

21 February 2012

Ms Brenda Berkeley  
The General Manager  
Indirect Tax Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Email: [GSTadministration@treasury.gov.au](mailto:GSTadministration@treasury.gov.au)

Dear Ms Berkeley,

**Re: Proposed section 8AAZLGA of the Taxation Administration Act 1953**

The Financial Services Council (**FSC**) welcomes the opportunity to provide comments to Treasury on proposed section 8AAZLGA of the *Taxation Administration Act 1953* (**Section 8AAZLGA**).

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks. The FSC has 128 members who are responsible for investing \$1.8 trillion on behalf of more than 11 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Stock Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Please contact Blake Briggs at [bbriggs@fsc.org.au](mailto:bbriggs@fsc.org.au) or on 0432 663875 if you have further questions.

Yours sincerely



**MARTIN CODINA**  
Director of Policy

## Summary

The FSC, like all Australian business organisations, has a strong interest in an efficient national tax collection system. It also, like other business organisations, has an equally strong interest in ensuring that this system and our nation's economic health is not dimmed by excesses, whether they be those of taxpayers or the Australian Taxation Office (**ATO**). Individual fraudulent refund claims by a taxpayer harm the greater community. Unwarranted retention by the Commissioner of a refund to which a taxpayer is entitled can equally have irreversible impacts on a business. An interruption to cash flow can produce domino effects that become uncontrollable.

The FSC is therefore supportive of the Government and Treasury's desire to strike, in the Assistant Treasurer's words of 15 February, "an appropriate balance between a taxpayer's right to a prompt refund and the Commissioner's responsibilities."

However, the FSC considers that proposed Section 8AAZLGA does not achieve that balance. As currently drafted it confers limited legal rights on taxpayers and few practical limits on the ATO's expanded legal power to retain refunds. Section 8AAZLGA in effect confers on the Commissioner a statutory form of Mareva Injunction, but without any of the checks and balances required to get such an order.

Significant amendment would need to be made to the drafting of Section 8AAZLGA before the FSC could support its enactment. Issues which need to be addressed include:

- (i) Deferral of the implementation date for income tax and taxes other than GST to allow for informed consultation on how the measure should apply in a non-GST context.
- (ii) Redrafting of Section 8AAZLGA to accord with the principles of the Australia's self-assessment model of taxation.
- (iii) Removal of the Commissioner's *practical* capacity to retain refunds potentially indefinitely through the mechanism of repeated information requests regardless of materiality.
- (iv) Imposing a legal obligation on the Commissioner to pay a refund unless within 14 days the Commissioner asks the taxpayer to substantiate the refunds claimed. Thereafter the onus should rest with the taxpayer to substantiate the claim.
- (v) At the least the Commissioner's initial decision to retain a refund needs to be made an objective test, if a primary legal obligation is not imposed on the Commissioner to pay a refund as mentioned above.
- (vi) Clear parameters must be given to the term "verification of information" so as to make it an objective test.
- (vii) The factors listed in section 8AAZLGA(8) factors should be redrafted, a greater weighting be given to the economic impact on the taxpayer's business and item (f) deleted.
- (viii) The scope of the Commissioner's power to retain refunds should be limited to circumstances where it is reasonable to retain the refund because the information is more likely than not incorrect due to fraud or reckless disregard of the tax law.

## 1. Deferred implementation date for income tax and taxes other than GST

At the consultation meeting of Friday, 17 February (**Consultation**) Treasury officials advised:

- (i) it is Government's intention that Section 8AAZLGA should apply to income tax. There was some discussion in the meeting as to just how that outcome was achieved under the present drafting. That discussion was inconclusive; and
- (ii) a short consultation period was appropriate because Section 8AAZLGA was a revenue integrity measure prompted by the decision in *Commissioner of Taxation v Multiflex Pty Ltd [2011] FCAFC 142 (Multiflex)*, a GST case, and because there had been prior consultation on an earlier version of section 8AAZLGA in the context of the transfer of GST to self-assessment system.

The FSC submits that the implementation date for income tax and taxes other than GST should be deferred.

There has been no prior consultation on the operation of draft section 8AAZLGA in these contexts. Indeed, most income tax practitioners will be unaware of the sections application to income tax refunds since the reform has been publicised as a response to a GST decision. Nor was any assertion made by Treasury and ATO officials at the Consultation that the *Multiflex* decision was causing problems in the administration of refunds in the context of income tax and taxes other than GST. Further, the lack of clarity at the Consultation as to how Section 8AAZLGA applies in an income tax context merely reinforces the need for a deferral to allow for informed consultation.

## 2. Drafting in accordance with the self-assessment model

Australia's current tax system is founded on the self-assessment model. Under this model primary responsibility is placed on the taxpayer to correctly determine their tax liability, whether that be GST or income tax. It follows that as a matter of principle provisions which depart from that model should be strictly and narrowly drafted and expressed with utmost clarity. If not, those provisions serve to undermine the integrity of the taxation system.

