



**Australian Government**

**Inspector-General of Taxation**

**Taxation Ombudsman**

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13 August 2020

Mr Jason Falinski MP  
Chair  
House of Representatives Standing Committee on Tax and Revenue  
Parliament House  
CANBERRA ACT 2600

Dear Chair

**Inquiry into the Commissioner of Taxation Annual Report 2018-19**

The Inspector-General of Taxation and Taxation Ombudsman (IGTO) appeared before the Committee at a public hearing on 31 July 2020. We provide our answers to three questions that were taken on notice at that hearing in the attached Annexures as follows:

- Annexure A – Cash Flow Boost Complaint information
- Annexure B – International Comparison of Revenue Agency rights to collect disputed tax debts
- Annexure C - Tax profession submissions and concerns about the trends in ATO advice and guidance
- Annexure D – Submission by the Tax Institute to the ATO dated 14 November 2019
- Annexure E -- Submission by the Tax Institute to the Treasury dated 14 November 2019

We trust this information is useful and of assistance to the Committee.

The IGTO thanks the Committee again for the opportunity to participate in this this inquiry and to appear at the public hearing. If we may be of any further assistance to the Committee, please don't hesitate to contact me on [REDACTED]

Kind regards,

[REDACTED]

Karen Payne  
Inspector-General of Taxation and Taxation Ombudsman

## **Annexure A – Cash Flow Boost Complaint Information**

### **Inquiry into the Commissioner of Taxation Annual Report 2018-19**

**CHAIR:** Doesn't it strike you as a bit absurd that I was sent money that I didn't apply for, I then spent that money, because I've been assured that I'm entitled to it, and a month later I'm told I need to repay it and, if I don't, despite the fact that I've now spent it, I will suffer penalties for not doing so?

**Mr YOUNG:** Could I interrupt, Chair. I don't know that this is happening, because there was no eligibility, there was no turnover case. The only people who didn't get it were people who didn't have employees on their books. They wouldn't have got it anyway. It was your activity statement that triggered it, so I can't see how anyone would have to pay that back, because there was no turnover drop. You could be 300 per cent up and still get it. It was purely cashflow for business. There's no eligibility.

**CHAIR:** Is that the case? Why am I getting reports that businesses are being sent these letters?

**Mr YOUNG:** I don't think it's about that, though. As long as your turnover is under \$50 million—that was the only thing.

**CHAIR:** Terry, we'll let the Inspector-General answer that.

**Andrew McLoughlin:** It would be helpful to us if we were able to connect with those who have issues. We are receiving some letters, but it would be good to make sure that we understand exactly what is being provided to members so that we can investigate that more effectively, if that could be agreed with those members—sorry, with those—

**CHAIR:** No-one has raised this with you as a matter of concern?

**Unidentified speaker:** If I could clarify, we have received complaints—

**Ms Payne:** About cashflow boost, where they've been asked to repay it.

**Andrew McLoughlin:** Where they've received a letter which has asked for them to clarify their position. Chair, to go to your initial point about fairness, we'd be keen to see that there are fair outcomes in cases. The law operates as it does; however, the ATO has discretion to achieve fair outcomes. We'd be seeking to ensure that, in the way that they are using their discretionary power, they are seeking those outcomes. We're seeking clarity on their approach.

**Ms Payne:** It would be the case [interrupted]

**Unidentified speaker:** Of course.

**Ms Payne:** If you put yourself in the position of a small business, if you've received money without asking for it and now you're being told you have to pay it back with penalties, I don't see how that could be perceived other than unfair.

**Unidentified speaker:** I'm in agreement.

We understand from the discussion that the Committee is interested to understand whether the IGTO is aware of or has received complaints about the following scenarios:

- a taxpayer was automatically paid the Cashflow Boost (CFB) without having applied for it; and
- that taxpayer has subsequently been contacted by the ATO requesting they repay the cashflow boost with the potential for penalties to apply due to their ineligibility.

We understand that automatic CFB payments may be made to taxpayers, especially where the taxpayer lodged an income tax return for the financial year ended 30 June 2019.

IGTO has manually reviewed our case management system to identify any cases which may align with the scenario presented by the Committee. We have also examined notes and materials that the ATO has provided to the IGTO as part of its briefings on the administration of COVID-19 support measures. However, as a number of our investigations are still in progress, it is difficult for IGTO to definitively confirm or rule out that we have cases which match this description.

Our further observations are set out below.

### *Executive Summary*

Based on a review of our case management system, we have identified 61 complaints about the CFB.

- 25 of these complaints were resolved directly by the IGTO without the need to commence a formal investigation.
- Of the 36 investigations commenced:
  - 31 relate to cases in which the employer needed to provide additional information to the ATO about their eligibility. The complaints in these cases concerned the timeliness of ATO decision-making or disagreement with the ATO's decision on eligibility.
  - These complaints typically pertain to situations where the taxpayer was required to contact the ATO to provide additional information and considered by the ATO to be ineligible for the CFB. These may raise the scenario contemplated, but it is difficult to confirm definitively;
  - 5 cases related to other matters concerning the CFB.
- We note that not all CFB payments were received automatically.
- A new business or a business that has not lodged a 2019 income tax return would likely have been required to contact the ATO to provide information to demonstrate their eligibility before any initial payment was made.<sup>1</sup>
- Employers who have been found to have participated in a scheme to access or increase their CFB will be required to pay back their CFB and potentially face penalties.

### *Schemes*

Paragraph 5(1)(g) of the *Boosting Cash Flow for Employers (Coronavirus Economic Response Package) Act 2020* provides that an employer is not eligible for the CFB if the entity has entered into or carried out a scheme or part of a scheme for the sole or dominant purpose of accessing the CFB, or increasing the amount of CFB to which they are entitled. Examples of such schemes may include restructuring to become eligible to receive the CFB, resurrecting dormant entities, phoenix activity, and fraudulently reporting inflated Pay As You Go Withholding figures.

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<sup>1</sup> Australian Taxation Office (ATO), *Boosting Cashflow for Employers* (31 July 2020)  
<[https://www.ato.gov.au/Business/Business-activity-statements-\(BAS\)/In-detail/Boosting-cash-flow-for-employers/](https://www.ato.gov.au/Business/Business-activity-statements-(BAS)/In-detail/Boosting-cash-flow-for-employers/)>

The ATO has stated on its website:

*If we find you have entered into or carried out a scheme with the aim of becoming entitled to the cash flow boost, or increasing the amounts of the cash flow boost, you will be required to repay the entire amount back to the Commissioner.*

*Significant penalties and interest charges can apply to overpayments of the cash flow boost arising from schemes. Sanctions under criminal law may also apply to fraudulent claims.<sup>2</sup>*

The IGTO understands the ATO's approach to schemes is to undertake 'pre-issue verification' checks prior to the payment of the CFB to prevent payments going out to entities who have engaged in these types of activities. Where entities may have passed the 'pre-issue verification' and received the CFB, the ATO has identified those with residual risk and flagged them for compliance action<sup>3</sup>.

As part of the ATO's briefings to the IGTO, we have received a number of letter templates relating to the various COVID-19 support measures (Jobkeeper, CFB etc.). We note that none of these templates relate to CFB compliance action.

### *Conclusion*

From the IGTO's understanding of the ATO's compliance approach, it may be possible for employers who were initially paid the CFB to subsequently receive correspondence from the ATO in relation to compliance action, especially if the ATO considers that there is a risk that the employer may have entered into a scheme to access or increase their CFB.

Notwithstanding the above, the IGTO cannot definitively say whether any approaches from complainants represent a class of taxpayer who were initially paid the CFB automatically and were then subsequently the subject of ATO compliance action.

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<sup>2</sup> ATO, *Accessing the cash flow boosts* (31 July 2020) <[https://www.ato.gov.au/Business/Business-activity-statements-\(BAS\)/In-detail/Boosting-cash-flow-for-employers/?page=4#Schemes](https://www.ato.gov.au/Business/Business-activity-statements-(BAS)/In-detail/Boosting-cash-flow-for-employers/?page=4#Schemes)>.

<sup>3</sup> ATO Briefing to the IGTO on Cashflow Boost dated 28 May, p 10.

## Annexure B – International Comparison of Revenue Agency rights to collect disputed tax debts

### Inquiry into the Commissioner of Taxation Annual Report 2018-19

**CHAIR:** Could I talk through the process in Australia versus, say, the UK, the US and, as we heard this morning, New Zealand. When you've had an audit done and the auditor reaches an opinion, which may be that you were overpaid and you owe the ATO money, is it not the case that, in Australian law, versus laws overseas, that opinion in law becomes fact? You can appeal that opinion, but the ATO, from the point that the opinion is issued, is able to collect the money as a debt, whereas, in other jurisdictions, while it is still in contention, it's unable to be collected.

**Ms Payne:** We definitely need to take on notice any position in overseas jurisdictions. I'll confirm with you at the end of this whether you want us to do that. In the Australian jurisdiction, the assessment is it, once the tax office has issued you an assessment, that creates a debt liability. You are then liable to pay that debt. Accordingly, when you've been through an audit process, if the ATO issues you with an assessment saying, 'Your amended assessment is X and you owe this,' that is, as a matter of our tax law, something that creates a debt liability at that point.

**CHAIR:** Even if it is being challenged in court or at the AAT?

**Ms Payne:** Correct.

**Mr Dam:** I just want to add to what the inspector said. In fact, the notice of assessment is, in and of itself, conclusive evidence of the assessment being made and of the amounts included therein. I would also note for the committee's benefit that the Taxation Administration Act has two provisions, sections 14ZZM and 14ZZR, which very clearly state that the commissioner is entitled to pursue recovery, notwithstanding any objections that are on foot and not withholding any legal challenges to the AAT or the Federal Court that might be on foot with respect to that particular assessment.

**CHAIR:** So you could have a situation where you're a small business and you're having an argument about a \$100,000 debt and you're having to pay that debt while also funding the challenge to the debt?

**Mr Dam:** Circumstances such as that could arise. However, it is worthwhile noting that the tax office does have a number of different policies about whether or not debt recovery should be pursued during a dispute, and there are a number of considerations that are taken into account. Secondly, there are a number of discretionary provisions that exist for the commissioner to accept—for example, a fifty-fifty arrangement—as a way to defer recovery until the finalisation of the dispute itself. So, it's not to say absolutely that in all cases the commissioner would pursue recovery where there is a dispute on foot.

**CHAIR:** As I keep saying, I really like our tax commissioner as a person, but I don't know that I'd like the next one as much. He has a lot of discretionary power, which doesn't seem to be a feature of other tax codes around the world in democratic systems similar to ours.

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**Ms Payne:** Would you like us to take on notice and follow up the position in New Zealand, the UK and the US?

**CHAIR:** Yes, and maybe Canada. I don't want to create work for you, but it would be of some interest, I think.

The Inspector-General of Taxation and Taxation Ombudsman (IGTO) has compiled the following general information based on publicly available material for the benefit of the Committee. The IGTO is grateful for the assistance of KPMG International – specifically, the United Kingdom, United States of America and Canada - in providing some references and information that has been included by IGTO in preparing these responses and to Mr Grant Wardell-Johnson, Lead Tax Partner from KPMG Australia, for coordinating information and material provided by KPMG International offices. The IGTO also acknowledges the assistance of Ms Joanne Dunne in compiling the New Zealand materials.

#### **Executive Summary**

In each of the jurisdictions that we have considered at the request of the Committee, we note there is some legislative or other mechanism that defers or restricts debt recovery and collection actions by the relevant Revenue Agency in respect of a tax debt amount where that amount is disputed by the taxpayer. Further details are provided in the comparative table below, but this includes for example:

**Canada** - an assessment is generally deemed to be valid and binding, and thus the collection of the debt thereafter is permitted. However, there are some “Collection Restrictions” (defined) which restrict debt recovery action - for example, income tax debts of individuals and some companies are generally not subject to collection actions if they are contested (a valid notice of objection must be filed).

**New Zealand** - Where a competent objection has been lodged or “challenge proceedings” are commenced (the matter is disputed beyond objection stage i.e. in a court), payment of the tax in dispute may be deferred while the dispute is being resolved.

**United Kingdom** - Where a company does not agree with the HMRC audit conclusions then it can appeal the closure notice and request that any excess tax charged is postponed while the disputed matter continues to be debated with HMRC. The disputed/postponed tax does not become payable until the appeal is finally determined – either by agreement between the company and HMRC, or by a Tribunal/Court.

**United States of America** – An assessment of tax and/or penalty (i.e., when collection efforts may be initiated) may not be made until such time as a determination of the IRS becomes final - which is defined for these purposes. This includes, that the corporation or individual agrees with the IRS's proposed determination of tax and signs a waiver to permit the assessment of tax or where it is disputed, the matter is resolved finally in the Court or Tribunal.

Based upon our research, we observe that the position in Australia is that the Commissioner is given statutory authority to pursue any outstanding taxes, notwithstanding the amounts to be collected may be in dispute. This overarching power is subject to the ATO's own administrative practices which guide its officers

on when disputed tax debt recovery action may be taken<sup>4</sup>. These administrative practices are not enforceable taxpayer<sup>5</sup> or statutory rights. In other jurisdictions that we examined, the position appears to be that there is a statutory and/or enforceable restriction on the recovery of tax debts that are in dispute. There may be exceptions where the Revenue Agency determines there is a risk of debt recovery (eg tax avoidance), but this necessarily reverses the default position (and possibly the onus of proof). In some cases, an order of the court to pursue recovery while disputes are on foot is required (see Canada).

Jurisdiction and Revenue Collection Agency	What creates a tax debt liability that is due and payable? Eg An assessment	Is a disputed tax debt able to be collected (including if it is being challenged in a Court or Tribunal)?
Australia - Australian Taxation Office (ATO)	<p>The law requires tax liabilities to be paid by the due date.</p> <p>An income tax debt arises (which is due and payable) when the Commissioner makes an assessment (<a href="#">s. 5-5 Income Tax Assessment Act 1997</a>).</p> <ul style="list-style-type: none"> <li>▪ For companies (which are full assessment taxpayers) – the tax is due and payable on the first day of the sixth month after the end of the financial year</li> <li>▪ For non-full self assessment taxpayers – the tax debt is due and payable 21 days after the day (the <b>return day</b>) on or before which they were required to lodge an income tax return with the Commissioner.</li> </ul>	<p>The debt remains due and payable even if an objection is lodged or legal proceedings are commenced in a Court or Tribunal. Accordingly, the Commissioner can take legal action to recover outstanding tax irrespective of whether the tax is subject to an objection, review or appeal (<a href="#">DCT v Broadbeach Properties Pty Ltd [2008] HCA 41</a>).</p> <p>This outcome is expressly provided in the legislation – refer sections 14ZZM and 14ZZR of the <i>Taxation Administration Act 1953</i>.</p> <p><b>Section 14ZZM - Pending review not to affect implementation of taxation decisions</b></p> <p><i>The fact that a review is pending in relation to a taxation decision does not in the meantime interfere with, or affect, the decision and any tax, additional tax or other amount may be recovered as if no review were pending.</i></p> <p><b>14ZZR Pending appeal not to affect implementation of taxation decisions</b></p> <p><i>The fact that an appeal is pending in relation to a taxation decision does not in the meantime interfere with, or affect, the decision and any tax, additional tax or other amount may be recovered as if no appeal were pending.</i></p>

<sup>4</sup> Refer Australian Taxation Office, Law Administration Practice Statement (PS LA) 2011/4, *Recovering disputed debts* (26 February 2015) <[www.ato.gov.au](http://www.ato.gov.au)>.

<sup>5</sup> *Macquarie Bank Limited v Commissioner of Taxation [2013] FCAFC 119*.

