor had specifically identified documentation that was needed to be produced at the 18 December 2012 interview, including the R&D Plans and the R&D and income tax working papers – of which the above calculation (referred to in the 22 October 2014 email) was a part. His file note of the interview states that the documents that he asked for were produced. There is no record that he requested any further documentation. He also did not raise any concerns when provided opportunity to do so in responding to VOT's February 2013 request to lodge

its 2011–12 income tax return, which included a substantial claim for the R&D tax offset.

c. The Case Leader who attended the 18 December 2012 interview was the same Case Leader who later oversaw the review of the audit in November 2014. This review verified SFC and VOT's substantiation (or as the SBIT Assistant Commissioner later described it: "confirm(ed) the legitimacy of making the claim") for all but $12,000 of their claims for the 2010–11 year (which was the stated scope for the audits). As the Case Leader was selected to conduct the review, it would be expected that he would have had a level of proficiency in auditing R&D tax offset claims and, on this basis, would have been expected to alert the auditor to any deficiencies in his information gathering at the 18 December 2012 interview. There is no record that he had any such concerns.

d. The ATO officers who reviewed the audit in November 2014 verified that the documentation which VOT and SFC had in their possession was sufficient to substantiate their claims (except for the [redacted] that the ATO had identified as an 'inadvertent error').

e. The initial ATO CDDA decision maker concluded that the original audit outcome was "flawed" as, amongst other things, the "new officer did not realise that [SFC] had already provided significant information relevant to the audit, even though this information was available to her in the case notes". Furthermore, the auditor "had made an erroneous assumption that the ATO had provided clear and consistent requests for additional evidence to support the R&D claims, but received no response from SFC. This assumption was incorrect. The ATO had never requested additional information."

f. From mid-November to late March 2014, representatives of VOT and SFC had asked a number of ATO officers on a number of occasions for informal review of the audit decisions. These requests were declined and, instead, ATO officers in the audit and objection areas advised VOT and SFC to lodge objections. As the ATO's amendments were made to a refundable tax offset in the 2009–10 and 2010–11 financial years, there was no legal right of objection, unless the ATO issued the taxpayers with a section 73IA(1) notice. Where these notices are not issued in such cases, informal review of the audit decision is the only practicable avenue open for taxpayers to challenge such decisions. In this case, the ATO did not issue s.73IA(1) notices to SFC or VOT and had declined requests for informal review of the audit decisions until November 2014, which was 12 months after the amended assessments had issued.

g. You have provided reasons why VOT and SFC's representatives did not provide documentation to the ATO over the December 2013 – October 2014 period. When the ATO's amendments were issued and the companies' requests for informal review were declined, there appeared no quick means to correct the shortcomings of the audit which, as a result, would 'put off' potential investors in any raising capital. Accordingly, efforts were directed to the company's survival, as a priority, by seeking to generate cash flow.

h. Absent the audit errors, there has been no question raised regarding the bona fides of SFC, VOT or its representatives. They had continued to seek engagement with the ATO and communicate transparently during the audit and when objections were

lodged. The ATO has also paid refunds for all the R&D claims made by SFC and VOT — for the claims that ATO officers have verified and for the 2011–12 financial year that the first ATO auditor did not raise concerns with as well as for VOT's claim for the 2012–13 year, which was made with the ATO's knowledge and informal 'approval' in 2016. The latter resulted in an approximate [redacted] refund.

i. The question of whether a claim is "substantiated" does not depend on an audit or objection decision or the satisfaction of an ATO officer. Under the tax laws, claims are substantiated by taxpayers having the required records of events, transactions and/or documents. An ATO audit or objection decision may "verify", in the ATO's view, whether the taxpayers' claims are substantiated. A suggestion that such an ATO decision is required before a claim may be considered as 'substantiated' is a suggestion that, by logical extension, displaces the appellate role of the AAT and Federal Court in tax cases.

62. In summary, it appears reasonable to conclude that VOT and SFC, at the relevant times, did have possession of documentation that substantiated their claims to the satisfaction of:

a. their R&D consultant and registered tax agents, at the time of lodging the companies' income tax returns;

b. (in relation to VOT) the ATO's first auditor and Case Leader, at the time of the 18 December 2012 audit interview; and

c. the ATO reviewers in November 2014 (with the exception of the 'inadvertent error' in VOT's 2011 claim).

63. Had the audit been completed in a manner that was expected by the ATO, it is likely that the audits would have concluded by mid-2013 on the same basis as that which was reached by the ATO reviewers in November 2014.

64. The history of a series of unfortunate events in this matter, as acknowledged by the ATO's earlier apologies for the audit process and acknowledgement of defective administration, speak sadly of a number of opportunities that were missed, both during and after the audit.

65. It was not until the matter was brought to the attention of a senior ATO officer in November 2014 that action was taken quickly to review the audits and reverse the decisions. The SBIT Director and his Assistant Commissioner should be commended for their proactive and quick response. Such action demonstrates the aims of the Commissioner's published vision for the ATO. Unfortunately, however, the details of the case were brought to their attention far too late.

66. As an overall observation, this case evidences a recurring pattern of ATO officer behaviour — those who are *new* to this case repeat the same inaccuracies that other officers had voiced without appropriate due diligence and analysis regarding the range of facts and interactions that have taken place in this matter.

67. In the IGT's view, the three identified statements made by the Deputy Commissioner, as a new officer to this case, do not accurately reflect the range of interactions and evidence in this matter, that have been set out above and in Attachment C.

68. Accordingly, on 26 September 2018, the IGT recommended to the ATO that the statements be retracted and an apology be offered.

69. You have provided us with a copy of a letter, dated 11 October 2018, that Second Commissioner Andrew Mills had sent to you (reproduced in Annexure 2). In that letter, amongst other things, he states that he recognises there has been some confusion over exactly what occurred and some miscommunication in the conduct of the audit of your companies, SFC and VOT, and apologised for any impression that the ATO's recent communications with you might suggest that the ATO did not think that such confusion and miscommunication arose. He also sought to assure you that, at the highest levels, the ATO continues to be committed to understanding your concerns and engaging with you in an attempt to provide you with finality in the matter, including an ATO invitation to recommence discussions with you to explore the available avenues to resolve the matter.

70. I trust that this resolves your complaint lodged with our office and acknowledge that you may have additional actions or processes to work through with the ATO. Should you require further assistance regarding complaints in future we remain open to assisting you in that regard.

David Pengilley
General Manager