Section 8AAZLGA is drafted on the opposite presumption. That is, it presumes that taxpayers invariably, improperly and incorrectly determine their tax liabilities. This presumption is directly contrary to the self-assessment model and is evident from the width of the Commissioner's power to retain, the limited legal rights conferred on taxpayers, the low threshold for retention and the high threshold for challenge.

For example, section 8AAZLGA(1)(b) sets a remarkably low threshold for retention of refunds by the ATO. Indeed, the threshold is so low that it, arguably, amounts to a presumption that refunds should be retained in all circumstances. Given this low threshold in the law it can be expected that over time ATO internal service standards will move to reflect that presumption.

Under section 8AAZLGA(1)(b) the Commissioner must merely be satisfied that it is "reasonable to require verification of information". The term "verification" is undefined in Section 8AAZLGA and the ordinary meaning of "verify" is "to prove to be true, as by evidence or testimony".

Accordingly, in order for the Commissioner to retain a refund he or she need be satisfied that it is reasonable to determine that the information is 100% correct. But given the Commissioner is also under an obligation to collect the correct amount of tax the Commissioner will always be under an obligation under section 8AAZLGA(1)(b) to confirm the information is 100% correct and hence will retain all refunds. Further, credence is given to this interpretation by the absence of any legal criteria which the Commissioner must consider in reaching that view. Moreover, the Commissioner is empowered, arguably required, to retain the whole of the refund amount even though he or she may be satisfied that only 1% of the information is incorrect and relates to an immaterial proportion of the refund.

The FSC accepts the representations by Treasury and ATO officials at the Consultation that this outcome is not intended by Section 8AAZLGA. But, such an approach by the Commissioner is nonetheless permissible under the legal words of Section 8AAZLGA as currently drafted. Indeed, on this view it is arguable that the Commissioner is remiss in his or her duties if all refunds are not retained without first making verification enquiries. In truth these representations, as contrasted to the words of Section 8AAZLGA, point to the deficiencies in Section 8AAZLGA and the need for it to be re-drafted in accordance with the self-assessment model.

### **3. Removal of the Commissioner's practical power to retain refunds indefinitely**

Where the taxpayer gives the Commissioner a notification that affects, or may affect, the amount of a refund section 8AAZLGA(3) empowers the Commissioner to retain that refund for up to 14 days (for GST) or 30 days (for other taxes) plus 60 days while the Commissioner verifies the information contained in the notification.

This 72-day or 90-day period may be extended under section 8AAZLGA(4) by a further period where the Commissioner "requests information for the information mentioned in paragraph (1)(b)." That period is the length of time it takes for the Commissioner to receive the information requested. Therefore, if it takes the taxpayer 20 days to reply to the Commissioner's request the 72-day period is extended to a 92-day period and the 90-day period is extended to a 110-day period. Further, this period can be repeatedly extended by subsequent requests from the Commissioner.

The FSC acknowledges the point made by Treasury officials at the Consultation that 14 days is too short a time period within which the ATO can be expected to identify fraud. However, the ATO's practical capacity to extend the refund retention period indefinitely through repeated information requests goes far beyond that concern. This capacity arises through several defects in the drafting of section 8AAZLGA(4), namely:

- (i) there is no requirement in section 8AAZLGA(4) that "the request be reasonable" or even relevant (as distinct from the requirement that the initial decision to retain the refund be based on a view that it is "reasonable to require verification" (section 8AAZLGA(1)(b)), or that a later decision to release the refund be based on a view that it is "no longer reasonable to require verification" (section 8AAZLGA(3)(a)));
- (ii) there is no objective criteria as against which the permissibility of the Commissioner's request for information can be measured for the purposes of section 8AAZLGA(4);

- (iii) there is no requirement that the information request must be made to the taxpayer. This must be the case. The Commissioner should not be permitted to defer payment of the refund while it makes enquiries of third parties who, unlike the taxpayer, have no particular financial interest in responding to the enquiry;
- (iv) there is no limitation that either the first request or any subsequent requests be directed at identifying whether there had been fraud or reckless disregard by the taxpayer; and
- (v) there is no capacity for a taxpayer to challenge the merits of the request. This is because the taxpayer's objection rights commence only after the end of the end of the extended refund retention period (section 8AAZLGA(8)), which period the Commissioner can unilaterally continue to extend by simply requesting yet further information.

In short, as currently drafted the Commissioner's request can be as reasonable and relevant or as unreasonable and irrelevant as the ATO officer making the enquiry and the taxpayer has no legal capacity to challenge the relevance of the request. Moreover, the enquiry, whether it be the initial or subsequent, need have no connection to establishing whether or not the refund claim is based on fraud or reckless disregard.

**4. Impose an explicit legal obligation on the Commissioner to pay a claimed refund within a limited defined period, unless during this period the Commissioner asks the taxpayer to substantiate the refund claim**

The Commissioner should be under a primary and explicit obligation to pay a refund claimed by a taxpayer. The Commissioner should only be relieved of this obligation if within a limited period, say 14 days, the Commissioner asks the taxpayer to substantiate the refund. If the taxpayer does not do so to the Commissioner's satisfaction within a further limited period, say a further 14 days, the Commissioner should be required to justify the extraordinary step of continuing to withhold the refund by issuing a refund freezing order. The taxpayer should be able to object to that order.