<p><b>Jurisdiction and Revenue Collection Agency</b></p>	<p><b>What creates a tax debt liability that is due and payable? Eg An assessment</b></p> <ul style="list-style-type: none"> <li>▪ If the Commissioner amends your assessment, any extra income tax resulting from the amendment is due and payable 21 days after the day on which the Commissioner gives you notice of the amended assessment.</li> </ul> <p>Per s. 166 of <a href="#">Income Tax Assessment Act 1936</a> – The Commissioner must make an assessment of:</p> <ol style="list-style-type: none"> <li>a. the amount of taxable income (or that there is no taxable income) of any taxpayer; and</li> <li>b. the amount of the tax payable thereon (or that no tax is payable); and</li> <li>c. the total of the taxpayer’s tax offset refunds (or that the taxpayer can get no such refunds)</li> </ol>	<p><b>Is a disputed tax debt able to be collected (including if it is being challenged in a Court or Tribunal)?</b></p> <p>Where tax is paid and the dispute is resolved in favour of the taxpayer (in whole or in part), the Commissioner will pay interest on overpayments under the <a href="#">Taxation (Interest on Overpayments and Early Payments) Act 1983</a>, in respect of certain types of tax which have been overpaid.</p> <p>Guidance on the ATO’s practice regarding collection and recovery of disputed debts is provided in <a href="#">PS LA 2011/4</a>.</p> <p>The includes a summary of the 50/50 arrangement which the Commissioner may offer a taxpayer.</p>
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Jurisdiction and Revenue Collection Agency	What creates a tax debt liability that is due and payable? Eg An assessment	Is a disputed tax debt able to be collected (including if it is being challenged in a Court or Tribunal)?
<p><b>Canada – Canada Revenue Agency (CRA)</b></p>	<p>An assessment is generally deemed to be valid and binding, and thus the collection of the debt thereafter is permitted – subject to “Collection Restrictions”.</p> <p>Any amount you owe is payable in full as soon as your return is assessed or reassessed. If you do not pay your outstanding debt or contact CRA to discuss payment of the debt, CRA may take legal action to collect the unpaid amount. Until an amount is paid in full, CRA charges daily compounding interest at the prescribed rate.</p> <p>When filing your return, you may have a balance owing. Generally, if this amount is \$2 or less for 2019, you do not have to make a payment.</p> <p>If you owe tax for 2019, and you file your 2019 return after the <u>filing due date</u>, the CRA will charge a <u>late-filing penalty</u>.</p> <p>The CRA will charge daily compounding <u>interest</u> on any outstanding balance starting October 1, 2020, until you pay it in full.</p>	<p>The following information circular provides some relevant background and guidance.</p> <p>Refer Canada Revenue Agency publication - INCOME TAX INFORMATION CIRCULAR NO.: IC98-1R7 (Issued: April 2017) - <i>Tax collections policies</i></p> <p><a href="https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic98-1/tax-collections-policies.html">https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic98-1/tax-collections-policies.html</a> - <i>Unfiled Returns and Refunds</i></p> <p>There are several “Collection Restrictions” which restrict collection and recovery action by CRA.</p> <p>For example, income tax debts of individuals are generally not subject to collection actions if they are contested (a valid notice of objection must be filed). A similar rule applies to corporations – unless they are “large corporations” (i.e. generally assets greater than CAD\$10 million). Large corporations are subject to collection actions on 50% of the amount in dispute.</p> <p><b>Collections restrictions</b></p> <p>There are certain types of legal action that CRA cannot normally start until 90 days after CRA sends a notice of assessment or reassessment.</p> <p>These include:</p> <ul style="list-style-type: none"> <li>▪ starting proceedings in court</li> <li>▪ certifying the amount in the Federal Court under section 223 of the <i>Income Tax Act</i>, section 83 of the <i>Excise Tax Act</i>, section 288 of the <i>Excise Act 2001</i>, or section 88 of the <i>Softwood Lumber Products Export Charge Act, 2006</i></li> <li>▪ requiring a third party who owes a person money to make a payment under subsection 224(1) of the <i>Income Tax Act</i>, subsection 84(1) of the <i>Excise Tax Act</i>, subsection 289(1) of the <i>Excise Act 2001</i>, or subsection 89(1) of the <i>Softwood Lumber Products Export Charge Act, 2006</i></li> </ul>

<p><b>Jurisdiction and Revenue Collection Agency</b></p>	<p><b>What creates a tax debt liability that is due and payable? Eg An assessment</b></p> <p>As long as you file your return by the <a href="#">filing due date</a> and pay by September 30, 2020, the CRA will not charge <a href="#">interest</a> on your balance owing.</p>	<p><b>Is a disputed tax debt able to be collected (including if it is being challenged in a Court or Tribunal)?</b></p> <ul style="list-style-type: none"> <li>▪ requiring an institution or other third party who is lending or advancing a person money to make a payment under subsection 224(1.1) of the <i>Income Tax Act</i>, subsection 289(2) of the <i>Excise Act 2001</i>, or subsection 89(2) of the <i>Softwood Lumber Products Export Charge Act, 2006</i></li> <li>▪ requiring a person to turn over money under subsection 224.3(1) of the <i>Income Tax Act</i>, subsection 292(1) of the <i>Excise Act 2001</i>, or subsection 92(1) of the <i>Softwood Lumber Products Export Charge Act, 2006</i></li> <li>▪ giving a notice, issuing a certificate, or making a direction under subsection 225(1) of the <i>Income Tax Act</i>, subsection 293(1) of the <i>Excise Act 2001</i>, or subsection 93(1) of the <i>Softwood Lumber Products Export Charge Act, 2006</i></li> </ul> <p><b>Note:</b> The collections restrictions do not apply to the application of payments or refundable credits to other debts, which can occur at any time after a notice of assessment or reassessment is sent under the <i>Income Tax Act</i>, the <i>Excise Tax Act</i>, the <i>Excise Act 2001</i>, the <i>Softwood Lumber Products Export Charge Act, 2006</i>, or the <i>Air Travellers Security Charge Act</i>. For the <i>Excise Act</i>, the application of payments or refundable credits to other debts is done under the authority of the <i>Financial Administration Act</i>.</p> <p>If the Canada Revenue Agency (CRA) believes a debt may be in “jeopardy” – a court order can be obtained to enforce collection and thereby override the collection restrictions. The Information Circular notes:</p> <p><b>Collection of tax debts in jeopardy</b></p> <p>If the Canada Revenue Agency (CRA) determines there is a risk of not collecting all or part of your tax debt due to collection restrictions, it can apply to the Federal Court or the superior court of a province for a jeopardy order. <b>This allows the CRA to take immediate action to collect your tax debt.</b></p>
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Jurisdiction and Revenue Collection Agency	What creates a tax debt liability that is due and payable? Eg An assessment	Is a disputed tax debt able to be collected (including if it is being challenged in a Court or Tribunal)?
<p><b>New Zealand - Inland Revenue Department (IRD)</b></p>	<p>At the end of the tax year the Inland Revenue Department (IRD) will send an income tax assessment (<a href="https://www.ird.govt.nz/income-tax/income-tax-for-individuals/what-happens-at-the-end-of-the-tax-year/income-tax-assessments">https://www.ird.govt.nz/income-tax/income-tax-for-individuals/what-happens-at-the-end-of-the-tax-year/income-tax-assessments</a>)</p>	<p>Under the <i>Income Tax Act</i>, the CRA can apply for a jeopardy order without informing you. As a result, you are not present in court when the CRA’s application is heard.</p> <p>Based on the evidence the CRA presents, the court will decide whether it should grant a jeopardy order. If the court decides there is enough evidence to prove that delaying collection action will put collecting the tax debt at risk, it will grant a jeopardy order.</p> <p>For assessments of amounts “in trust”, e.g. payroll withholdings, the Harmonized Sales Tax (i.e. a VAT), and other withholdings on payments to non-residents for example, there are no “Collection Restrictions”.</p> <p>Where a competent objection has been lodged or if the matter is disputed beyond objection stage i.e. in a court, payment of <b>the tax in dispute</b> may be deferred while the dispute is being resolved. If the taxpayer has already paid all the tax in dispute, a refund may be requested.</p> <p>Where there is disputed tax and a competent objection (Part 8) has been lodged then a Taxpayer is not liable to pay Deferrable Tax<sup>8</sup>, penalties or interest until the due date for payment of that deferrable tax – refer section 128 <i>Tax Administration Act 1994</i> (New Zealand).</p>

<sup>8</sup> **deferrable tax**, for a person who is a taxpayer or disputant, means—

- a. an amount of tax, assessed under a tax law as payable by the person, in relation to which the person makes a competent objection under [Part 8A](#);
- b. goods and services tax, payable (as defined in [section 20A\(1\)](#)) of the Goods and Services Tax Act 1985) by the person on a due date, in relation to which the person makes a competent objection under [Part 8](#) or that the person challenges under [Part 8A](#);
- c. an amount of tax assessed under a tax law as payable by the person and described in [section RP 17B\(3\)\(bb\)](#) of the Income Tax Act 2007

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Jurisdiction and Revenue Collection Agency	What creates a tax debt liability that is due and payable? Eg An assessment	Is a disputed tax debt able to be collected (including if it is being challenged in a Court or Tribunal)?
	<p>Generally, Tax is payable 30 days after an Assessment<sup>6</sup> but an Assessment is disputable, so any disputed tax is ultimately payable 30 days after 'the day of determination of final liability'<sup>7</sup>.</p> <p>The relevant provisions are set out in the <i>Tax Administration Act 1994</i> (New Zealand) - which can be found on the free legislation website in NZ <a href="http://www.legislation.govt.nz">www.legislation.govt.nz</a></p>	<p>A similar rule applies if the matter is disputed beyond objection stage (ie in the Courts) - what is known as 'challenge proceedings' or a 'challenge' (see Part 8A) – refer section 138I <i>Tax Administration Act 1994</i> (New Zealand) generally and section 138I(2B) specifically.</p> <p>However, the Commissioner may require a taxpayer to pay all tax in dispute if the Commissioner considers that there is a significant risk that the tax in dispute will not be paid should the taxpayer not succeed in objection proceedings or court (<a href="#">s. 128</a> and <a href="#">s. 138I Tax Administration Act 1994</a>; <a href="#">IRD guidance IR776 2019 – Disputing an assessment</a>).</p>
<p><b>UK - Her Majesty's Revenue &amp; Customs (HMRC)</b></p>	<p>Under the UK self-assessment system, the obligation to pay tax is not linked to the issue of an assessment. Usually the taxpayer is automatically required to make two payments on account towards the tax due for any year and then a third and final 'balancing payment' to meet any tax still outstanding following the year of assessment. The first payment on account is due on 31 January of the tax year in</p>	<p>In appeals against decisions relating to direct taxes, taxpayers can apply to postpone paying the disputed tax until the appeal is settled. The application must be made to HMRC first, and if HMRC refuses to postpone payment, the taxpayer can apply to the First-tier Tribunal. If taxpayers do not make an application for postponement, the tax is payable in full whether or not they appeal (<a href="#">s. 55 Taxes Management Act 1970</a>; <a href="#">HMRC guidance ARTG2510: Reviews and appeals for direct taxes: Payment of tax pending the outcome of an appeal: Postponement applications</a>).</p> <p>Where a taxpayer has appealed against a penalty or surcharge, there is no formal arrangement in law for postponement of the penalty or surcharge. HMRC's policy is that where a penalty or</p>

<sup>6</sup> Section 109 and 114 of the *Tax Administration Act 1994* deem assessments to be valid (note the definition of 'disputable decision' includes assessment- [s. 3](#)).

<sup>7</sup> Section 142F provides that the due date for payment of deferrable tax' is the 30th day after the last day of the relevant 'period of deferral'. The 'period of deferral' is also defined and in essence it ends on the 'day of determination of final liability' - so 30 days post final determination that's when you have to pay.

<p><b>Jurisdiction and Revenue Collection Agency</b></p>	<p><b>What creates a tax debt liability that is due and payable? Eg An assessment</b></p>	<p><b>Is a disputed tax debt able to be collected (including if it is being challenged in a Court or Tribunal)?</b></p>
	<p>question, the second payment on account is due on the following 31 July, and any balancing payment on the next 31 January.</p> <p>Guidance is provided in HMRC's Self-Assessment: the legal framework manual - see <a href="#">HMRC guidance SALF 302: Payment of tax: introduction</a>)</p>	<p>surcharge is under appeal, it should be informally stood over pending settlement of the appeal (<a href="#">HMRC guidance ARTG2570: Reviews and appeals for direct taxes: Payment of tax pending the outcome of an appeal: Postponement applications - informal standovers</a>)</p> <p>In appeals against decisions regarding indirect taxes, the taxpayer must pay the amount of tax that is being appealed in order to progress the appeal, unless the taxpayer can demonstrate payment would cause hardship (<a href="#">s. 16(3) Finance Act 1994</a>; <a href="#">s. 84 Value Added Tax Act 1994</a>). <a href="#">HMRC guidance ARTG3320: Reviews and appeals for indirect taxes: Payment of tax pending the outcome: Following appeal to the tribunal</a>)</p> <p>Under the <i>Finance Act 2014</i>, if a taxpayer has been involved in a tax avoidance scheme, HMRC can issue an Accelerated Payment Notice which requires the disputed tax to be paid upfront. HMRC will hold this money until an enquiry or appeal is resolved (<a href="#">s. 224 Finance Act 2014</a>).</p> <p><b>The General Position</b></p> <p>The general position in the UK is that when HMRC concludes a company audit they issue a closure notice which states either that HMRC can accept the tax return as submitted or states the adjustments HMRC believe are required. Any additional tax due will be payable within 30 days of the closure notice.</p> <p>However, if the company does not agree with the conclusions then it can appeal the closure notice and request that any excess tax charged is postponed while the disputed matter continues to be debated with HMRC. The disputed/postponed tax does not become payable until the appeal is finally determined – either by agreement between the company and HMRC, or by a Tribunal/Court.</p>

Jurisdiction and Revenue Collection Agency	What creates a tax debt liability that is due and payable? Eg An assessment	Is a disputed tax debt able to be collected (including if it is being challenged in a Court or Tribunal)?
<p><b>USA – Internal Revenue Service (IRS)</b></p>	<p>The Internal Revenue Service (IRS) is responsible for the determination, assessment, and collection of internal revenue in the United States. The Internal Revenue Manual (IRM) contains the policies, procedural instructions and guidelines used by the Internal Revenue Service.</p> <p><a href="#">Internal Revenue Manual, Part 35, Chapter 9, Section 2, 1(1)</a> states that an assessment is the statutorily required recording of the tax liability. Section 6203 [of the Internal Revenue Code]. Assessment is made by recording the taxpayer’s name, address, and tax liability. The assessment date is the 23C date. The 23C date is the Monday on which</p>	<p>There are limited circumstances in which HMRC can refuse a request for the tax to be postponed.</p> <p><b>Specific Exceptions</b></p> <p>There are also specific regulations where the tax has to be paid up front while the disputed matter continues to be debated with HMRC, e.g. Diverted Profits Tax charging notices and Accelerated Payment Notices in relation to disclosed avoidance schemes.</p> <p>We understand, the vast majority of audits fall within the general category described above.</p> <p>An assessment of tax and/or penalty (i.e., when collection efforts may be initiated) may not be made until such time as a determination of the IRS becomes final.</p> <p>A determination becomes final when either:</p> <ol style="list-style-type: none"> <li>1. the corporation or individual agrees with the IRS’s proposed determination of tax and signs a waiver to permit the assessment of tax;</li> <li>2. the corporation or individual disagrees with the IRS’s proposed determination of tax, but settles with the IRS’s Office of Appeals (an administrative, not judicial, process) and signs a waiver to permit the assessment of tax;</li> <li>3. the corporation or individual does not agree with the IRS’s proposed determination, the IRS issues a statutory notice of deficiency (i.e., “ticket to court”), and the corporation or individual fails to file a petition/claim with the appropriate court within 60-days of issuance of the statutory notice of deficiency;</li> <li>4. the corporation or individual does not agree with the IRS’s proposed determination, the IRS issues a statutory notice of deficiency, the corporation or individual files a</li> </ol>

Jurisdiction and Revenue Collection Agency	What creates a tax debt liability that is due and payable? Eg An assessment	Is a disputed tax debt able to be collected (including if it is being challenged in a Court or Tribunal)?
	<p>the recording of assessment and other adjustments are made in summary manner on Form 23C and signed by a Service Center officer. In non-TEFRA cases [that is, cases that do not fall under the <i>Tax Equity and Fiscal Responsibility Act of 1982</i>], the taxpayer is mailed a notification that a tax (plus interest, and additions and penalties, if any) is due and a demand for payment.</p>	<p>petition/claim with the court with 60-days of issuance of the statutory notice of deficiency (note, a taxpayer has the option to either go to the U.S. Tax Court, the appropriate U.S. District Court or the U.S. Court of Claims; <u>note further, if a taxpayer elects to file a claim with either the U.S. District Court of the U.S. Court of Claims, the taxpayer must pay the proposed determined amount first and file a claim to have the amounts refunded</u>), the court determines that an amount of tax is to be assessed, and the corporation or individual fails to file a petition with the appropriate U.S. Appeals court; and</p> <p>5. the corporation or individual does not agree with the IRS’s proposed determination, the IRS issues a statutory notice of deficiency, the corporation or individual files a petition/claim with the court with 60-days of issuance of the statutory notice of deficiency, the court determines that an amount of tax is assessed, the corporation or individual files a petition with the appropriate U.S. Appeals court, and the Appeals court upholds an amount of tax due. Note that a taxpayer can continue to attempt to appeal up through and including the U.S. Supreme Court.</p>
		<p>Extracts from the relevant <a href="#">Internal Revenue Manual Part 5, Chapter 19, Section 1, 4(3)</a> are set out below:</p> <p><i>Determine Correct Tax Liability</i></p> <ul style="list-style-type: none"> <li>• The taxpayer may indicate verbally or in writing the tax liability is questionable, such as:             <ul style="list-style-type: none"> <li>○ They do not owe the balance due</li> <li>○ They dispute the amount owed</li> <li>○ They do not know why they have a balance due</li> </ul> </li> <li>• Do not pursue collection if you are not able to determine the correct tax liability. You must, however, secure telephone numbers and levy sources to update the account with current information. See IRM 5.19.1.4.2, Taxpayer Information and IRM 5.19.1.4.4.2,</li> </ul>

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Jurisdiction and Revenue Collection Agency	What creates a tax debt liability that is due and payable? Eg An assessment	Is a disputed tax debt able to be collected (including if it is being challenged in a Court or Tribunal)?
		<p>Obtain and Verify Levy Sources. If there are prior histories on the account indicating the taxpayer has indicated doubt as to liability previously, and has submitted nothing to support that claim within 45 days since the last history, and it is apparent the taxpayer is attempting to delay collection, pursue collection.</p> <ul style="list-style-type: none"> <li>• If a tax liability has been disputed in court - the timing of an assessment after a decision is entered depends on whether an appeal is filed. For a detailed discussion of appeals, see CCDM Part 36. Moreover, even if the taxpayer files an appeal, the timing of assessment also depends on whether the taxpayer posts a bond. Bonded taxpayer appeals require special attention because when an adequate bond is posted, assessment cannot be made as to any deficiencies, additional amounts, and interest covered by the bond until the decision of the Tax Court becomes final. Section 7485. Once the decision of the Tax Court becomes final, the Service has only 60 days in non-TEFRA cases in which to assess the tax, plus any additional time obtained through "tacking." For time limitation on assessment in TEFRA cases, see CCDM 35.9.3.5.2.</li> </ul> <p>The IRS has also published a document on "Collection Appeal Rights" to inform taxpayers of the different avenues through which certain IRS collection action may be appealed. The document is available here - <a href="https://www.irs.gov/pub/irs-pdf/p1660.pdf">https://www.irs.gov/pub/irs-pdf/p1660.pdf</a></p>



## Annexure C – Tax profession submissions and concerns about the trends in ATO advice and guidance

### Inquiry into the Commissioner of Taxation Annual Report 2018-19

**Ms OWENS:** Yes, and your report made that case very well. Thank you for that. Can I also talk about the breakdown of advice and guidance you've covered in your report—I don't know what page it was—where the number of private rulings have been reduced over a couple of years from about 7½ thousand down to just over 5,000 and public rulings are down from the 70s to the 50s but the interpretive guidance products are up. There's a number of comments I could make about that. I used to manage a national trade association for small businesses and I used to get public rulings, and there's nothing as good as a public ruling. So are you're getting feedback from the sector generally about this trend away from rulings and towards advice?

