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House of Representatives
Standing Committee on Tax and Revenue
Parliament House
PO Box 6021
CANBERRA ACT 2600

By email: taxrev.reps@aph.gov.au

Dear Members of the House Tax Committee,

INQUIRY INTO SCRUTINY OF THE TAX OFFICE

Thank you for inviting me to make a submission to the inquiry.

I have practised as a tax lawyer in Melbourne since the 1980s. Most of my work relates to representing taxpayers (especially individuals and small businesses) in tax investigations and resolving tax disputes for those taxpayers. As a result, I have regular contact and communications with ATO officers and the Australian Government Solicitor (AGS), representing the ATO.

Scrutiny of ATO practices is essential. In fact, the scrutiny should be intensified and fine-tuned so as to get the best outcomes. I will explain why below, taking two different areas as an example where greater scrutiny ought to be focussed having regard to the Committee's terms of reference.

Mediation

First, while the ATO has the capacity and mechanisms to undertake formal mediation of tax disputes, ATO officers routinely avoid mediation. This imposes significant costs and inefficiencies.

Formal mediation is a mandatory method for alternative dispute resolution promoted by Courts. In fact, the Supreme Court of Victoria and other Courts will not refer a civil proceeding for trial (or in some instances will not even allow cases to advance beyond the first appearance) unless and until a formal mediation has been conducted. Knowing the attitude of the Courts, mediations between parties in dispute routinely occur before Court proceedings are issued. Mediation at an early stage (commonly before proceedings commence) is also routine in relation to family law disputes thanks to the Family Court's

active encouragement. As a result of Court practices, fostered by practice notes issued by the Courts, mediations are not only compelled, but litigants routinely engage in mediation well before commencing litigation. In fact, as a result of early effective mediation, a lot of costly litigation and inefficiency is avoided altogether, either because mediation has resolved the dispute and the parties decide never to go to Court, or the dispute ends up being swiftly dealt with by consent orders in Court, ie orders obtained by consent of both parties under which the Court formally endorses their agreed resolution of the dispute. It is now part of the dispute resolution culture to follow this approach, *except when engaging with the ATO*.

The ATO has employed a mediation team in the past to resolve tax disputes, but, to be frank, it has been sidelined by other ATO officers who I believe are suspicious of its commercial and merit-based approach. This means that tax disputes fail to get resolved at an early stage and become protracted, significantly increasing inefficiencies and costs for both taxpayers and the Government. Even if the ATO believes (rightly or wrongly) that its case is water-tight, early resolution through mediation works to the Government's advantage. Often the ATO's confidence in success is misconceived, which can be best explored at a mediation forum with a third party testing the ATO's views. It is better for the ATO to realise this at an early stage rather than embarking on a costly and protracted defence of a dubious position. Unfortunately, the checks and balances do not work well in practice within the ATO and the ATO officer determining a taxpayer's objection to a tax assessment is typically defensive of the ATO's audit position and will almost always conclude in favour of the ATO, which commits the ATO to the dispute. Furthermore, if a taxpayer refers the tax dispute to the Administrative Appeals Tribunal (AAT) for review, the ATO's costs of defending its position in the AAT are not recoverable from the taxpayer, even if the ATO succeeds. Despite success, the Government is still out of pocket for ATO time spent on preparing for the case and attending at the AAT, AGS representation of the ATO and the barrister's preparation for and appearance at AAT hearings. Moreover, the ATO then faces the possibility of the taxpayer appealing or being impecunious, with the result that even a water-tight technical case turns into a pyrrhic victory.

Scrutiny is required of the ATO's systemic failure to embrace and promote formal mediation by an independent mediator or by a separate mediation team within the ATO as a cost effective and efficient way to resolve tax disputes. While the Commissioner has publicly said in the past that the ATO favours alternative dispute resolution such as mediation, it is not being adopted in practice and from my experience is resisted and rejected by ATO officers when it is requested. Moreover, mediation is rarely, if ever, offered as a dispute resolution option by ATO officers, who I believe are unfamiliar and uncomfortable with the commercial practice of negotiating and settling disputes as early as possible. It follows that there is a serious breakdown in communication and a lack of internal scrutiny within the ATO given the widespread failure to implement the Commissioner's public pronouncements in favour of alternative dispute resolution.

