Question taken on notice:

> **Senator WHISH-WILSON:** In your submission you talked about all the various elements of legislation around thin capitalisation et cetera, and you said that some of them are unadministrable because of the greyness of the laws. Is there a way we can fix that? You may not be able to answer that now, but is there any law that you consider would be black and white rather than grey—from a legislative point of view—or does it come down to this constant assessment of tax ruling? I know there are lots of laws. You can take that on notice.

Response

Grey law by definition lacks certainty of meaning, application, or both. By nature, grey tax law is unpredictable and inconsistent in its tax outcomes.

Grey law can arise when Parliament is uncertain how it intends new legislation to apply, or when it doesn't adequately articulate its intent in the words of legislation, or hasn't anticipated particular circumstances arising, or if might intend that the tax commissioner (or possibly also taxpayers) has a discretion in applying a particular law. In the last case, the legislation would ordinarily be expected to use language expressly reflecting that intent.[1]

Grey tax law can be very costly and time consuming for the ATO to administer, even to the point of a reluctance to challenge various tax claims of large corporates and multinationals. Challenges are often likely to trigger long drawn-out disputes, and settlements through negotiation or litigation may still leave the Commissioner and others unclear on how the law would apply to materially different sets of facts.

Tax law uncertainty is inconsistent with the notion of tax compliance.

In a paper entitled *Tax Uncertainty*[2] the Honourable Justice GT Pagone points out:[3]

> Certainty in the law is fundamental to the rule of law, which holds that the law 'should be clear, easily accessible, comprehensible, prospective rather than retrospective, and relatively stable'.[4]

His Honour goes on to observe:[5]

> At times –alas, all too frequently – the complexity of drafting is such that 'what seem[ed] obvious at first sight quickly recedes into obscurity' [*Inland Revenue Commissioners v Bew Estates Ltd* [1956] 1 Ch 407, 413 (Roxburgh J)]. The consolidation provisions [*Income Tax Assessment Act 1997* (Cth) pt 3-90] may be one such example, to which one may rapidly add the controlled foreign companies regime [*Income Tax Assessment Act 1936* (Cth) pt X], the foreign investment funds regime [*Income Tax Assessment Act 1936* (Cth) pt XI] and other provisions, before the number of additions becomes a flood.

Carried in that flood, I would argue, are also the Thin Capitalisation rules, the transfer pricing rules and the royalty withholding tax rules.

For example the ATO's only published ruling on the taxing of cross-border, outbound, licence fees for the right to use copyrighted computer applications is over two decades old[6] and was issued

before the age of digital downloading. Stuck in the 'shrink-wrap' era the ruling fails to address burning royalty withholding tax questions concerning payments for cross-border licensing of foreign-owned copyright in computer applications, particularly when it is a business application used by Australian corporates and government organisations. Similarly, the ATO has published no view on the taxing of cross-border, outbound, related-party licence fees for rights to use the intellectual property in business trademarks and logos, particularly where unspecified licence fees are bundled up in a 'mixed contract' to import goods, access services and grant sub licences of the IP to Australian customers. Nor does any ruling address schemes that seek to avoid royalty withholding tax by bifurcating copyright rights in computer applications, e.g. where a multinational authorises its Australian subsidiary to grant rights to corporate and government end-users to use the multinational's copyrighted applications but another, separately contracted entity, supplies the actual computer application, such as by way of a digital download.

In the face of obscure and uncertain tax laws, particularly those relevant to large corporates and multinationals, the ATO's claim that, 'most corporates pay the tax they are required to under Australia's law', lacks foundation. [7]

Tax rulings – public and private- express the tax Commissioner's view of the way a tax law applies to one or more entities in particular circumstances. Rulings go some way to addressing uncertainty but they aren't law, and although they are legally binding on the Commissioner they're not legally binding on taxpayers.

As indicated in my Submission and above, on many important big-dollar tax law issues affecting large corporates and multinationals the ATO has published no ruling or view. Some published rulings have been withdrawn but not replaced, and some tax law issues have remained outstanding for a decade or more, adding to the potential for tax avoidance, uncertainty of compliance and inconsistency of tax outcome.

Compared to grey law, black and white tax law is probably less costly and time consuming for the ATO to administer. However, depending on its terms, black and white law may sometimes appear less fair to some business taxpayers or sectors than to others.

Undoubtedly, it is for Parliament to strike the 'right' balance between law that is *intentionally* grey and law that is black and white. Arguably, it is not desirable for grey law to remain *unintentionally* grey.

The starting point for striking the balance, I think, is to ask what legislative object Parliament wishes to achieve; what law design alternatives might achieve it; what costs, benefits, advantages and disadvantages attach to each alternative; and which of them is most likely to optimally achieve the balance sought.

Justice Pagone has suggested that:

> An alternative solution to reduce uncertainty might be the creation of a specialist tribunal charged primarily with the development of consistent, clear and predictable rules concerning tax law.[8]

In my view, it is essential that well before proposed tax legislation is introduced into Parliament the draft of it is thrown open to the rigorous scrutiny of a well-informed, diverse group of reviewers, including especially independent legal counsel. Also, the ATO should permit and encourage its own officers to air any contrary or divergent views directly with the review group, rather than have the ATO filter and edit those views first.

In my opinion it is too costly and inefficient to leave the task of addressing tax uncertainty until after the impugned legislation has been enacted.

Martin Lock

23 April 2015

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[1] For example, under section 177F of Part IVA of the Income Tax Assessment Act 1936 the Commissioner 'may', not 'must', apply the Part.

[2] Melbourne University Law Review [Vol 33, 2009] p.886

[3] At p.887

[4] Citing Sarah Joseph and Melissa Castan, *Federal Constitutional Law: A Contemporary View* (2nd ed, 2006) 6, citing Joseph Raz, 'The Rule of Law and Its Virtue' (1977) 93 *Law Quarterly Review* 195, 198–202.

[5] At p.899

[6] TR 93/12: Income tax: computer software

[7] Opening sentence of paragraph 1 of the Executive Summary of the ATO's submission to the Senate Inquiry into corporate and multinational tax avoidance.
The fact that the ATO doesn't conduct general audits of its 1,100 large businesses - only 50-70 issue-specific audits within that group - raises further evidentiary doubt about the claim.

.[8] At p.905