**Ms Payne:** Yes is the short answer, and perhaps we can come back to you with a reply on notice to be sure that you've seen the reference. In our report we reference a number of submissions that are publicly available where, for example, The Tax Institute has raised concerns about this very issue, that the quality or the 'bindingness', the value of the advice and guidance, that's been issued is moving in a way that the tax profession would say is unhelpful.

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The IGTO submission to this Inquiry sets out the concerns expressed amongst the taxpayer and tax professional community about the trend in decreasing ATO binding advice and the increase in non-binding guidance being issued by the ATO. These include for example:

#### Submissions by the Tax Institute

The Tax Institute submission *ATO Guidance* to the ATO's Deputy Chief Tax Counsel, dated 14 November 2019 made observations about some growing trends in relation to ATO guidance.<sup>9</sup> A copy is reproduced in Annexure D and can be found at the following link:

*The Tax Institute has prepared the following submission to the Australian Taxation Office (ATO) in relation to ATO guidance. The purpose of this submission is to outline the Institute's concerns in relation to what we perceive to be growing trends in relation to ATO guidance.*

<https://tticdn.blob.core.windows.net/tti-files/dmfile/tax-institute-submission---ato-guidance-.pdf>.

Amongst other things raised, the Tax Institute observed:

*The Institute also considers that there has been a trend for the ATO to move away from binding advice. Members have perceived this as a deliberate change in approach to guidance. While we encourage all types of ATO guidance, whether binding or not, to be developed, there needs to be balance. Further, it is our position that non-binding advice is not the place for the ATO to outline their interpretation of legislation.<sup>10</sup>*

The Tax Institute goes on to say:

*The Institute is concerned that the use of ATO non-binding guidance and correspondence to nudge taxpayers in certain ways without giving precise guidance on how the law will be*

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<sup>9</sup> The Tax Institute, *ATO Guidance* (Submission to the ATO's Deputy Chief Tax Counsel, 14 November 2019) <https://tticdn.blob.core.windows.net/tti-files/dmfile/tax-institute-submission---ato-guidance-.pdf>.

<sup>10</sup> *Ibid*, p 4.

*administered will be interpreted as blurring the line between regulatory and prudential guidance. Such non-binding guidance in the form of bulletins and letters to nudge taxpayers have been issued without consultation which has caused uncertainty for taxpayers.<sup>11</sup>*

The IGTO is not aware of whether the ATO provided the Tax Institute with a response to the concerns raised and, if so, the nature of that response.

The Tax Institute submission *Treasury-Explanatory Memoranda* – to Ms Maryanne Mrakovcic, Deputy Secretary Revenue Group, The Treasury, dated 14 November 2019 also raises issues in relation to ATO guidance. A copy is reproduced in Annexure E and can be found at the following link but it is the third bullet point that is of relevance in respect of ATO Guidance:

*The Tax Institute has prepared the following submission to Treasury in relation to Explanatory Memoranda (EMs). The purpose of this submission is to outline the Institute’s concerns in relation to what we perceive to be growing trends in relation to the quality of EMs being prepared by Treasury.*

*Members have observed the quality and practical use of EMs is being diminished by the following matters, being:*

- *Misalignments between statements of Parliament’s intent captured in EMs and the actual drafting of the legislation;*
- *Leaving pertinent examples, explanations and interpretative guidance out of EMs; and*
- *A growing trend whereby the Australian Taxation Office (ATO) is including material in Law Companion Rulings (LCRs) that should be included in EMs.*

<https://www.taxinstitute.com.au/tisubmission/the-tax-institute-submission-treasury-explanatory-memoranda>

On page 3 of this submission, the Tax Institute note:

#### ***Content of ATO guidance***

*The trend towards leaving pertinent guidance out of EMs, has resulted in another trend. The content of guidance from the ATO appears to be expanding to include material that should be included in EMs. For example, guidance regarding the intended interpretation of the law, as informed by the underlying tax policy, should be included in the EM. The trend towards putting interpretive material into ATO guidance that should be in EMs is problematic.*

### **Research and Analysis explored in a paper by Professor Richard Vann and Mr Andrew Hirst of Greenwoods & Herbert Smith Freehills**

Professor Richard Vann and Andrew Hirst<sup>12</sup> presentation - *Rulings Update* - at The Tax Institute’s 2020 Financial Services Taxation Conference in Melbourne, 5 - 7 February 2020. The IGTO attended this presentation and also presented at this conference.

The presentation observed, across three decades (1999, 2009 and 2019) a decline in the level of binding advice issued by the ATO and an increase in the level of non-binding advice that was issued.<sup>13</sup>

<sup>11</sup> Ibid, p 6.

<sup>12</sup> Professor Richard Vann and Andrew Hirst, *Rulings Update* (Presentation at The Tax Institute’s 2020 Financial Services Taxation Conference, Melbourne, 5 - 7 February 2020).

<sup>13</sup> Ibid, p 14.

## Article in the CPA Australia Magazine – In the Black

The Committee may also be interested in an article published in CPA Australia's magazine, *In The Black*, which discussed the ATO's views of ATO Alerts. The article included discussions with the ATO Second Commissioner as well as leading tax and legal practitioners on their views.<sup>14</sup>

The Second Commissioner described ATO Alerts as saying:

*Just be aware we are looking into this, we have some concerns about it, we are going to look into and we are going to give you some guidance down the track.*<sup>15</sup>

The article expresses the following view from a tax practitioner:

*They [alerts] may be helpful in some cases, but they are general in nature. Taxpayers have to consider whether what's covered in the alert is an issue for them. Then the guidance from the ATO is that if they do think it's an issue for them, they must get independent advice. So it doesn't provide taxpayers with clarity.*<sup>16</sup>

The article notes that rulings, both public and private, still provide taxpayers with greater certainty through more analysis of facts and law and a higher level of protection.<sup>17</sup>

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<sup>14</sup> Zilla Efrat, 'ATO alerts vs rulings: is there a change in direction?', *In the Black* (24 October 2017) <<https://www.intheblack.com/articles/2017/10/24/ato-alerts-vs-rulings>>

<sup>15</sup> *Ibid.*

<sup>16</sup> *Ibid.*

<sup>17</sup> *Ibid.*



## THE TAX INSTITUTE

14 November 2019

Mr Andrew Orme  
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Australian Taxation Office  
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MELBOURNE, VIC 3001

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Dear Andrew,

### **ATO Guidance**

The Tax Institute has prepared the following submission to the Australian Taxation Office (**ATO**) in relation to ATO guidance. The purpose of this submission is to outline the Institute's concerns in relation to what we perceive to be growing trends in relation to ATO guidance.

Our National Technical Committee members have noticed a decrease in the quality of Explanatory Memoranda (**EMs**) being produced by Treasury. This has caused great concern among The Tax Institute's members, particularly as it seems to have allowed a chasm in interpretive guidance to grow. Members' perception is that the ATO is now moving to fill this chasm. Our specific concerns with EMs are contained in the submission entitled *Treasury – Explanatory Memoranda* dated 14 November 2019 (**Treasury Submission**), a copy of which is attached for your reference. While improving the quality of EMs would address this matter to an extent, regardless there are several other concerns that members have with the guidance being issued by the ATO.

### **Growing Trends**

Our National Technical Committees have noticed what appears to be some concerning trends in relation to ATO guidance. The perceived trends that the Institute is concerned about, and are discussed in detail below, can be grouped as:

- Transparency;
- Foreshadowing positions;
- Decrease in binding guidance;
- Content of guidance; and
- Time taken to complete rulings.

We have discussed these trends below with the purpose of opening a dialogue with the ATO to discuss whether these trends, which appear to be widespread and systemic, are deliberate new directions of the ATO, and, if so, the reasons for such a change of direction.

## 1. Transparency

The Tax Institute contends that the ATO should be transparent in relation to competing legal interpretations.

The Institute considers that there is a growing trend for the ATO to take a position and provide legal analysis that is consistent with their position without acknowledging or refuting other widely and reasonably held legal positions or interpretations.

The Institute contends that it would be beneficial for the tax system if the ATO was open and acknowledged the existence of competing interpretations of the law which are reasonably held. Further, the ATO should refute or explain why they consider that the competing interpretations are incorrect.

One example where the Institute and other professional bodies specifically requested the ATO to acknowledge and explain why they did not accept a widely held industry view was in relation to the definition of 'central management and control'. During the consultation on *TR 2018/5 Income tax: central management and control test of residency* and *PCG 2018/9 Central management and control test of residency: identifying where a company's central management and control is located*, there were differing views between the ATO and stakeholders regarding the decision in the *Bywater*<sup>1</sup> case and whether the case had enough impact to cause the ATO to revise its long-held views in relation to this residency test.

The ATO relied on the *Bywater* case to support revising its views on the central management and control test but did not provide an explanation regarding the change in its long-held view contained in *TR 2004/15 Income tax: residence of companies not incorporated in Australia – carrying on business in Australia and central management and control* (now withdrawn) that was widely accepted by industry.

The professional bodies asked for an explanation as well as examples to support the view the ATO now takes in relation to central management and control. In the absence of a proper explanation and supporting examples, and where the case law clearly doesn't support the ATO's interpretation, there is a lack of transparency as to how the view was arrived at.

Another example of this is the consultation that was conducted in relation to the negative control issue contained in the *Draft Privatisation and Infrastructure Framework: Control under Division 6C* document issued in 2017. The main contention was that the ATO's position that the ability of a shareholder to veto certain decisions gives that shareholder control of the company's business had no support in either the text of the legislation, the purpose for which Division 6C (*Income Tax Assessment Act 1936* (Cth)) was enacted or the cases cited by the ATO. The ATO officers involved in this consultation would not provide stakeholders with an explanation in writing of their view. (Refer to the Institute's submission for further information regarding this issue<sup>2</sup>). A current example of this is in relation to the consultation on draft *GSTD 2018/D1 Goods and Services Tax: determining the creditable purpose of acquisitions in a credit card issuing business*, which is about determining what is a supply in relation to a credit card issuing business. Members considered the analysis regarding basic elements of the issues raised in the consultation to be scant, with minimal case law support provided for positions taken. The case law support that was provided relied on minor statements in cases rather than the ratio.

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<sup>1</sup> *Bywater Investments Ltd v Commissioner of Taxation and Hua Wang Bank Berhad v Commissioner of Taxation* [2016] HCA 45

<sup>2</sup> <https://www.taxinstitute.com.au/tisubmission/draft-privatisation-and-infrastructure-framework-control-under-division-6c>

For example, the Commissioner relies upon commentary in *Commissioner of Taxation v American Express Wholesale Currency Services Pty Limited* [2010] FCAFC 122 (Amex) to essentially conclude that the provision of a credit card facility encompasses a bundle of rights supplied to the cardholder on the entry into the credit card contract which includes the cardholder's exercise of those rights (refer to paragraph 7 in GSTD 2018/D1). In fact, the parties to those proceedings agreed to adopt this proposition and there was no dispute between the parties on this point. The Court in Amex did not fully turn their minds to what constitutes the 'relevant thing supplied' to the cardholder and it is therefore open to conclude that Amex is not binding authority for this proposition.

The examples above demonstrate the importance of transparency in ATO views, particularly where the ATO's view represents a change from a past view or differs greatly from the profession's understanding of the case law and legislative guidance on a particular issue.

#### *Different views in private rulings*

GSTD 2018/D1 Goods and services tax: determining the creditable purpose of acquisitions in a credit card issuing business is an example where the ATO view taken in the public guidance contradicts the ATO positions in private rulings that have been given to taxpayers directly affected by the public guidance. In effect, the public guidance overrides long-held positions confirmed by private rulings without an explanation as to why this change has occurred. Such a change in view in the absence of an explanation is confusing to the market place.

In the context of transparency, we also consider that the ATO should not remove private rulings from the online database. If the rulings no longer reflect the ATO's view, it would be useful if an explanation in relation to why the rulings are no longer consistent with the ATO view is provided or noted in the relevant private rulings.

## **2. Foreshadowing positions**

Another trend that the Institute is concerned about is the perceived trend for the ATO to foreshadow their position before they have analysed issues in detail. This is a concerning trend as consultation in relation to legal interpretation should start with an open dialogue of all positions.

It was noted at the 4 April 2019 Consultation Steering Group meeting<sup>3</sup> that the ATO is looking to foreshadow the outcomes of ruling consultations by including an outline of what the ATO thinks the answer will be.

Members of our National Technical Committees have noted examples in the context of rulings and audits where they perceive that the ATO has reached a conclusion at the beginning of the process. There is a perception that the ATO then produces selective legal analysis to match their foreshadowed opinion.

The Institute would like to discuss the processes the ATO has in relation to reaching legal conclusions on interpretative issues. The Institute considers that it is vital for the tax system to have open dialogue about different interpretations of complex legal issues before a conclusion is reached. To foreshadow a conclusion

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<sup>3</sup> We note this discussion was not recorded in the Key Messages from that meeting.

prior to performing such analysis (both in the context of rulings and audits) can have a potentially detrimental effect on the tax system.

### 3. Decrease in binding guidance

The Institute also considers that there has been a trend for the ATO to move away from binding advice. Members have perceived this as a deliberate change in approach to guidance. While we encourage all types of ATO guidance, whether binding or not, to be developed, there needs to be balance. Further, it is our position that non-binding advice is not the place for the ATO to outline their interpretation of legislation. This should be included in binding guidance documents such as Taxation Rulings (**TR**) and Law Companion Rulings (**LCR**). In fact, Institute members consider that an LCR accompanying new legislation should not be needed if EMs were better prepared (see below). A TR covering specific matters paired with a Taxation Determination (**TD**) or two (if required) should be sufficient. In the event the ATO considers that an LCR is required, the LCR should focus on how the ATO intends to administer the new law, not its interpretation.

It also appears that the ATO is producing more Practical Compliance Guidelines (**PCG**) than rulings and putting more effort into producing PCGs than binding rulings. Consequently, there seems to be a growing trend in the ATO using PCGs as an interpretive product rather than rulings. This is concerning if the ATO is then applying the PCGs as if they are a binding legal interpretation of the law.

We also note the increasing reliance on guidance material on the ATO website and 'Let's Talk' web page.

Our National Technical Committees have noted examples of the above including:

- a) transfer pricing: *TD 2019/10 Income tax: can the debt and equity rules in Division 974 of the Income Tax Assessment Act 1997 limit the operation of the transfer pricing rules in Subdivision 815-B of the Income Tax Assessment Act 1997* – this is an example where members considered the ATO preferred to put out a PCG in relation to the application of the transfer pricing rules to inbound and outbound interest-free loans rather than support its view in a binding product. The request for binding guidance with respect to the application of the transfer pricing rules in Subdivision 815-B to inbound and outbound interest-free loans was originally raised in the Division 815 Technical Working Group. The minutes of the meeting held on 26 July 2016 record that the ATO had approved the listing of this issue on the ATO Rulings Program as a Tax Determination. The minutes of the same meeting also record that the ATO had listed the interaction between Division 974 and Subdivision 815-B as a separate Tax Determination on the ATO's Rulings Program. Subsequently the ATO decided, without external consultation, to combine both interpretative issues into a single Tax Determination and to issue guidance relating to how the transfer pricing rules apply in relation to inbound and outbound interest-free loans in the form of a PCG (see [3901] on ATO's Advice and Guidance).
- b) *PCG 2019/D3 ATO Compliance Approach to the Arm's Length Debt Test* - unlike other PCGs which state that they outline the ATO's compliance approach<sup>4</sup>, the first sentence of paragraph 1 of PCG 2019/D3 states that it 'provides guidance to entities in applying the arm's length debt test in Division 820 of the Income Tax Assessment Act 1997'. This statement is borne out when the PCG is examined in more detail as the discussion under the heading '*Applying the arm's length debt test*' covers in excess of 130 paragraphs (paragraphs 44 to 175) and relates to guidance with respect to application of the arm's length debt test and not to the ATO's compliance approach (which is discussed in

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<sup>4</sup> See for example, paragraph 1 of PCG 2017/1, Paragraph 1 of PCG 2017/4, Paragraph 1 of PCG 2019/1.

paragraphs 11 to 43). Further, the discussion in PCG 2019/D3 needs to be considered in light of *TR 2019/D2 Income tax: thin capitalisation – the arm's length debt test* where the interpretative guidance relating to the factual assumptions (paragraphs 18-21) and relevant factors (paragraphs 22-23) covers 6 paragraphs and largely simply restates the legislation without providing any useful guidance.