Until formal mediation of disputes is mandatorily adopted and promoted by the ATO, preferably as soon as issues in dispute are identified (ie once ATO investigations are concluded and both parties have been able to identify and narrow the issues in dispute) there will be significant costs and inefficiency for both taxpayers and Government whenever a tax dispute arises. The tax dispute will just continue to run, embroiling both taxpayers and the Government in protracted expensive fights.

Enforcement and debt collection

Second, the ATO's powers are extensive, in fact more extensive than police powers. The ATO can (and often does) compel a taxpayer to attend at an interview to answer questions on oath. Unlike criminals interviewed by police over their criminal activities, taxpayers do not have a right to remain silent at such interviews in relation to their tax affairs. Taxpayers are compelled to answer, under oath! Moreover, a taxpayer's right to legal representation at an interview is very limited. Lawyers are not invited. A lawyer can attend if they ask to attend, but is cautioned at the interview that they cannot assist the taxpayer with answering questions. At best, the lawyer's role at an interview is limited to ensuring that the taxpayer understands what is being asked by the ATO (taxpayers unfamiliar with tax laws can easily become confused) and ensuring that their client's right to legal professional privilege is protected. Furthermore, the ATO can attend and search a taxpayer's home or business premises at any time without a search warrant. In addition, if ATO officers attend at a taxpayer's home or business, the ATO officers in attendance are not required to read the taxpayer his/her rights, as limited as they may be.

In view of the tremendous powers conferred on the ATO which can heavily infringe upon freedoms we tend to take for granted, the ATO should be held fully accountable and remain under close scrutiny. If that scrutiny is weakened, then we are weakening individual rights and freedoms because no taxpayer, except for large well-funded corporates, has the resources to hold the ATO to account. At best a taxpayer can dispute a tax assessment, but even then the ATO has the power to bankrupt the taxpayer before the tax dispute is determined. If that happens, the taxpayer effectively loses their rights and the ATO's tax assessment succeeds by default. Even if the taxpayer is not bankrupted, the ATO routinely compels payment of some or all of the disputed tax, which often leaves the taxpayer to struggle without adequate financial resources to contest a disputed tax assessment.

In the circumstances, a body or mechanism should be established to scrutinise and monitor the ATO's use of its enforcement (including debt collection) powers. This should not only be done in the best interests of ensuring that taxpayers are not "monstered" by the ATO, but because it will deliver efficiencies and savings for Government.

There is no point in the ATO resorting to heavy-handed tactics and using scarce resources to assess and collect tax in relation to taxpayers who do not have the capacity to pay. While a large tax assessment may be warranted, chasing every last dollar of tax makes no sense when the taxpayer's financial resources (eg through mismanagement, gambling, business failure, divorce or departure overseas) are such that those taxes will never be recovered. I see this happen time and time again. After a tax investigation, tax auditors raise assessments that the debt collection department at the ATO (which has not been consulted) subsequently discovers can't be recovered, but nonetheless the debt collection department finds it difficult to compromise and settle the tax debt because the amount actually able to be recovered is a relatively small percentage of the large tax assessment which has been raised by the audit team. In short, the tax auditors' enthusiasm for assessing every last dollar of tax, which can tie up considerable ATO resources (eg because of interviews, reviewing paperwork and submissions, preparing audit position papers) at significant cost to the Government, takes no account of a taxpayer's capacity to pay, which can often mean that a lot of ATO investigative time has been wasted for nothing, or very little, leaving the ATO's debt collection area with a

headache. This lack of co-ordination and commerciality within the ATO desperately requires scrutiny.

Even the debt collection area itself needs scrutiny. Sometimes its persistence in seeking to recover money from impecunious taxpayers beggars belief. There should be external scrutiny to ensure that costly investigative time is not invested in impecunious taxpayers and if, for instance, a commercially sensible settlement proposal is put on the table by a taxpayer, it is accepted, not perpetually deferred or rejected, as often happens. Moreover, the ATO should not be allowed to withdraw a settlement proposal it has previously put on the table to compromise a tax debt just because the taxpayer has made a counter-offer to the ATO. Again this sort of egregious ATO behaviour, which will perpetuate a tax dispute needlessly, requires scrutiny. Self-evidently, the perpetuation of a tax dispute increases cost to the Government.

I would be pleased to discuss this submission and to appear as an expert witness at a hearing of the inquiry into scrutiny of the ATO.

Should you have any queries, please do not hesitate to contact me.

Yours faithfully,

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GRAEME HALPERIN