The imposition of such an explicit primary obligation on the Commissioner is consistent with the self-assessment model. It mirrors the primary obligation on the taxpayer to correctly self-assess their tax liability. It follows that this approach is to be preferred from a tax design perspective to that currently contained in Section 8AAZLGA.

**5. The Commissioner's initial decision to retain a refund needs to be made an objective test**

At the Consultation ATO officials expressed the desire that the test in section 8AAZLGA(1) be an objective test. The FSC shares that desire.

The current test in section 8AAZLGA(1), however, is not an objective test because there is no defined criteria against which that decision must be measured. This flaw can be remedied by requiring the Commissioner to have regard to the factors listed in section 8AAZLGA(8) in reaching the decision that it is reasonable to require verification of the information.

## **6. The term “verification of information” should be made an objective test**

The concept of “verification” is new to the *Taxation Administration Act 1953 (TAA)*. Its meaning is not defined for the purposes of the TAA. The term’s ordinary meaning, as already noted, connotes a forensic test whereby the ATO through a process of collecting evidence from the taxpayer and others determines whether or not the relevant information provided by the taxpayer in the notification is 100% correct. The relevant information is information which affects, or may affect, computation of the tax refund.

In the FSC’s opinion setting the test of verification at 100% accuracy is too high. This was result in undue delays in paying refunds which may adversely affect the economic viability of compliant businesses.

Accordingly, the FSC submits that Section 8AAZLGA should be amended to explicitly specify the standard at which “verification” will be met and that standard should be lower than 100% correct. The FSC is of the view that the appropriate threshold is that “the information is likely as not correct”.

Further, it should be clarified that the test of “verification of information” only refers to the factual accuracy of information. It does not extend to the interpretation of law which underpins the assembly of the information where that view is legitimately held. The Commissioner should not have a power to retain a refund merely because the taxpayer has a different view of the law to the Commissioner. This needs to be made explicit.

## **7. Section 8AAZLGA(8) factors should be redrafted, a greater weighting to the economic impact on the taxpayer’s business and item (f) deleted**

The self-assessment model of taxation implies that the Commissioner’s decision to retain a refund should be seen as an extraordinary decision rather than an ordinary decision. Accordingly, the criteria against which that decision must be expressed with utmost clarity. In the FSC’s view the current drafting of the criteria in section 8AAZLGA(8) are not sufficiently clearly expressed and need to be redrafted with greater precision.

For example, paragraph 8(a) requires the Commissioner to have regard to “the likelihood that the information contained in the notification, and the likely extent of that inaccuracy”. What degree of likelihood is it to which the Commissioner must have regard? Is it a probability? A high likelihood? As likely as not? A little likelihood?

The FSC considers that paragraph (a) should be redrafted to require the Commissioner to have regard to “*whether it is more likely than not that the information contained in the notification is inaccurate, and that the inaccuracy materially affects, or may affect, the amount of the refund claimed.*” The Explanatory Memorandum (EM) should then give further guidance on the meaning of “more likely than not” and “materially affects”.

A further example is paragraph 8(d) refers to “any complexity that would be involved in verifying the information”. However, that is not the real concern. The real concern is the length of time which it will likely take to verify the information. A long length of time may be due to complexity. But, it may also be due to other factors. It is better to express the real concern, or “the cause not the symptom”.

The FSC considers that 8(d) should be redrafted to require the Commissioner to have regard to *“whether it is more likely than not that it will take a long time to verify the information due to complexity and other reasons”*.

The FSC does not agree that equal weighting should be to all factors. The FSC considers that “a higher weighting” should be given to whether or not it is more than likely that retaining the refund will have a significant adverse economic impact on the taxpayer’s business.

The retention of a single repayment will often have a materially adverse impact on a taxpayer’s economic viability. The payment of a refund, which is subsequently found to be incorrect, will seldom have a materially adverse impact on the States and Territories’ economic viability. This is particularly important since any taxpayer rights to object may be long delayed under current Section 8AAZLGA until potentially well after the Commissioner’s decision has damaged their business.

Therefore it is not appropriate to give the same weight to this factor as it is to other listed factors. Indeed, para 1.26 of the EM somewhat indifferently suggests that this factor will be given less than equal weight, since it will always be “outweighed” by the risk to the revenue. Rather, this factor should be given a greater than equal weighting.

Under the self-assessment system the Commissioner’s power to retain refunds should be an exception circumstance. Accordingly, it follows that the factors which the Commissioner takes into account in reaching that decision should be narrowly and tightly defined. Accordingly, the FSC considers that 8(f) “any other matter the Commissioner considers relevant” should be deleted.

**8. Commissioner’s power to retain refunds should be limited to circumstances where the claimed refund is more likely than not is due to fraud or reckless disregard.**

As a statement of principle the self-assessment system model implies that the Commissioner’s power to retain refunds should be limited to circumstances where the claimed refund is due to fraud or reckless disregard.

At no point in the retention process is the Commissioner’s decision to retain, to continue to retain or to release the refund limited to an assessment as to the likelihood of fraud or reckless disregard. This is wholly inappropriate.