- c) Guidance relating to the Mutual Agreement Procedure (MAP) - the ATO withdrew *TR 2000/16 Income tax: international transfer pricing – transfer pricing and profit reallocation adjustments, relief from double taxation and the Mutual Agreement Procedure* on 21 November 2018 and replaced it with updated guidance on the principles and procedures relating to MAP on the ATO website. While a MAP request, in a number of respects, involves the application of processes – which do not lend themselves to being set out in guidance material – there are nevertheless a number of matters of an interpretative nature that were addressed in *TR 2000/16* where it remains appropriate for the ATO to provide relevant guidance in the form of a ruling rather than on its website. As an aside, the Institute notes that there was no public consultation with respect to the proposed withdrawal of *TR 2000/16* or in relation to the ATO website guidance that replaced it. If such consultation had occurred, matters being raised now may have been able to be addressed.

#### *Particular comments in relation to PCGs*

We refer to Practical Compliance Guideline PCG 2016/1 Practical Compliance Guidelines: purpose, nature and role in ATO's public advice and guidance which provides at paragraph 13:

*13. Although practice statements are published in the interests of open administration, **their intended audience is ATO staff and they have a main purpose of providing instructions to staff on the manner of performing law administration duties.** Going forward, practice statements will align more closely with their main purpose and **practical compliance guidelines will be the appropriate communication product providing broad law administration guidance to taxpayers.** [Emphasis added]*

We also note paragraph 23 which states:

*23. Practical compliance guidelines, on the other hand, **are not prepared for the primary purpose of expressing a view on the way a tax law provision applies.** They represent guidance material on how the ATO will allocate its compliance resources according to assessments of risk, and may outline administrative approaches that mitigate practical difficulties relating to the operation of tax laws. Accordingly, practical compliance guidelines will generally not be public rulings. [Emphasis added]*

Members have observed a number of particular matters in relation to PCGs. In our members' view, a PCG should clearly set out how the ATO will allocate its compliance resources when administering a particular piece of legislation in line with their intended purpose set out above. However, members have noted increasing use of PCGs for other purposes, such as taking positions on the law in the PCG which are not being supported and using a PCG as if it were equivalent to a Legislative Instrument.

Members also note their experience with ATO Tax Counsel Network staff and Audit teams refusing to move outside the 'green zones' provided in the PCGs, particularly during transfer pricing disputes. Rather than relying on a PCG as a 'risk assessment tool', members' experience is that PCG's are often being used by Audit teams as though they represent an interpretation of the law. An example of this is how both *PCG 2017/1 ATO compliance approach to transfer pricing issues related to centralised operating models involving procurement, marketing, sales and distribution* and *PCG 2019/1 Transfer Pricing issues related to inbound*



*distribution arrangements* are being applied in practice. Members' experience is that the methodology and 'green zone' outcomes in each of these PCGs is being used as de facto interpretative guidance for the transfer pricing rules in SubDiv 815-B in audit cases or is being used by ATO officers to provide the underlying basis for any settlement. This is clearly not the purpose of a PCG.

The statements in paragraph 8 of PCG 2017/1 and paragraph 29 of PCG 2019/1 provide that the transfer pricing methodology used in the PCGs is for risk assessment purposes only. Where a matter has been escalated to an audit, Audit teams should be testing transfer pricing outcomes of distributor arrangements consistent with paragraph 8 of PCG 2017/1 and paragraph 5 of PCG 2019/1. As such, Audit teams do still need to follow due process and undertake appropriate transfer pricing analyses taking into account the particular facts and circumstances of each case when assessing the outcomes of a particular transfer pricing arrangement.

Further, a number of members have had ATO officers indicate to them that a PCG will be used to determine if a settlement is appropriate or not and will apply the PCG to determine the 'reasonableness' of the settlement. In this regard, a risk tool has now morphed into a quasi-Legislative Instrument and the arbiter of the appropriateness / reasonableness of settlement outcomes. Members believe this is not appropriate as risk tools are rarely designed to reflect accurately the relevant law and are thus inappropriate for use by ATO officers in making attempts to apply the law to the facts and circumstances of taxpayers.

#### *Other uses of non-binding guidance*

The Institute is concerned that the use of ATO non-binding guidance and correspondence to nudge taxpayers in certain ways without giving precise guidance on how the law will be administered will be interpreted as blurring the line between regulatory and prudential guidance. Such non-binding guidance in the form of bulletins and letters to nudge taxpayers have been issued without consultation which has caused uncertainty for taxpayers.

The Institute has prepared submissions on this issue in relation to SMSFRB 2019/D1 (confidential submission to the ATO dated 18 September 2019) and the ATO's recent letter to SMSF trustees on meeting diversification requirements (confidential submission to the ATO dated 17 October 2019) and the ATO's recent crypto currency warnings.

## **4. Content of guidance**

### *Nature of analysis*

The Institute also considers that there is a growing trend for ATO guidance to include analysis that should actually be included in the relevant EM. That is, the content of guidance issued by the ATO appears to be expanding to include outlining the ATO's interpretation of the policy intent of the legislation where this has not been adequately set out in the EM.

Separately, we have raised this concern with Treasury in the Treasury Submission. This is problematic from both an interpretation and evidentiary viewpoint. (Please refer to the letter to Treasury for further explanation.)

ATO interpretive guidance, such as an LCR or public ruling, is important and the Institute welcomes and encourages the ATO to continue to issue such guidance. However, it should not replace or reduce the guidance that should correctly be included in EMs.

### *Consistency of view*

Members have also noted examples of where the content of the guidance can be construed in different ways giving rise to inconsistent views from the ATO. One example highlighted by members is paragraph 15 of *LCG 2017/3 Superannuation reform: Superannuation death benefits and the transfer balance cap* regarding binding death benefit nominations (**BDBN**).

For ease of reference, we have extracted the relevant paragraph:

15. A binding death benefit nomination, by itself, does not make a superannuation income stream reversionary. If the governing rules or the agreement/standards under which the superannuation income stream is provided does not expressly provide for reversion then a binding death benefit nomination cannot alter this. The binding death benefit nomination may have the effect of directing the superannuation provider as to whom the death benefit is to be paid and the form, but it cannot turn a non-reversionary superannuation income stream into a reversionary superannuation income stream.

Broadly, the competing views are:

- A BDBN cannot make a pension reversionary. This view is reflected throughout paragraph 15, especially the last clause of the last sentence;
- A BDBN can make a pension reversionary. This view gains support from the words 'by itself,' in the first sentence and 'If the governing rules or the agreement/standards under which the superannuation income stream is provided does not expressly provide for reversion then a binding death benefit nomination cannot alter this' in the second sentence (eg, the governing rules or the agreement/standards may expressly provide for a BDBN to so provide reversion).

The ATO holds one view publicly on how the paragraph can be construed. However, members note they have been advised on a confidential basis of the other view and have relied on it. A consistent view in all circumstances should be put forward by the ATO.

A more recent example can be found in the ATO's website guidance entitled *Death benefit income streams – meeting minimum pension payment requirements* last modified 24 July 2019. This article was "updated to clarify that this is in relation to reversionary pensions only". However, the first iteration was not only confusing, it was in conflict with TR 2013/5 paragraph 129.

The Guidance included a context statement - *A number of questions have recently been raised by the SMSF sector around the interaction between compulsory cashing requirements following a member's death and the requirement to pay a minimum pension amount each year*. It would seem as though a more fulsome answer should have been provided however, the first iteration did not include the Commissioner's opinion as set out in a Public Ruling.

The Guidance was updated within a short period of time to ensure that it was clear that it applies only to reversionary pensions however, in the interim, it created uncertainty for the SMSF sector.

### *Consistency of approach*

There is a clear difference between the approach taken in PCG (*PCG 2017/1 ATO compliance approach to transfer pricing issues related to centralised operating models involving procurement, marketing, sales and distribution*) and the PCG which applies to inbound distributors (*PCG 2019/1 Transfer Pricing issues related to inbound distribution arrangements*).

PCG 2017/1 looks at certain profit level indicators (**PLI**) when considering the arms' length nature of transfer pricing arrangements and prescribes use of cost-based transfer pricing methods (refer for example paragraphs 139 and following). Paragraph 34 of PCG 2019/1 states that the ATO analyses the profit outcomes of inbound distribution arrangements using Earnings Before Interest and Tax (**EBIT**) relative to sales (ie an EBIT margin approach).

Stakeholders anticipated these PCGs would have a similar approach. It is understood that risk tools do not reflect the actual application of the transfer pricing rules, but (for the reasons noted in 3 above) inconsistency between these PCGs can lead to inconsistent treatment of taxpayers.

### *Change of view – retrospectivity*

Where the ATO issues guidance which changes a long-standing view that it has held and is one which the profession has long accepted, such a change should not apply retrospectively. Members have noticed a trend towards the ATO changing long-held views contained in non-binding guidance which impacts on clients, for example the website guidance in relation to General Purpose Financial Statements which applies to significant global entities that have an Australian presence<sup>5</sup>.

Another example is *Draft Taxation Determination TD 2019/D1 Income tax: what is a 'restructuring' for the purposes of subsection 125-70(1) of the Income Tax Assessment Act 1997?* regarding demergers. With this particular example, consideration needs to be given to whether boilerplate language, such as that included in paragraph 41 regarding the Date of Effect of the Taxation Determination, is appropriate for inclusion in all draft guidance. Inclusion of this language alone suggests retrospectivity<sup>6</sup>. In our view, guidance should apply prospectively from the date the guidance is finalised.

## **5. Time taken to complete rulings**

Some members of our National Technical Committees have also expressed concerns in relation to the time it takes for the ATO to issue a public ruling. Members note it is often a lengthy process between the time a draft ruling is issued and the ruling is finalised. The delays between issuing in draft and finalisation of the ruling create uncertainty for taxpayers, particularly if the ATO's view changes between the draft and finalised ruling.

Members note as an example *TR 2004/D25 Income Tax: capital gains: meaning of the words 'absolutely entitled to a CGT asset as against the trustee of a trust' as used in Parts 3-1 and 3-3 of the Income Tax Assessment Act 1997* regarding 'absolute entitlement' which has remained outstanding for 15 years. Delays

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<sup>5</sup> <https://www.ato.gov.au/Business/Public-business-and-international/General-purpose-financial-statements/Guidance-on-the-provision-of-general-purpose-financial-statements/>

<sup>6</sup> For further information in relation to this draft Taxation Determination, please refer to the joint submission from The Tax Institute and Law Council of Australia (<https://www.taxinstitute.com.au/tisubmission/draft-taxation-determination-td-2019/d1-joint-submission>)

in the finalisation of a ruling need to be explained to stakeholders. Stakeholders are always more than happy to provide their technical expertise to assist the ATO in arriving at views.

Members have also raised *Taxation Ruling TR 2017/D6 Income tax and fringe benefits tax: when are deductions allowed for employees' travel expenses?* and the revisions to *Taxation Ruling TR 96/26 Fringe Benefits Tax: car parking fringe benefits*. Concern has been expressed in relation to the length of time it is taking to provide these interpretive materials. We have recently received an update from the ATO regarding the progress of these two rulings where the ATO acknowledged the delays with both these rulings (the ATO has since determined that it would be better to issue the content in TR 2017/D6 in three separate pieces of guidance and the update to TR 96/26 is ready for consultation)

While these materials remain under development, uncertainty remains for taxpayers and their advisers.

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These are important issues causing considerable concern to a wide spectrum of our members. We look forward to discussing these issues with you. Please contact Tax Counsel, Stephanie Caredes on [REDACTED] or Tax Counsel Angie Ananda, on [REDACTED] to arrange a suitable time.

Yours faithfully,



**Tim Neilson**  
President



## THE TAX INSTITUTE

14 November 2019

Ms Maryanne Mrakovcic  
Deputy Secretary  
Revenue Group  
The Treasury  
Langton Crescent  
PARKES ACT 2600

By email: [REDACTED]

Dear Ms Mrakovcic,

### **Treasury - Explanatory Memoranda**

The Tax Institute has prepared the following submission to Treasury in relation to Explanatory Memoranda (**EMs**). The purpose of this submission is to outline the Institute's concerns in relation to what we perceive to be growing trends in relation to the quality of EMs being prepared by Treasury.

We would like to have a dialogue with Treasury with the aim of improving the quality and content of EMs in an effort to address these concerning trends.

### **Desirable attributes of an EM**

We submit that an EM should have the following characteristics:

- An EM should contain an overall objective statement of the policy behind the measure, including what is the mischief that the policy seeks to address with the introduction of the new legislation / legislative amendments.
- An EM should provide to readers an understanding of the government of the day's intended meaning of the new legislation / legislative amendments, ie the intended interpretation of the law. They should provide context and helpful, practical examples of the intended application. They should not just simply restate or reproduce the new legislation / legislative amendments.
- An EM should provide an explanation for all technical legislative corrections contained in the Bill. Even minor technical corrections should be acknowledged in the EM.
- An EM should contain clear statements regarding whether the amendments (including minor technical amendments) are intended to *change* the operation/application of the law or whether they are intended to *clarify* the operation/application of the law.
- An EM should be consistent with the drafting instructions / briefing provided to the Office of Parliamentary Counsel.
- An EM should align with the content of the Parliamentary Second Reading Speech of a Bill and the Bill itself so that Parliament has a precise understanding of the content of the Bill it is considering.

This is not an exhaustive list.

## **Growing Trends**

Our National Technical Committee members have observed that the quality of EMs can vary significantly. While Treasury is still producing quality EMs in some instances (see below for examples), this is not consistent across the production of all EMs. Our members have noticed what appears to be some concerning trends in relation to EMs.

Members have observed the quality and practical use of EMs is being diminished by the following matters, being:

- Misalignments between statements of Parliament's intent captured in EMs and the actual drafting of the legislation;
- Leaving pertinent examples, explanations and interpretative guidance out of EMs; and
- A growing trend whereby the Australian Taxation Office (**ATO**) is including material in Law Companion Rulings (**LCRs**) that should be included in EMs.

## **Misalignment**

The first concern we wish to discuss relates to the need for consistency between the wording of the legislation and the policy intent captured in the EM (which we understand is intended to capture how Parliament intended the law to operate). The policy intent as reflected in the EM should be aligned with the legislation. This will assist the ATO to properly administer the law as Parliament intended and in line with how the courts should interpret the particular legislation. A misalignment between the legislation and the EM causes uncertainty for taxpayers.

The approach taken by the ATO in performing its role in administering relevant legislation is, quite appropriately, based on applying principles of statutory construction established by the courts. In this respect, the rules of statutory construction direct attention to the text, context, and purpose of the statutory provision<sup>1</sup> and that the task of statutory construction must begin with a consideration of the statutory text.<sup>2</sup> As such, where a misalignment arises, statements of Parliament's intent as reflected in EMs must give way to the words of the legislation properly construed.<sup>3</sup>

## **Omitting examples and guidance**

Second, we are concerned about what appears to be a trend towards leaving pertinent examples, explanations and interpretative guidance out of EMs.

EMs should not merely repeat or paraphrase the legislation. They should provide practical and interpretive guidance that illustrates how the legislation is intended to apply and clearly articulate and explain the underlying tax policy of the legislation. EMs should assist the ability of all relevant stakeholders to

<sup>1</sup> *Ueese v Minister for Immigration and Border Protection* [2015] HCA 15 [42] (French CJ, Kiefel, Bell and Keane JJ); *Project Blue Sky Inc v Australian Broadcasting Authority* [1998] HCA 28; (1998) 194 CLR 355, 384 [78] (McHugh, Gummow, Kirby and Hayne JJ).

<sup>2</sup> *Commissioner of Taxation v Consolidated Media Holdings Ltd* [2012] HCA 55 per French CJ, Hayne, Crennan, Bell and Gageler JJ at [39]; *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* (2009) 239 CLR 27; [2009] HCA 41 per Hayne, Heydon, Crennan and Kiefel JJ at [47].

<sup>3</sup> *SAEED v Minister for Immigration and Citizenship* [2010] HCA 23 at [31]; (2010) 241 CLR 252 at 264-265 per French CJ, Gummow, Hayne, Crennan and Kiefel JJ. See also *Re Bolton; Ex Parte Beane* (1987) 162 CLR 514; [1987] HCA 12.

understand the objectives and operation of the law as well as the intention of the Parliament at the time the law was passed.

In our opinion, to achieve these objectives, it is vital for EMs to provide guidance regarding the intended interpretation of the law, as informed by the underlying tax policy and to include examples to illustrate the application of the law. Examples are important to illustrate general principles which can be used to assist in interpreting the law. A principle of the Tax Law Improvement Project (**TLIP**) drafting style was to include examples in the legislation itself. It is acknowledged that this is not always feasible as it may lead to overly-lengthy legislation. Where this is not a suitable outcome, our preference is to see relevant examples included in the EM. In our opinion, it is not useful to wait until the ATO issues its guidance for examples to explain new law.

### ***Content of ATO guidance***

The trend towards leaving pertinent guidance out of EMs, has resulted in another trend. The content of guidance from the ATO appears to be expanding to include material that should be included in EMs. For example, guidance regarding the intended interpretation of the law, as informed by the underlying tax policy, should be included in the EM. The trend towards putting interpretive material into ATO guidance that should be in EMs is problematic.

This trend is problematic as Treasury is responsible for ensuring that legislation reflects policy intent. Tax policy is the responsibility of Treasury not the ATO. Legislation and EMs are key to expressing tax policy and should be the responsibility of Treasury not the ATO. We refer to the protocol<sup>4</sup> agreed to between Treasury and the ATO in 2012 which sets out each organisation's role in relation to the stewardship of the tax and superannuation system which guides the interaction between Treasury and the ATO.

We acknowledge that the ATO has attempted to issue guidance (namely LCRs) to coincide with the passage of new law, though inevitably this cannot always be achieved. However, an LCR should not be used as a substitute for content that should correctly be included in an EM. The role of the EM is to explain the law and policy. This applies to both new law as well as amendments to existing laws. The role of ATO guidance is to administer the law. Insufficient pertinent content in the EM to guide the ATO in its role in administering the tax laws has made consultation with the ATO in relation to the development of ATO guidance problematic.

The absence of pertinent guidance in the EM has, in members' views, created a chasm in the available interpretive guidance. Consequently, members' perception is that the ATO is now moving to fill that chasm. This issue is discussed in detail in a submission we have made to the ATO concerning issues with ATO guidance (**ATO Submission**). A copy of this submission is included in Annexure C.

While an LCR is binding on the Commissioner if a taxpayer relies on it in good faith, it is still only 'an expression of the Commissioner's view about how a taxation law would apply' (paragraph 14 of LCR 2015/1). It does not necessarily accurately reflect the policy intent of the law. Rather, it represents 'the considered views of the Commissioner, informed by a **reasonable understanding** of the intended policy' (paragraph 12 of LCR 2015/1 with emphasis added). The policy intent of the law needs to be clearly articulated in the EM.

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<sup>4</sup> <https://www.ato.gov.au/General/New-legislation/In-detail/ATO---Treasury-protocols/ATO---Treasury-protocol/>

This trend is also problematic from an evidentiary point of view. Courts may look to an EM to provide guidance regarding statutory interpretation. Section 15AB(2)(e) of the *Acts Interpretation Act 1901* (Cth) permits the use of any explanatory material relating to the Bill containing the provision to assist with ascertaining the meaning of a provision in an Act. A court can use the EM to extract general principles, the interpretation of a particular provision as well as Parliament's intention at the time behind the provision. The same cannot be done with guidance from the ATO.

ATO guidance is important and the Institute welcomes and encourages ATO guidance. However, it should not replace or reduce the guidance included in EMs.

The Tax Institute considers that Treasury needs to consider the quality and content of EMs in an effort to address these concerning trends.

We have outlined below some examples and previous comments we have made that are relevant to the trends we have identified above.

## **Issue 1 – Misalignment**

### *Diverted Profits Tax*

A recent example of a misalignment between the drafting of the legislation and Parliament's intent as reflected in the EM as to how a law is intended to operate arose in relation to the diverted profits tax (**DPT**).

Paragraph 18 of the EM to *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017* (**DPT Bill**) provided that:

“The DPT, like the multinational anti-avoidance law, expands the scope of Part IVA and is still focused on tax avoidance arrangements that are of an artificial or contrived nature. Although the DPT is not a provision of last resort, consistent with the operation of Part IVA, it is expected that the DPT will be applied only in very limited circumstances. It is intended that the Commissioner would apply the DPT only after he or she has given consideration to the operation of the ordinary provisions in the income tax law.”

Similarly, the Treasurer's Second Reading Speech stated<sup>5</sup>:

“The diverted profits tax will not replace the operation of the transfer pricing rules as they apply to ordinary transfer pricing disputes. It is intended that the transfer pricing rules will remain the primary mechanisms for pricing the cross-border transactions of multinationals.”

Based on the EM (and the Second Reading Speech), taxpayers and their advisers would reasonably expect that the ATO would apply the ordinary provisions of the Tax Acts, such as the transfer pricing rules, first and would only seek to apply the DPT where its requirements were met after that.

However, during the consultation process with Treasury and the ATO on the exposure draft and accompanying explanatory memorandum which preceded the introduction of the DPT Bill, it became clear

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<sup>5</sup><https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22chamber%2Fhansard%2F5ff85d2-b96e-4e0e-8227-2131e40beaf7%2F0025%22>



that the ATO saw no such limitation in the words of the DPT Bill that would confine the operation of the DPT in the way intended by Parliament as expressed in the EM (and Second Reading Speech)<sup>6</sup>.

We submit that the legislation and the EM should have been drafted in a manner so that it was not open to the ATO to take such an interpretation. This would have mitigated or eliminated this misalignment.

This example shows that it is important that statements of Parliament's intent as reflected in EMs align with the words of the legislation properly construed. In particular, where a potential misalignment between the drafting in the exposure draft and the EM has been raised during the consultation process prior to a bill being introduced into Parliament, Treasury should ensure that appropriate steps are taken to mitigate the potential for uncertainty in interpreting proposed laws to arise and to ensure that the legislation properly reflects policy intent, including involving the Office of Parliamentary Counsel where necessary.

### Capital Gains Tax

In a recent Full Federal Court case, parties are contending that the content of the EM actually goes further than the legislation<sup>7</sup> (refer <http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/2019/394.html>).

The relevant capital gains tax (CGT) provisions referred to in the case were amended in 2010. A dispute arose regarding how the amended CGT provisions should be interpreted. In terms of legislative intention, the information and explanations given in the EM go further than the amending legislation.

In our opinion, this is not an appropriate use of an EM. The function of the EM is to explain and interpret the legislation, rather than expand the application of the legislation beyond its boundaries. In this particular case, we submit that there is a misalignment between the EM and the policy intent of the amending legislation.

## **Issue 2 – Omitting examples and guidance**

### Hybrid Mismatch Rules

The hybrid mismatch rules in the *Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Bill 2018* provide an example where relevant examples and guidance were omitted from the EM.

There are large passages in the EM where the EM passages are essentially verbatim restatements of the tests contained in the legislation itself. Examples are the passages in the EM in relation to the definition of hybrid payer mismatch and deducting hybrid. These statements provide no additional guidance in addition to the legislation itself.

In addition, the inclusion of these long restatements of the legislation cause the EM to be overly-long. This compounds the difficulties, because overly-long EMs have also been given as a reason for not including further examples requested by industry. This then reduces the scope for the EM to include guidance that would be useful to industry.

As outlined in our *Independent Review of the Australian Public Service (APS Submission, refer Annexure A)*, during the consultation process in relation to this legislation, stakeholders sought comfort from Treasury

<sup>6</sup> Refer to the Joint Bodies submission *Australian Taxation Office Guidance on the Diverted Profits Tax* (<https://www.taxinstitute.com.au/tisubmission/joint-organisations-submission-diverted-profits-tax-ato-guidance>)

<sup>7</sup> Refer to *Paule v Commissioner of Taxation* [2019] FCA 394 (<http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/2019/394.html>)

on the extent to which Part IVA of the *Income Tax Assessment Act 1936* (Cth) would apply if taxpayers were to restructure to remove the Australian impact of the anti-hybrid rules. Stakeholders had asked for more broad ranging and helpful comments to be inserted into the EM as they did not consider the example included was sufficient for this purpose (even though Treasury sought to improve the example during the consultation process in response to stakeholder comments).

Stakeholders were advised by Treasury that the EM would not contain extensive guidance as the ATO would release guidance on this issue when the legislation was enacted. While the ATO have since released draft *Practical Compliance Guideline PCG 2018/D4: Part IVA of the Income Tax Assessment Act 1936 and restructures of hybrid mismatch arrangements*, such guidance does not have the same value as guidance in an EM for interpreting the law (as noted above).

This is not best practice process.

### CCIVs

Stakeholders have expressed concern that Treasury did not take into account concerns stakeholders had regarding 'accepted industry practice' in relation to corporate collective investment vehicles and advised stakeholders that that was about administration and they should consult with the ATO. Upon doing so, the ATO advised stakeholders that that the ATO needs to apply the law in accordance with the policy intent so stakeholders should raise their concern with Treasury.

Stakeholders observed from this that it is not clear whether there is a mutual understanding between Treasury and the ATO regarding the policy intent in relation to the new CCIV measures. Stakeholders received a subsequent response from Treasury that the law does reflect the Government's policy intent and any concerns should be raised with the relevant Minister.

This is not a suitable process to ensure that there is a mutual understanding by all parties (Treasury, the ATO and stakeholders) regarding the Government's policy intent and the guidance issued reflects that.

In terms of this submission, the point we wish to highlight is that if the EM included appropriate guidance and examples, this issue may be avoided.

### Superannuation

In the context of superannuation, an example of this trend is highlighted by the question of whether a 'transition to retirement income stream' (**TRIS**) can be converted into an account-based pension (**ABP**). There is a significant difference between the understanding (and long-standing practice) of industry that a TRIS can be converted to an ABP (subject to the governing rules of the relevant superannuation fund) and Treasury and the ATO's view of the law which suggests this is not possible.

There is no express provision in the legislation that precludes the effective conversion of a TRIS to an ABP and therefore the view provided by Treasury and the ATO is, in our opinion, not consistent with the law.

Amendments to the enacted law were also subsequently required to be made after the initial legislation came into force for issues that were raised during the consultation period. These issues could have been resolved during the initial consultation phase by providing appropriate guidance in the relevant EM. A

detailed explanation of this issue is contained in previous submissions we have made to Treasury and the ATO (**refer Annexure B**).

Another example in the superannuation context is the non-arms' length income (**NALI**) provisions. Although examples were provided in the relevant EM, the examples did not address the actual examples that would be problematic for the industry.

### GST

We refer to the 2017-18 Budget measure 'GST withholding on property transactions'. Numerous issues were raised with Treasury during the consultation process. As Treasury was required to have the measure ready for tabling in Parliament within a certain time, members felt it was then left to the ATO to deal with a number of these issues after the measure was enacted. This included some issues that cannot be addressed administratively, thus making the role of the ATO even more difficult. The draft guidance that the ATO issued (*Law Companion Ruling LCR 2018/D1 Purchaser's obligation to pay an amount for GST on taxable supplies of certain real property*<sup>8</sup>) was not able to resolve any of the issues with the legislation.

To summarise, all the examples discussed above could have been mitigated if the relevant examples and guidance had been included in the EMs.

As illustrated above, this concerning trend to omit relevant examples and guidance from the EMs often leads to the next concerning trend. That is, ATO guidance being used to include guidance and examples that should properly be included in EMs.

### **Issue 3 - Content of ATO guidance**

We have previously raised our concerns regarding the content of ATO guidance in our submission dated 20 July 2018 in relation to the APS Submission. We also refer you to the ATO Submission for further discussion of our concerns with ATO guidance.

In that submission, we noted the following:

*Other problems that have arisen include situations where the Government has rushed to move from policy development stage to tabling the measure in a Bill in Parliament and not allowing Treasury sufficient time to prepare (and consult on) draft law and Explanatory Memoranda explaining the Government's intention on how the measure should apply.*

*Consequently, interpretation of the law is left to the administrator/regulator, the ATO, and in a number of cases has resulted in a disconnect between the Government's intention and the interpretation and application of the measure. However, this is problematic as a court is only able to consider extraneous material such as the explanatory memorandum relevant to a Bill to assist with interpreting a provision of an Act. Guidance material issued by the administrator, the ATO, is not acceptable for this purpose. In the absence of sufficiently prepared explanatory memoranda, there is little other relevant guidance available to a Court to consider from which to source the Government's or Parliament's intended application of a particular provision.*

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<sup>8</sup> Finalised as *LCR 2018/4 Purchaser's obligation to pay an amount for GST on taxable supplies of certain real property*

### **Quality EMs – examples**

We outlined our suggested characteristics of EMs above. The Tax Institute considers that aiming for EMs with these characteristics will help ensure the production of quality EMs.

In relation to EMs generally, as noted above, the quality varies.

Our members have identified examples of EMs that they consider to be high quality helpful products. A common theme with these EMs is that they do not simply restate the law and they provide useful examples to help interpret the law. They have often been subject to extensive consultation. Further, the EMs also clearly outline the policy intent of the relevant legislation.

- Hybrid mismatch EM – part of this EM provides useful background information in relation to OECD guidance<sup>9</sup>. This aspect of the EM is a good example of the type of guidance material that practitioners find helpful. However, we have concerns with the rest of this EM as noted above;
- Transfer Balance Cap EM - this EM provides lots of detail and examples of how the transfer balance cap provisions operate<sup>10</sup>;
- The EM on the recent changes to Div 152 to improve the integrity of the small business CGT concessions has been found to be relatively useful<sup>11</sup>; and
- The Tax Institute participated in extensive consultation in relation to amendments made to Division 83 regarding employee share schemes<sup>12</sup> – this is an example where extensive consultation gave rise to a better outcome.

### **Conclusion**

As stated above, the Institute's view is that Treasury needs to consider the quality and content of EMs in an effort to address these concerning trends.

The Tax Institute considers that Treasury should ensure that more guidance is incorporated into EMs so that taxpayers, courts, the ATO and all other relevant stakeholders have a good understanding of what the Government intends when legislation is introduced to Parliament.

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<sup>9</sup> Refer to the EM to *Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Bill 2018* (Cth)

<sup>10</sup> Refer to the EM to *Treasury Laws Amendment (2017 Measures No. 2) Bill 2017* (Cth)

<sup>11</sup> Refer to the EM to *Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Bill 2018* (Cth)

<sup>12</sup> Refer to the EM to *Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015* (Cth)

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This is an important issue causing considerable concern to many of our members. We look forward to discussing this issue with you. Please contact Tax Counsel, Stephanie Caredes on [REDACTED] or Tax Counsel Angie Ananda, [REDACTED] to arrange a suitable time.

Yours sincerely

[REDACTED]

**Tim Neilson**  
President

CC: Mr Simon Writer, Division Head – Law Design Office, Revenue Group, Treasury  
CC: Mr Andrew Mills, Second Commissioner of Taxation, Australian Taxation Office  
CC: Mr Peter Quiggin, First Parliamentary Counsel, Office of Parliamentary Counsel

**ANNEXURE A**

**APS SUBMISSION**



Tax Institute  
submission - Indepe

**ANNEXURE B**

**TRIS SUBMISSION**



Submission -  
Superannuation - TI

**ANNEXURE C**

**ATO SUBMISSION**



Tax Institute  
submission - ATO G





## THE TAX INSTITUTE

20 July 2018

Mr David Thodey AO  
Chair  
Independent Review of the Australian Public Service  
C/- Department of the Prime Minister and Cabinet  
PO Box 6500  
CANBERRA ACT 2600

By email: [apsreview@pmc.gov.au](mailto:apsreview@pmc.gov.au)

Dear Mr Thodey,

### **Independent Review of the Australian Public Service**

The Tax Institute welcomes the opportunity to make a submission to the Department of the Prime Minister and Cabinet in relation to the *Independent Review of the Australian Public Service (APS Review)*.

Through its work in relation to tax policy and administration, The Tax Institute liaises with a number of Departments of State and government entities that engage staff under the *Public Service Act 1999* (Cth) including:

- The Treasury;
- The Australian Taxation Office;
- The Inspector General of Taxation; and
- The Board of Taxation.

The focus of our submission is on the two key agencies involved in policy, law design and administration in the Australian tax and superannuation systems – being the Treasury and the Australian Taxation Office (**ATO**). The matters raised in our submission are directly relevant to these aspects of the APS review:

- delivering high quality policy advice, regulatory oversight, programs and services;
- tackling complex, multi-sectoral challenges in collaboration with the community, business and citizens;
- improving citizens' experience of government and delivering fair outcomes for them; and
- acquiring and maintaining the necessary skills and expertise to fulfil its responsibilities.

## Summary

The Tax Institute considers that improvements to the policy development and consultation phases of tax and superannuation law formation would result in better law. For Treasury and the ATO to properly fulfil their policy and regulatory roles respectively, they need sufficient resources, including both the requisite skill sets and experience and time to properly consider issues arising upon formation and interpretation of tax and superannuation law. This also includes addressing deficiencies in the consultation process. In the absence of this, policy advice and regulatory oversight will be of a lesser standard than what is demanded of such a complex area of law to develop and administer. Another concern of members is when the ATO changes a longstanding view on how it interprets a particular area of the law and the uncertainty, cost and inconvenience this means for taxpayers.

## Discussion

### 1. Overview

One of the greatest challenges facing the Australian Public Service (**APS**) in the tax and superannuation policy and law space is providing sound tax and superannuation policy to support well designed law. The better the tax and superannuation policy and law design, the easier the ensuing law is to administer. Necessary skills are required in the APS to ensure that 'good law' is formulated and put in place. The skills required include not only solid technical expertise in the areas of taxation and superannuation, but also a practical and commercial understanding of how tax and superannuation laws impact on a variety of taxpayers and participants in the system.

In the absence of these necessary skills, poor quality law may be designed and implemented. Where policy is rushed and not properly consulted on, poor law can also arise creating uncertainty and unintended results. This makes it difficult for a regulator, such as the ATO, to administer given that the ATO can only interpret the law as enacted.

### 2. Formation of Tax Policy and Law Design

#### *a) Improving policy development and law design*

Many of the issues that give rise to complexity in the tax and superannuation system could be resolved at the early stages of policy development and law design. The Tax Institute is of the view that a framework to involve the relevant parties as part of the policy development stage should be developed.

The 'relevant parties' include the policy arm of Treasury, the administrator (ATO), the drafters, and relevant tax practitioner and business representatives. Each of these stakeholders has a valuable contribution to make at the embryonic stage of policy development.

While steps have been taken over the last few years to improve consultation in the development of tax policy and the design of the law, the Institute is of the view that more needs to be done to reduce complexity in the tax and superannuation system and improve the quality of the tax and superannuation law being developed. Complexity will be reduced through having better resourced teams with relevant skills and knowledge and sufficient capacity to properly focus on issues during the policy development and law design stage and gain an understanding of the pragmatic implications of new policies. These issues include interactions between different parts of the law, the need for concessions and exemptions to the main rules and the need for integrity rules.

A change to policy development and law design of this nature would reduce complexity and improve the quality of new law as a lot of the issues that traditionally come up at later stages of consultation would be addressed much earlier in the process within the context of the broader scheme of the law change.

### ***b) Improving the consultation process***

The Government should develop an agreed procedure around consultation with all relevant stakeholders on matters of significant tax and superannuation policy change to be followed in all cases but extremely rare situations.

A major contributing factor to complexity in Australia's tax system is the recent history of developing tax policy 'on the run' where a media announcement is made about a new tax policy, with a relatively short timeframe to enact it or a Budget announcement is made and the scope of the announcement has not been fully developed<sup>1</sup>. In the case of tax law measures, often they are announced to address specific issues only<sup>2</sup> and are not necessarily thoroughly considered, particularly in terms of the context of the whole system. There is a sense that law change is constant, and it is difficult to keep up with all potential changes. The tax legislation continues to grow and there does not appear to be time or appetite for whether a reduction or simplification of certain tax measures can occur.

New Zealand could serve as a good model for Australia. Since the 1990s, New Zealand has operated a tax policy process called the 'generic tax policy process' that applies to tax law changes. This process sets a clear expectation around, and provides a sufficient amount of time for, thorough consultation. It ensures that well-considered tax legislation is introduced into the New Zealand parliament and that New Zealand tax policy is well-developed, and has involved the right stakeholders, prior to reaching the draft law stage.

The result is a positive and increased level of engagement in the policy process, and a greater level of understanding of tax policy intent. Retrospective law changes are also extremely rare, and this reduces uncertainty and complexity.

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<sup>1</sup> For example, the 2017-18 Budget measure 'Tax Integrity Package – improving the small business capital gains tax concessions' (announced in May 2017) where the scope and effect (of a policy change) was not apparent until the exposure draft was released in the following February 2018.

<sup>2</sup> For example, the diverted profits tax measure (which has since been implemented).

In its review of the tax consultation process<sup>3</sup> the Board of Taxation made a number of recommendations to improve Australia's tax consultation processes based on the New Zealand experience.

Subsequently, a further review was conducted by the Tax Design Review Panel. In its report<sup>4</sup>, the Panel also recommended a number of changes to Australia's tax law design. Those changes were in broad terms consistent with the generic tax policy process advocated by the Board of Taxation, although not completely. This was noted by the Board of Taxation in its subsequent report in 2011<sup>5</sup>.

A number of changes have been implemented following the Tax Design Review Panel report which have improved the system (such as the publication of a forward tax policy program for a period of time though this has since ceased). However, as the Board of Taxation noted in 2011, there is still an inconsistent process of consultation and a lack of quality in consultation<sup>6</sup>, a degree of lack of engagement from taxpayers, and there are still problems in the system. The Board of Taxation recommended a clear and consistent generic tax policy process be adopted and announced openly.

Other problems that have arisen include situations where the Government has rushed to move from policy development stage to tabling the measure in a Bill in Parliament and not allowing Treasury sufficient time to prepare (and consult on) draft law and Explanatory Memoranda explaining the Government's intention on how the measure should apply.

Consequently, interpretation of the law is left to the administrator/regulator, the ATO, and in a number of cases has resulted in a disconnect between the Government's intention and the interpretation and application of the measure. However, this is problematic as a court is only able to consider extraneous material such as the explanatory memorandum relevant to a Bill to assist with interpreting a provision of an Act<sup>7</sup>. Guidance material issued by the administrator, the ATO, is not acceptable for this purpose. In the absence of sufficiently prepared explanatory memoranda, there is little other relevant guidance available to a Court to consider from which to source the Government's or Parliament's intended application of a particular provision.

### **c) Changes in views**

There are instances that members have identified where the ATO has changed its longstanding view on how it is interpreting the law. These changes have a far-reaching impact on taxpayers, particularly where taxpayers have acted consistently with the ATO's

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<sup>3</sup> Board of Taxation *Improving Australia's Tax Consultation System Report*, February 2007

<sup>4</sup> Better Tax Design and Implementation: *A Report To The Assistant Treasurer And Minister For Competition Policy And Consumer Affairs*, 30 April 2008

<sup>5</sup> Board of Taxation *Post-Implementation Review of the Tax Design Review Panel Recommendations* December 2011.

<sup>6</sup> For example, the Superannuation Reform Package announced in the 2016-17 Federal Budget was announced largely by media release. Following that, industry was given two weeks to consult on over 600 pages of draft legislation. This made for very rushed consultation on a significant suite of measures.

<sup>7</sup> Section 15AB(2)(e) of the *Acts Interpretation Act 1901* (Cth)

previous position. It can be quite costly for taxpayers to unwind arrangements they have in place to comply with the new ATO view. It also creates uncertainty as to whether further changes will occur.

While the ATO may provide concessional relief in the form of a Practical Compliance Guideline, this does not provide a long-term solution.

**d) Recent examples**

The issues described above have arisen in a number and variety of situations. The following examples are included for illustration purposes.

*Examples of issues arising from the consultation process*

- i) Corporate and international taxation – the hybrid rules – during the consultation process, stakeholders sought comfort from Treasury on the extent to which Part IVA of the *Income Tax Assessment Act 1936* (Cth) would apply if taxpayers were to restructure to remove the Australian impact of the anti-hybrid rules. Stakeholders had asked for more broad ranging and helpful comments to be inserted into the Explanatory Memorandum (**EM**) as they did not feel the example included was sufficient for this purpose (even though Treasury sought to improve the example during the consultation process in response to stakeholder comments). Stakeholders were advised by Treasury that the EM would not contain extensive guidance as the ATO would release guidance on this issue when the legislation was enacted. While the ATO have since released draft *Practical Compliance Guideline PCG 2018/D4: Part IVA of the Income Tax Assessment Act 1936 and restructures of hybrid mismatch arrangements*, such guidance does not have the same value as guidance in an EM for interpreting the law (as noted above).
- ii) GST – 2017-18 Budget measure ‘GST withholding on property transactions’ – numerous issues were raised with Treasury during the consultation process. As Treasury was required to have the measure ready for tabling in Parliament within a certain time, members felt it was then left to the ATO to deal with a number of these issues after the measure was enacted. This included some issues that cannot be addressed administratively, thus making the role of the ATO even more difficult. The draft guidance that the ATO has issued (Law Companion Ruling LCR 2018/D1) is not able to resolve the outstanding issues with the legislation.
- iii) Superannuation – whether a ‘transition to retirement income stream’ (**TRIS**) can be converted into an account-based pension (**ABP**) – there is a significant difference between the understanding (and long-standing practice) of industry that a TRIS can be converted to an ABP (subject to the governing rules of the relevant superannuation fund) and Treasury and the ATO’s interpretation of the law which suggests this is not possible. There is no express provision in the legislation that precludes the effective conversion of a TRIS to an ABP and

therefore the interpretation provided by Treasury and the ATO is, in our opinion, not consistent with the law. Later amendments were required to be made to the legislation for issues that were raised in consultation prior to when the provisions were first enacted. These issues could have been resolved during the initial consultation phase. A detailed explanation of this issue is contained in submissions we have made to Treasury<sup>8</sup> and the ATO<sup>9</sup>.

#### *Examples of changes in views*

- i) Corporate and international taxation – revised guidance on the corporate residency test relying on the place of central management and control – there were differing views between the ATO and stakeholders regarding the decision in the *Bywater*<sup>10</sup> case and whether the case had enough impact to cause the ATO to revise its long-held views in relation to this residency test. The ATO has relied on the *Bywater* case to support revising its views on the central management and control test.
- ii) Superannuation - The ATO has taken a couple of differing views on when a self-managed superannuation fund (**SMSF**) is required to obtain an Actuarial Certificate in order to determine the exempt pension income (**ECPI**) percentage in an income year in accordance with section 295-385 and section 295-390 of the 1997 Act.

On 9 April 2014, the ATO issued Taxation Determination TD 2014/7 to provide its interpretation of what constitutes *segregated pension assets* for the purposes of calculating the ECPI for a SMSF. An Addendum was then issued 21 October 2015 that relaxed the view somewhat and brought it into line with industry practice.

In 2017, the ATO again reversed its position with regard to the requirements for claiming ECPI by a SMSF with effect from 1 July 2018. The ATO stated that it has been incorrectly interpreting the law and will now administer this provision in line with the revised view.

The last change necessitated a major change to the support systems the Actuarial industry use to produce SMSF Actuarial Certificates. In addition, the industry has been left with the nonsensical position that, even if an SMSF is 100% in the retirement phase (this results in an ECPI of 100%), but is excluded from segregating fund assets for tax purposes in accordance with section 295-385(7) of the 1997 Act, they must still obtain an Actuarial Certificate. This is an unnecessary cost and administrative burden that is caused by strict legislative interpretation.

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<sup>8</sup> <https://www.taxinstitute.com.au/tisubmission/reversionary-transition-to-retirement-income-streams>

<sup>9</sup> <https://www.taxinstitute.com.au/tisubmission/superannuation-treatment-of-a-reversionary-tris>

<sup>10</sup> *Bywater Investments Ltd v Commissioner of Taxation and Hua Wang Bank Berhad v Commissioner of Taxation* [2016] HCA 45

### 3. Possible directions

#### a) Policy development, law design and consultation

We recommend that the Government revisit the recommendations made by the Board of Taxation and the Tax Design Review Panel, and in particular draw on the New Zealand experience, to design a similar tax and superannuation consultation framework for Australia to apply when tax and superannuation policy changes are being considered. Such a framework should include an agreed timeframe for consultation applied in *all* but extremely rare situations and set procedures for thorough development of tax and superannuation policy.

There should be a commitment to avoid retrospective law change. This framework should alleviate some of the issues that add complexity to the tax and superannuation law, such as making multiple amendments to new laws subsequent to their enactment to address unintended consequences that are not considered prior to enactment, or resulting in situations where the ATO is required to try to administratively manage flaws in the law.

#### b) Ensuring the requisite skill sets are available in Treasury and ATO

The Treasury, the ATO and the Office of Parliamentary Counsel (**OPC**) will always benefit from drawing on the technical expertise and practical experience of members of the tax and superannuation professions to ensure sound policy and well-designed laws are formed. We note there continues to be a shortage of skills, particularly within Treasury, of industry experience and suggest Treasury be provided with further funding to acquire the skills it needs to ensure it can deliver the highest quality tax and superannuation policy advice and law design and fulfil its responsibilities in the future. OPC would also require additional resources to enable them to participate in the consultation process prior to drafting new law.

We note the ATO has recently been given funding (in the 2018-19 Federal Budget) to gain additional resources in the areas of enforcement against the Black Economy, increase debt collections (including their timeliness) and to ensure individual taxpayers meet their tax obligations. This funding will support the ATO to fulfil its responsibilities as the tax and superannuation regulator. However, this does not address the upfront challenge of contributing to the tax policy and design process.

If you would like to discuss any of the above, please contact either myself or Tax Counsel, Stephanie Caredes, on [REDACTED]

Yours faithfully,

[REDACTED]

**Tracey Rens**  
President

## **APPENDIX**

### **ABOUT THE TAX INSTITUTE**

The Tax Institute is the leading forum for the tax community in Australia. We are committed to representing our members, shaping the future of the tax profession and continuous improvement of the tax system for the benefit of all, through the advancement of knowledge, member support and advocacy.

Our membership of almost 12,000 includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our tax community reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate knowledge and learning.

We are committed to propelling members onto the global stage, with over 7,000 of our members holding the Chartered Tax Adviser designation which represents the internationally recognised mark of expertise.

The Tax Institute was established in 1943 with the aim of improving the position of tax agents, tax law and administration. More than seven decades later, our values, friendships and members' unselfish desire to learn from each other are central to our success.

Australia's tax system has evolved and The Tax Institute has become increasingly respected, dynamic and responsive, having contributed to shaping the changes that benefit our members and taxpayers today. We are known for our committed volunteers and the altruistic sharing of knowledge. Members are actively involved, ensuring that the technical products and services on offer meet the varied needs of Australia's tax professionals.





## THE TAX INSTITUTE

28 February 2018

Manager  
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Dear Sir/Madam

### **Reversionary Transition to Retirement Income Streams**

The Tax Institute (**TTI**) refers to the consultation on the exposure draft legislation referred to as *Treasury Laws Amendment (Measures for a Later Sitting) Bill 2018 – Miscellaneous Amendments – Transition to Retirement Income Streams*.

TTI welcomes the proposal to clarify the operation of reversionary transition to retirement income streams (**TRIS**).

It is noted that TTI has taken the view (as expressed in its submission of 17 October 2017) that a TRIS (on properly drafted terms) was always eligible for automatic reversion to eligible dependants upon the death of the primary pensioner and that legislative reform was therefore unnecessary. As such, in the view of TTI, the issue could have been more immediately addressed via administrative guidance (potentially offering better flexibility to the superannuation industry for the various approaches taken by both self-managed superannuation funds (**SMSFs**) and large Australian Prudential Regulation Authority (**APRA**) regulated funds (including public sector, industry and retail funds). For this reason, we ask that the alternative of the provision of administrative guidance rather than the introduction of more legislation is further considered.

In the meantime, TTI makes the following points with respect to the exposure draft legislation:

#### **1. Commencement date**

It is unclear to TTI whether the legislature intends the amendments to apply retrospectively from 1 July 2017.

A statement in the explanatory materials suggests that the amendments will apply retrospectively as it is stated that: *'in practice, the amendment largely applies from 1 July 2017'* (see paragraph 1.15 of the exposure draft explanatory memorandum (**EM**)).

However, the draft bill does not in fact provide for commencement of the amendments until the first day of the relevant quarter first occurring after the legislation receives Royal Assent (see item 2 of the table appearing with 'Commencement information' at the start of the draft bill).

Accordingly, it is not clear to the TTI why the EM assumes practical commencement retrospectively occurs on 1 July 2017. Therefore it is submitted that further clarification is required on this timing issue. There are also practical ramifications for any retrospective application set out below.

## 2. Retrospective application

If the proposed amendments are to apply retrospectively from 1 July 2017 there are various problems that can be envisaged around how death benefits might have already been paid since 30 June 2017. For example, a trustee may have determined not to automatically pay a reversionary TRIS to a reversionary beneficiary (due to the stated position of the Australian Taxation Office (**ATO**)) and the death benefit may have then had to have been paid and distributed amongst dependants and the legal personal representatives at the discretion of the trustee or in accordance with a binding nomination that applied if there was no reversionary beneficiary in play.

Similarly, there may have been confusion since 1 July 2017 about the ongoing payment of a reversionary TRIS in respect of a primary pensioner who died many years prior to 1 July 2017. It is possible that any such reversionary pensions were commuted and re-commenced and/or cashed out (with possible adverse ramifications for the recipient) by 1 July 2017.

Accordingly, as is often the difficulty with retrospective legislation treatment, now seeking to apply these amendments from 1 July 2017 (if that is in fact what is intended) has the potential to interfere with the process for payment of death benefits that have actually been paid out since 30 June 2017.

TTI submits that this particular issue could not be addressed by administrative action by the ATO (or the Australian Prudential Regulation Authority (**APRA**)) because the death benefit may have already been paid on the basis that the reversionary beneficiary was *not* automatically entitled. This is not simply a matter impacting the taxation treatment of reversionary TRISs, but it extends to a trustee determining whether a dependant has a binding entitlement to a death benefit pension.

TTI considers that a preferred approach is for the amendments to apply prospectively only and that the explanatory materials contain an acknowledgment that differing treatment of reversionary TRISs has been open to funds depending upon the terms governing the pension benefits offered and it is a decision for each fund to determine how their own rules have been applied.

## 3. Automatic reversion on death

The proposed insertion of a new paragraph (aa) after paragraph 307-80(3)(a) in the manner set out in the draft bill has the potential to be administratively problematic for large APRA funds with unitised investments where they may not be in a position to immediately transfer (or back-date) a TRIS from the taxed pool of assets to the untaxed pool of assets that is subject to the exempt current pension income (**ECPI**)

exemption on the death of a pensioner with a reversionary TRIS. Further, even where the death is reported promptly to the trustee there may be administrative difficulties in then promptly transferring the pension to the ECPI pool of investments.

It appears to TTI that the effect of the amendment is that as soon as the primary pensioner under a reversionary TRIS dies the assets supporting the TRIS are then in retirement phase and eligible for the ECPI pool. However, it may be a number of weeks or months (or into the next financial year) before the trustee is informed about the death of the primary pensioner and it would only be after that notice that the trustee can act to move the pension into the ECPI pool of assets.

This might be contrasted with the position where a TRIS has already been moved to 'retirement phase' as a consequence of a pensioner reaching age 65 years or satisfying one of the other relevant conditions of release with a nil cashing restriction and notifying the trustee.<sup>1</sup> In these cases, following the death of the primary pensioner the TRIS would continue in the ECPI pool and there would be no change of taxation treatment necessary.

As such, the automatic transfer to retirement phase makes sense where the TRIS has already entered 'retirement phase' prior to the death of the primary pensioner and therefore differs to the scenario above, where the TRIS has never been in retirement phase.

Accordingly, the TTI submits that there is scope for the legislation to distinguish between reversionary TRISs where the primary pensioner has entered retirement phase and those where the primary pensioner is yet to enter retirement phase.

#### 4. Reversionary beneficiary definition

TTI is concerned that the intended operation of s 307-80(3)(aa) may be undermined by the absence of a clear and practical definition for 'reversionary beneficiary' (**RB**). Accordingly, the TTI recommends that an appropriate definition be included in the draft bill to define RB for the purposes of the *Income Tax Assessment Act 1997 (ITAA 97)* provisions.

It is submitted that such a legislative definition is necessary to provide greater certainty about the operation of s 307-80(3)(aa) as well as other relevant provisions (e.g., the 12-month deferral in the timing of transfer balance account credits under s 294-25(1) of ITAA 97). It would also be desirable to define 'reversionary pension' with reference to the meaning of RB.

TTI respectfully submits that RB has no fixed normative meaning at common law and that the appeal to a plain language 'ordinary meaning' of RB in paragraph 1.12 of the exposure draft EM is unhelpful. Anecdotal experience suggests there is widespread confusion about the precise meaning of RB. This is perhaps unsurprising given there is no full legislative definition and the main ATO guidance dealing with this issue takes the following form in three different sections of TR 2013/5 as follows:

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<sup>1</sup> In these circumstances TTI would argue that the terms and conditions of some pensions would mean that it is no longer a TRIS at this point (with a condition of release with a 'nil' cashing restriction having been satisfied by the primary pensioner).

14. A superannuation income stream ceases when there is no longer a member who is entitled, or a dependant beneficiary of a member who is automatically entitled, to be paid a superannuation income stream benefit from a superannuation interest that supports a superannuation income stream

...

29. A superannuation income stream ceases as soon as a member in receipt of the superannuation income stream dies, unless a dependant beneficiary of the deceased member is automatically entitled, under the governing rules of the superannuation fund or the rules of the superannuation income stream, to receive an income stream on the death of the member. If a dependant beneficiary of the deceased member is automatically entitled to receive the income stream upon the member's death, the superannuation income stream continues.

...

125. If the entitlement to a superannuation income stream automatically transfers to a dependant beneficiary on the death of a member, the superannuation income stream does not cease. There is a continuing liability to make the payments under that superannuation income stream albeit the recipient of those payments has changed.

126. A superannuation income stream automatically transfers to a dependant beneficiary on the death of a member if the governing rules of the superannuation fund, or other rules governing the superannuation income stream, specify that this will occur. The rules must specify both the person to whom the benefit will become payable and that it will be paid in the form of a superannuation income stream. The rules may also specify a class of person (for example, spouse) to whom the benefit will become payable. It is not sufficient that a superannuation income stream becomes payable to a beneficiary of a deceased member only because of a discretion (or power) granted to the trustee by the governing rules of the superannuation fund. The discretion (or power) may relate to determining either who will receive the deceased member's benefits, or the form in which the benefits will be payable.

It is also useful to note that the phrase 'superannuation income stream did not automatically revert to another person' is used in regs 307-125.02 and 995-1.01 of *Income Tax Assessment Regulations 1997*.

TTI considers that enacting a legislative definition is the preferable approach given that a statutory standard that can only be precisely construed by reference to extrinsic materials is not ideal, particularly given the importance of the RB standard in affecting the fundamental rights and entitlements of superannuants (including from a tax, superannuation and trust law perspective). For example, it should be borne in mind that the standard is likely to impact many issues of importance, including allocation of life insurance proceeds and asset testing eligibility for Centrelink/DHS concessions.

TTI expects that certain ATO materials (refer to TR 2013/5 and LCG 2017/3) would inform Treasury's consideration of potential standards for a definition of RB. However, we note that TR 2013/5 provides a very strict standard that we believe

many industry documents fall short of (eg, the ATO does not allow any discretionary element but many superannuation fund documents do not satisfy this test and in practice many simply consider a reversionary nomination to be sufficient evidence). Accordingly, TTI recommends that in considering a definition for RB, Treasury should have regard to the desirability of implementing a workable standard that provides for a nomination and that provided some documentary evidence exists that the intent was to revert the pension, that would suffice.

Broadly, a substantial compliance test could be provided where a written nomination that the member and trustee intend the pension to be automatically reversionary will suffice despite the deed or pension documents not having the power to 'fetter' the trustee's discretion as effectively promulgated as 'law' by the ATO in TR 2013/5. This substantial compliance test should apply across the industry, both for public offer funds where the wording in documents vary widely (and probably not satisfying the ATO's criteria) and in the SMSF sector where most documents are supplied by non-qualified suppliers (who are not only not legally trained but would not know what an automatically reversionary pension is).

Accordingly, TTI recommends that paragraph 1.12 of the exposure draft EM should be replaced with new explanatory material to provide further context for the proposed RB definition with examples to illustrate the operation of the RB standard. Alternatively, if Treasury decides not to define RB, the paragraph should be recast so that the explanatory memorandum provides express guidance on the meaning of RB.

#### 5. **Automatic conversion of primary TRIS**

Following from the point immediately above, TTI submits that there are clearly now strong grounds for the legislation to provide for the 'TRIS' nomenclature to cease to apply upon a primary pensioner with a TRIS entering retirement phase pursuant to the current provisions under section 307-80(3).

From a practical and administrative point of view it is usual for most funds to treat a TRIS as having ceased to be treated as a TRIS upon a primary pensioner having satisfied a condition of release with a 'nil' cashing restriction. Following from the terms of the proposed amendment, any requirement on funds to continue to ' earmark' these pensions as TRIS' no longer has any relevance or practical application.

Further, such an approach would not prevent funds from still choosing to require that TRIS' be formally commuted and re-commenced as an account-based pension (**ABP**) on reaching one of the relevant conditions of release.

TTI has previously made the point that if a member commences a TRIS before age 65 years and is permitted by the fund to continue that pension for life it is unlikely that the fund would continue to recognise the pension as a TRIS – instead the TRIS conditions would have fallen away by no later than the pensioner reaching age 65 years and, unless required by the terms of the pension, the pension would continue to be paid beyond age 65 years as an ordinary ABP.

TTI submits that this matter be addressed in the amendments.

## 6. Background and legal analysis – conversion of TRIS to ABP

A TRIS is a type of ABP that is overlaid with certain extra terms which limit the size of pension payments and prevent lump sum withdrawals unless the pensioner has satisfied a condition of release with a 'Nil' cashing restriction, e.g. retirement, death, terminal illness, permanent incapacity, or attaining age 65 years (see the definition of TRIS under r 6.01(2) of *Superannuation Industry (Supervision) Regulations 1994 (SISR)*). The standards that allow for a TRIS were originally introduced to permit members who had attained preservation age but not otherwise satisfied a condition of release to 'transition to retirement' by commencing a pension subject to limited draw-downs.

A significant feature of the 2016 Budget reform measures was to rationalise the tax incentives associated with TRIS by coupling the fund-level ECPI exemption with a new 'retirement phase' standard (refer to ss 295-385 and 295-390 of ITAA 97). As such, the first major tranche of super reform legislation excluded TRIS from being in 'retirement phase' so as to remove ECPI in respect of the earnings on assets supporting a TRIS. However, at first instance, industry's concerns about the widespread loss of ECPI due to the TRIS changes was tempered by the understanding that many members who had originally commenced TRIS had, over time, converted their TRIS to ABPs when a condition of release with a 'Nil' cashing restriction was met without necessarily ceasing the TRIS.

Industry's broadly accepted understanding of such a conversion process is that, subject to the governing rules and pension documentation of the fund, a pension being paid to a member can meet the standards of a TRIS at a point in time and then subsequently meet the standards of an ABP, when a relevant condition of release is met. TTI is aware that industry practice has varied in respect of TRIS-to-ABP conversion, and there are cases where conversion was implemented via adaptable documents that permitted auto-conversion, as well as cases where specific conversion documents were used. Moreover, it is readily acknowledged that the governing rules and pension documents used by many funds do not facilitate conversion due to hard-wired restrictions.

However, it was not until June 2017 (i.e., the time that *Treasury Laws Amendment (2017 Measures No. 2) Act 2017* was enacted as law) that TRIS-to-ABP conversion emerged as a major source of contention between industry and Treasury (and the ATO). The gulf of understanding between industry and Treasury on this issue was first made apparent to TTI at this time due to paragraphs 1.131–1.132 of the explanatory memorandum to the Treasury Laws Amendment (2017 Measures No. 2) Bill 2017 which asserted that '...a superannuation income stream that is established as a TRIS will always retain its character...' which strongly implies TRIS-to-ABP conversion is impossible. Over time, this implication has only been reinforced, particularly in light of ATO commentary in the media, and TTI notes that paragraph 1.5 of the EM essentially repeats the same assertion of the earlier explanatory memorandum. The implication of this assertion is that the definition of a TRIS is to be construed as a 'legal straitjacket' whereby the applicable standards of the income stream are irrevocably determined at its commencement. With respect, TTI does not accept that this assertion has a sound basis in law.

If the exposure draft bill is enacted as law, the issue of TRIS-to-ABP conversion may be something of a moot point insofar as there appears to be no revenue impact or anything of legal significance that turns on the issue. However, as it is a

matter of proper legal construction which could impact future income stream products, TTI considers that it is important to deal with this issue in this submission.

It is submitted that the term pension as used in SISR is an adaptive term as prescribed by the governing rules of the particular fund from time to time rather than being a fixed term as Treasury asserts (presumably by relying on reg 6.01 of the SISR). As noted above, a TRIS is by definition an ABP with additional restrictions and TTI submits that a TRIS becomes an ABP when the two restrictions discussed above are satisfied, subject to the documentation and applicable standards. More specifically, if the governing rules of the fund and related pension documents provide for the rules of an ABP once a relevant condition of release with a 'Nil' cashing restriction is met, the income stream meets the definition of an ABP regardless of whether it commenced as a TRIS originally. We refer to the following extracts:

The definition of TRIS in reg 6.01 of SISR states that a 'transition to retirement income stream' means:

*(b) a pension provided from a superannuation fund, the rules of which:*

*The definition of pension in reg 1.06(1):*

*A benefit is taken to be a pension for the purposes of the Act if:*

*(a) it is provided under rules of a superannuation fund that:*

*(i) meet the standards of subregulation (9A) or 1.06A(2); and*

*(ii) do not permit the capital supporting the pension to be added to by way of contribution or rollover after the pension has commenced; and ...*

This TRIS definition relies on the definition of pension which is defined in s 10 of the *Superannuation Industry (Supervision) Act 1993 (SISA)* to mean:

*"pension, except in the expression old-age pension", includes a benefit provided by a fund, if the benefit is taken, under the regulations, to be a pension for the purposes of this Act.*

For completeness since the term pension refers to old-age pension we have extracted that definition from s 10 of the SISA below:

*"old-age pensions" has the same meaning as in paragraph 51(xxiii) of the Constitution.*

It is therefore submitted that the term 'pension' for SISA and SISR purposes is an adaptive term that depends on what is reflected in the deed and terms that govern the pension being provided by the particular fund from time to time. The term 'pension' is not a fixed term as implied by paragraph 1.5 of the EM.

As you would be aware, the governing rules of a pension can include the superannuation fund deed, pension documents and any unwritten rule. In particular, the term governing rules is defined in s10 of the SISA to mean:

**"governing rules"**, in relation to a fund, scheme or trust, means:

(a) any rules contained in a trust instrument, other document or legislation, or combination of them; or

(b) any unwritten rules;

governing the establishment or operation of the fund, scheme or trust.

Furthermore, there is no express provision in the legislation that precludes the conversion of a TRIS to an ABP. One would have expected express wording in the recent legislative changes including some clarification in s 307-80(3) of the ITAA 1997 if there was an intent to change long established industry practice that was initiated by the explanatory statement to the *Superannuation Industry (Supervision) Amendment Regulations 2007 (No. 1)*. There have been no relevant changes to the definition of a TRIS or an ABP in the SISR that would support the conclusion that a TRIS cannot be converted to an ABP. In particular, TTI understands from numerous members that TRISs have since 1 July 2007 been able to convert to an ABP and we understand that this has been undertaken on a fairly widespread basis in the superannuation industry. This practice may not have been as popular in some large APRA funds since many of these are systemised to treat a TRIS as a separate 'financial product' type offering and therefore an auto conversion is not always possible under their systems.

TTI understands that this conversion practice became quite popular following the super reforms that occurred in mid-2007 aimed at 'crystallising' a tax free component in respect of a pension (broadly, the then pre-1983 component); which was typically then an allocated pension, which soon followed in respect of transition to retirement allocated pensions ('TRAP') (a TRAP was the predecessor to a TRIS) converting to an allocated pension or an ABP. Following the mid-2007 reforms a member was permitted to convert their allocated pension (which were phased out with no new allocated pensions being allowed to commence after 19 September 2007) to an ABP without the need to first commute their original allocated pension back to accumulation to commence a new ABP (and therefore be subject to the proportioning rule on the commencement of the new ABP). Instead, the member could convert straight across from their allocated pension to a new ABP. Similarly, the practice developed of converting a TRAP to an allocated pension or an ABP. In this regard, the Explanatory Statement to the *Superannuation Industry (Supervision) Amendment Regulations 2007 (No. 1) (Cth)* made the following comment:

*The new minimum standards [being the payment rules for an ABP] will not be restricted to income streams which commence on or after 20 September 2007. This means that existing allocated pensions will be able to operate under the new minimum payment rules from 1 July 2007 **without the need to commute and restart the pension.***

*[Emphasis added]*

For the purposes of s 307-80(3) of ITAA 97 (and despite the operation of Part 6 of SISR) TTI accepts that a pension that does not have flexible governing rules that enables an auto conversion to an ABP and therefore does remain a TRIS under the particular governing rules that such a pension is deemed to remain a TRIS and the ECPI consequences of such a TRIS will be fully determined by the retirement phase rules in s 307-80(3).

TTI also considers that in the absence of express provisions to preclude the conversion of a TRIS to an ABP, if the pension standards and governing rules provide for a conversion mechanism after a relevant condition of release is met, the resulting income stream is not 'locked in' as a TRIS. One would have expected express wording in the legislation if there was an intent to change long established industry practice discussed above regarding conversion of allocated pensions to



ABPs, TRAPs to allocated pensions and TRISs to ABPs that was initiated and encouraged by the explanatory statement to the *Superannuation Industry (Supervision) Amendment Regulations 2007 (No. 1)*. There have been no such relevant changes to change long established practice.

\* \* \* \* \*

If you would like to discuss any aspects of this submission, please contact either me or Senior Adviser, Bruce Quigley, [REDACTED]

Yours sincerely

[REDACTED]

**Tracey Rens**  
President



## THE TAX INSTITUTE

14 November 2019

Mr Andrew Orme  
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By email: [andrew.orme@ato.gov.au](mailto:andrew.orme@ato.gov.au)

Dear Andrew,

### **ATO Guidance**

The Tax Institute has prepared the following submission to the Australian Taxation Office (**ATO**) in relation to ATO guidance. The purpose of this submission is to outline the Institute's concerns in relation to what we perceive to be growing trends in relation to ATO guidance.

Our National Technical Committee members have noticed a decrease in the quality of Explanatory Memoranda (**EMs**) being produced by Treasury. This has caused great concern among The Tax Institute's members, particularly as it seems to have allowed a chasm in interpretive guidance to grow. Members' perception is that the ATO is now moving to fill this chasm. Our specific concerns with EMs are contained in the submission entitled *Treasury – Explanatory Memoranda* dated 14 November 2019 (**Treasury Submission**), a copy of which is attached for your reference. While improving the quality of EMs would address this matter to an extent, regardless there are several other concerns that members have with the guidance being issued by the ATO.

### **Growing Trends**

Our National Technical Committees have noticed what appears to be some concerning trends in relation to ATO guidance. The perceived trends that the Institute is concerned about, and are discussed in detail below, can be grouped as:

- Transparency;
- Foreshadowing positions;
- Decrease in binding guidance;
- Content of guidance; and
- Time taken to complete rulings.

We have discussed these trends below with the purpose of opening a dialogue with the ATO to discuss whether these trends, which appear to be widespread and systemic, are deliberate new directions of the ATO, and, if so, the reasons for such a change of direction.

## 1. Transparency

The Tax Institute contends that the ATO should be transparent in relation to competing legal interpretations.

The Institute considers that there is a growing trend for the ATO to take a position and provide legal analysis that is consistent with their position without acknowledging or refuting other widely and reasonably held legal positions or interpretations.

The Institute contends that it would be beneficial for the tax system if the ATO was open and acknowledged the existence of competing interpretations of the law which are reasonably held. Further, the ATO should refute or explain why they consider that the competing interpretations are incorrect.

One example where the Institute and other professional bodies specifically requested the ATO to acknowledge and explain why they did not accept a widely held industry view was in relation to the definition of 'central management and control'. During the consultation on *TR 2018/5 Income tax: central management and control test of residency* and *PCG 2018/9 Central management and control test of residency: identifying where a company's central management and control is located*, there were differing views between the ATO and stakeholders regarding the decision in the *Bywater*<sup>1</sup> case and whether the case had enough impact to cause the ATO to revise its long-held views in relation to this residency test.

The ATO relied on the *Bywater* case to support revising its views on the central management and control test but did not provide an explanation regarding the change in its long-held view contained in *TR 2004/15 Income tax: residence of companies not incorporated in Australia – carrying on business in Australia and central management and control* (now withdrawn) that was widely accepted by industry.

The professional bodies asked for an explanation as well as examples to support the view the ATO now takes in relation to central management and control. In the absence of a proper explanation and supporting examples, and where the case law clearly doesn't support the ATO's interpretation, there is a lack of transparency as to how the view was arrived at.

Another example of this is the consultation that was conducted in relation to the negative control issue contained in the *Draft Privatisation and Infrastructure Framework: Control under Division 6C* document issued in 2017. The main contention was that the ATO's position that the ability of a shareholder to veto certain decisions gives that shareholder control of the company's business had no support in either the text of the legislation, the purpose for which Division 6C (*Income Tax Assessment Act 1936* (Cth)) was enacted or the cases cited by the ATO. The ATO officers involved in this consultation would not provide stakeholders with an explanation in writing of their view. (Refer to the Institute's submission for further information regarding this issue<sup>2</sup>). A current example of this is in relation to the consultation on draft *GSTD 2018/D1 Goods and Services Tax: determining the creditable purpose of acquisitions in a credit card issuing business*, which is about determining what is a supply in relation to a credit card issuing business. Members considered the analysis regarding basic elements of the issues raised in the consultation to be scant, with minimal case law support provided for positions taken. The case law support that was provided relied on minor statements in cases rather than the ratio.

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<sup>1</sup> *Bywater Investments Ltd v Commissioner of Taxation and Hua Wang Bank Berhad v Commissioner of Taxation* [2016] HCA 45

<sup>2</sup> <https://www.taxinstitute.com.au/tisubmission/draft-privatisation-and-infrastructure-framework-control-under-division-6c>

For example, the Commissioner relies upon commentary in *Commissioner of Taxation v American Express Wholesale Currency Services Pty Limited* [2010] FCAFC 122 (Amex) to essentially conclude that the provision of a credit card facility encompasses a bundle of rights supplied to the cardholder on the entry into the credit card contract which includes the cardholder's exercise of those rights (refer to paragraph 7 in GSTD 2018/D1). In fact, the parties to those proceedings agreed to adopt this proposition and there was no dispute between the parties on this point. The Court in Amex did not fully turn their minds to what constitutes the 'relevant thing supplied' to the cardholder and it is therefore open to conclude that Amex is not binding authority for this proposition.

The examples above demonstrate the importance of transparency in ATO views, particularly where the ATO's view represents a change from a past view or differs greatly from the profession's understanding of the case law and legislative guidance on a particular issue.

#### *Different views in private rulings*

GSTD 2018/D1 Goods and services tax: determining the creditable purpose of acquisitions in a credit card issuing business is an example where the ATO view taken in the public guidance contradicts the ATO positions in private rulings that have been given to taxpayers directly affected by the public guidance. In effect, the public guidance overrides long-held positions confirmed by private rulings without an explanation as to why this change has occurred. Such a change in view in the absence of an explanation is confusing to the market place.

In the context of transparency, we also consider that the ATO should not remove private rulings from the online database. If the rulings no longer reflect the ATO's view, it would be useful if an explanation in relation to why the rulings are no longer consistent with the ATO view is provided or noted in the relevant private rulings.

## **2. Foreshadowing positions**

Another trend that the Institute is concerned about is the perceived trend for the ATO to foreshadow their position before they have analysed issues in detail. This is a concerning trend as consultation in relation to legal interpretation should start with an open dialogue of all positions.

It was noted at the 4 April 2019 Consultation Steering Group meeting<sup>3</sup> that the ATO is looking to foreshadow the outcomes of ruling consultations by including an outline of what the ATO thinks the answer will be.

Members of our National Technical Committees have noted examples in the context of rulings and audits where they perceive that the ATO has reached a conclusion at the beginning of the process. There is a perception that the ATO then produces selective legal analysis to match their foreshadowed opinion.

The Institute would like to discuss the processes the ATO has in relation to reaching legal conclusions on interpretative issues. The Institute considers that it is vital for the tax system to have open dialogue about different interpretations of complex legal issues before a conclusion is reached. To foreshadow a conclusion

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<sup>3</sup> We note this discussion was not recorded in the Key Messages from that meeting.

prior to performing such analysis (both in the context of rulings and audits) can have a potentially detrimental effect on the tax system.

### 3. Decrease in binding guidance

The Institute also considers that there has been a trend for the ATO to move away from binding advice. Members have perceived this as a deliberate change in approach to guidance. While we encourage all types of ATO guidance, whether binding or not, to be developed, there needs to be balance. Further, it is our position that non-binding advice is not the place for the ATO to outline their interpretation of legislation. This should be included in binding guidance documents such as Taxation Rulings (**TR**) and Law Companion Rulings (**LCR**). In fact, Institute members consider that an LCR accompanying new legislation should not be needed if EMs were better prepared (see below). A TR covering specific matters paired with a Taxation Determination (**TD**) or two (if required) should be sufficient. In the event the ATO considers that an LCR is required, the LCR should focus on how the ATO intends to administer the new law, not its interpretation.

It also appears that the ATO is producing more Practical Compliance Guidelines (**PCG**) than rulings and putting more effort into producing PCGs than binding rulings. Consequently, there seems to be a growing trend in the ATO using PCGs as an interpretive product rather than rulings. This is concerning if the ATO is then applying the PCGs as if they are a binding legal interpretation of the law.

We also note the increasing reliance on guidance material on the ATO website and 'Let's Talk' web page.

Our National Technical Committees have noted examples of the above including:

- a) transfer pricing: *TD 2019/10 Income tax: can the debt and equity rules in Division 974 of the Income Tax Assessment Act 1997 limit the operation of the transfer pricing rules in Subdivision 815-B of the Income Tax Assessment Act 1997* – this is an example where members considered the ATO preferred to put out a PCG in relation to the application of the transfer pricing rules to inbound and outbound interest-free loans rather than support its view in a binding product. The request for binding guidance with respect to the application of the transfer pricing rules in Subdivision 815-B to inbound and outbound interest-free loans was originally raised in the Division 815 Technical Working Group. The minutes of the meeting held on 26 July 2016 record that the ATO had approved the listing of this issue on the ATO Rulings Program as a Tax Determination. The minutes of the same meeting also record that the ATO had listed the interaction between Division 974 and Subdivision 815-B as a separate Tax Determination on the ATO's Rulings Program. Subsequently the ATO decided, without external consultation, to combine both interpretative issues into a single Tax Determination and to issue guidance relating to how the transfer pricing rules apply in relation to inbound and outbound interest-free loans in the form of a PCG (see [3901] on ATO's Advice and Guidance).
- b) *PCG 2019/D3 ATO Compliance Approach to the Arm's Length Debt Test* - unlike other PCGs which state that they outline the ATO's compliance approach<sup>4</sup>, the first sentence of paragraph 1 of PCG 2019/D3 states that it 'provides guidance to entities in applying the arm's length debt test in Division 820 of the Income Tax Assessment Act 1997'. This statement is borne out when the PCG is examined in more detail as the discussion under the heading '*Applying the arm's length debt test*' covers in excess of 130 paragraphs (paragraphs 44 to 175) and relates to guidance with respect to application of the arm's length debt test and not to the ATO's compliance approach (which is discussed in

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<sup>4</sup> See for example, paragraph 1 of PCG 2017/1, Paragraph 1 of PCG 2017/4, Paragraph 1 of PCG 2019/1.

paragraphs 11 to 43). Further, the discussion in PCG 2019/D3 needs to be considered in light of *TR 2019/D2 Income tax: thin capitalisation – the arm's length debt test* where the interpretative guidance relating to the factual assumptions (paragraphs 18-21) and relevant factors (paragraphs 22-23) covers 6 paragraphs and largely simply restates the legislation without providing any useful guidance.

- c) Guidance relating to the Mutual Agreement Procedure (MAP) - the ATO withdrew *TR 2000/16 Income tax: international transfer pricing – transfer pricing and profit reallocation adjustments, relief from double taxation and the Mutual Agreement Procedure* on 21 November 2018 and replaced it with updated guidance on the principles and procedures relating to MAP on the ATO website. While a MAP request, in a number of respects, involves the application of processes – which do not lend themselves to being set out in guidance material – there are nevertheless a number of matters of an interpretative nature that were addressed in *TR 2000/16* where it remains appropriate for the ATO to provide relevant guidance in the form of a ruling rather than on its website. As an aside, the Institute notes that there was no public consultation with respect to the proposed withdrawal of *TR 2000/16* or in relation to the ATO website guidance that replaced it. If such consultation had occurred, matters being raised now may have been able to be addressed.

#### *Particular comments in relation to PCGs*

We refer to Practical Compliance Guideline PCG 2016/1 *Practical Compliance Guidelines: purpose, nature and role in ATO's public advice and guidance* which provides at paragraph 13:

*13. Although practice statements are published in the interests of open administration, **their intended audience is ATO staff and they have a main purpose of providing instructions to staff on the manner of performing law administration duties.** Going forward, practice statements will align more closely with their main purpose and **practical compliance guidelines will be the appropriate communication product providing broad law administration guidance to taxpayers.** [Emphasis added]*

We also note paragraph 23 which states:

*23. Practical compliance guidelines, on the other hand, **are not prepared for the primary purpose of expressing a view on the way a tax law provision applies.** They represent guidance material on how the ATO will allocate its compliance resources according to assessments of risk, and may outline administrative approaches that mitigate practical difficulties relating to the operation of tax laws. Accordingly, practical compliance guidelines will generally not be public rulings. [Emphasis added]*

Members have observed a number of particular matters in relation to PCGs. In our members' view, a PCG should clearly set out how the ATO will allocate its compliance resources when administering a particular piece of legislation in line with their intended purpose set out above. However, members have noted increasing use of PCGs for other purposes, such as taking positions on the law in the PCG which are not being supported and using a PCG as if it were equivalent to a Legislative Instrument.

Members also note their experience with ATO Tax Counsel Network staff and Audit teams refusing to move outside the 'green zones' provided in the PCGs, particularly during transfer pricing disputes. Rather than relying on a PCG as a 'risk assessment tool', members' experience is that PCG's are often being used by Audit teams as though they represent an interpretation of the law. An example of this is how both *PCG 2017/1 ATO compliance approach to transfer pricing issues related to centralised operating models involving procurement, marketing, sales and distribution* and *PCG 2019/1 Transfer Pricing issues related to inbound*

*distribution arrangements* are being applied in practice. Members' experience is that the methodology and 'green zone' outcomes in each of these PCGs is being used as de facto interpretative guidance for the transfer pricing rules in SubDiv 815-B in audit cases or is being used by ATO officers to provide the underlying basis for any settlement. This is clearly not the purpose of a PCG.

The statements in paragraph 8 of PCG 2017/1 and paragraph 29 of PCG 2019/1 provide that the transfer pricing methodology used in the PCGs is for risk assessment purposes only. Where a matter has been escalated to an audit, Audit teams should be testing transfer pricing outcomes of distributor arrangements consistent with paragraph 8 of PCG 2017/1 and paragraph 5 of PCG 2019/1. As such, Audit teams do still need to follow due process and undertake appropriate transfer pricing analyses taking into account the particular facts and circumstances of each case when assessing the outcomes of a particular transfer pricing arrangement.

Further, a number of members have had ATO officers indicate to them that a PCG will be used to determine if a settlement is appropriate or not and will apply the PCG to determine the 'reasonableness' of the settlement. In this regard, a risk tool has now morphed into a quasi-Legislative Instrument and the arbiter of the appropriateness / reasonableness of settlement outcomes. Members believe this is not appropriate as risk tools are rarely designed to reflect accurately the relevant law and are thus inappropriate for use by ATO officers in making attempts to apply the law to the facts and circumstances of taxpayers.

#### *Other uses of non-binding guidance*

The Institute is concerned that the use of ATO non-binding guidance and correspondence to nudge taxpayers in certain ways without giving precise guidance on how the law will be administered will be interpreted as blurring the line between regulatory and prudential guidance. Such non-binding guidance in the form of bulletins and letters to nudge taxpayers have been issued without consultation which has caused uncertainty for taxpayers.

The Institute has prepared submissions on this issue in relation to SMSFRB 2019/D1 (confidential submission to the ATO dated 18 September 2019) and the ATO's recent letter to SMSF trustees on meeting diversification requirements (confidential submission to the ATO dated 17 October 2019) and the ATO's recent crypto currency warnings.

## **4. Content of guidance**

### *Nature of analysis*

The Institute also considers that there is a growing trend for ATO guidance to include analysis that should actually be included in the relevant EM. That is, the content of guidance issued by the ATO appears to be expanding to include outlining the ATO's interpretation of the policy intent of the legislation where this has not been adequately set out in the EM.

Separately, we have raised this concern with Treasury in the Treasury Submission. This is problematic from both an interpretation and evidentiary viewpoint. (Please refer to the letter to Treasury for further explanation.)

ATO interpretive guidance, such as an LCR or public ruling, is important and the Institute welcomes and encourages the ATO to continue to issue such guidance. However, it should not replace or reduce the guidance that should correctly be included in EMs.

### *Consistency of view*

Members have also noted examples of where the content of the guidance can be construed in different ways giving rise to inconsistent views from the ATO. One example highlighted by members is paragraph 15 of *LCG 2017/3 Superannuation reform: Superannuation death benefits and the transfer balance cap* regarding binding death benefit nominations (**BDBN**).

For ease of reference, we have extracted the relevant paragraph:

15. A binding death benefit nomination, by itself, does not make a superannuation income stream reversionary. If the governing rules or the agreement/standards under which the superannuation income stream is provided does not expressly provide for reversion then a binding death benefit nomination cannot alter this. The binding death benefit nomination may have the effect of directing the superannuation provider as to whom the death benefit is to be paid and the form, but it cannot turn a non-reversionary superannuation income stream into a reversionary superannuation income stream.

Broadly, the competing views are:

- A BDBN cannot make a pension reversionary. This view is reflected throughout paragraph 15, especially the last clause of the last sentence;
- A BDBN can make a pension reversionary. This view gains support from the words 'by itself,' in the first sentence and 'If the governing rules or the agreement/standards under which the superannuation income stream is provided does not expressly provide for reversion then a binding death benefit nomination cannot alter this' in the second sentence (eg, the governing rules or the agreement/standards may expressly provide for a BDBN to so provide reversion).

The ATO holds one view publicly on how the paragraph can be construed. However, members note they have been advised on a confidential basis of the other view and have relied on it. A consistent view in all circumstances should be put forward by the ATO.

A more recent example can be found in the ATO's website guidance entitled *Death benefit income streams – meeting minimum pension payment requirements* last modified 24 July 2019. This article was "updated to clarify that this is in relation to reversionary pensions only". However, the first iteration was not only confusing, it was in conflict with TR 2013/5 paragraph 129.

The Guidance included a context statement - *A number of questions have recently been raised by the SMSF sector around the interaction between compulsory cashing requirements following a member's death and the requirement to pay a minimum pension amount each year*. It would seem as though a more fulsome answer should have been provided however, the first iteration did not include the Commissioner's opinion as set out in a Public Ruling.

The Guidance was updated within a short period of time to ensure that it was clear that it applies only to reversionary pensions however, in the interim, it created uncertainty for the SMSF sector.



### *Consistency of approach*

There is a clear difference between the approach taken in PCG (*PCG 2017/1 ATO compliance approach to transfer pricing issues related to centralised operating models involving procurement, marketing, sales and distribution*) and the PCG which applies to inbound distributors (*PCG 2019/1 Transfer Pricing issues related to inbound distribution arrangements*).

PCG 2017/1 looks at certain profit level indicators (**PLI**) when considering the arms' length nature of transfer pricing arrangements and prescribes use of cost-based transfer pricing methods (refer for example paragraphs 139 and following). Paragraph 34 of PCG 2019/1 states that the ATO analyses the profit outcomes of inbound distribution arrangements using Earnings Before Interest and Tax (**EBIT**) relative to sales (ie an EBIT margin approach).

Stakeholders anticipated these PCGs would have a similar approach. It is understood that risk tools do not reflect the actual application of the transfer pricing rules, but (for the reasons noted in 3 above) inconsistency between these PCGs can lead to inconsistent treatment of taxpayers.

### *Change of view – retrospectivity*

Where the ATO issues guidance which changes a long-standing view that it has held and is one which the profession has long accepted, such a change should not apply retrospectively. Members have noticed a trend towards the ATO changing long-held views contained in non-binding guidance which impacts on clients, for example the website guidance in relation to General Purpose Financial Statements which applies to significant global entities that have an Australian presence<sup>5</sup>.

Another example is *Draft Taxation Determination TD 2019/D1 Income tax: what is a 'restructuring' for the purposes of subsection 125-70(1) of the Income Tax Assessment Act 1997?* regarding demergers. With this particular example, consideration needs to be given to whether boilerplate language, such as that included in paragraph 41 regarding the Date of Effect of the Taxation Determination, is appropriate for inclusion in all draft guidance. Inclusion of this language alone suggests retrospectivity<sup>6</sup>. In our view, guidance should apply prospectively from the date the guidance is finalised.

## **5. Time taken to complete rulings**

Some members of our National Technical Committees have also expressed concerns in relation to the time it takes for the ATO to issue a public ruling. Members note it is often a lengthy process between the time a draft ruling is issued and the ruling is finalised. The delays between issuing in draft and finalisation of the ruling create uncertainty for taxpayers, particularly if the ATO's view changes between the draft and finalised ruling.

Members note as an example *TR 2004/D25 Income Tax: capital gains: meaning of the words 'absolutely entitled to a CGT asset as against the trustee of a trust' as used in Parts 3-1 and 3-3 of the Income Tax Assessment Act 1997* regarding 'absolute entitlement' which has remained outstanding for 15 years. Delays

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<sup>5</sup> <https://www.ato.gov.au/Business/Public-business-and-international/General-purpose-financial-statements/Guidance-on-the-provision-of-general-purpose-financial-statements/>

<sup>6</sup> For further information in relation to this draft Taxation Determination, please refer to the joint submission from The Tax Institute and Law Council of Australia (<https://www.taxinstitute.com.au/tisubmission/draft-taxation-determination-td-2019/d1-joint-submission>)

in the finalisation of a ruling need to be explained to stakeholders. Stakeholders are always more than happy to provide their technical expertise to assist the ATO in arriving at views.

Members have also raised *Taxation Ruling TR 2017/D6 Income tax and fringe benefits tax: when are deductions allowed for employees' travel expenses?* and the revisions to *Taxation Ruling TR 96/26 Fringe Benefits Tax: car parking fringe benefits*. Concern has been expressed in relation to the length of time it is taking to provide these interpretive materials. We have recently received an update from the ATO regarding the progress of these two rulings where the ATO acknowledged the delays with both these rulings (the ATO has since determined that it would be better to issue the content in TR 2017/D6 in three separate pieces of guidance and the update to TR 96/26 is ready for consultation)

While these materials remain under development, uncertainty remains for taxpayers and their advisers.

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These are important issues causing considerable concern to a wide spectrum of our members. We look forward to discussing these issues with you. Please contact Tax Counsel, [REDACTED]  
[REDACTED]

Yours faithfully,

[REDACTED]

**Tim Neilson**  
President