**Submission to the TASA Review (the Review)**

I am currently on leave pending retirement as Second Commissioner of Taxation. My tenure formally comes to an end on 19 September 2019. The comments in this submission are my own and do not purport to represent the views of the ATO. To avoid any risk of misunderstanding, I would ask that this submission not be published and be treated as confidential. Hopefully the comments are helpful. I have limited them principally to the issue of tax law penalties for tax agents, with which I have had some experience.

**Discussion**

1. The Review is an opportunity to reset behavioural standards expected of key tax system actors under self-assessment

The consultation paper notes that the TASA had its origins in the transition in Australia to a system of self-assessment for income tax. As the paper also notes, the TASA had a long genesis. It has now been over thirty years since the introduction of income tax self-assessment, and with the passage of time and the chance to reflect on some of the “practical compromises” that were made when the TASA was introduced, it is timely to bring the original context and intent back to the fore. This is also an important element of “post-implementation reviews”.

The shift to income tax self-assessment in Australia was one of the most significant changes to the system of collection of the Federal income tax since its inception in 1910. In a system of income tax *assessment*, taxpayers were required to gather together and present to the Commissioner the facts relevant to their income for the relevant period. The Commissioner then assessesed the application of the income tax law to those facts and issues an assessment.

To fully comply in Australia’s *assessment* system, taxpayers were required to present their relevant facts with honesty, accuracy and completeness. The standard of behaviour expected of taxpayers was expressed in the penalty provisions relating to the making of false or misleading statements (and various iterations). In other words, the penalty provisions of the income tax law set the standard of how taxpayers were expected to behave to fully meet their income tax obligations. (Note that this did not mean that taxpayers must have paid the “correct” amount of tax to have fully complied. For example, if the Commissioner assessed the taxpayer incorrectly on a question of law even though the taxpayer had made a full and true disclosure of the facts, the taxpayer had still fully complied – that is, they had done all that the Parliament, and hence the community, expected of them.)

It is worth noting that under the previous assessment system the standards of behaviour were imposed primarily on taxpayers, and not their agents. This was presumably on the basis that it was not unreasonable to expect taxpayers to take full responsibility for a statement of the facts that relate to their income – after all, they ought to know! But if the taxpayer attracted a penalty through the negligence of their tax agent, the agent was liable to pay the taxpayer the amount of that penalty and the taxpayer could enforce recovery through the courts (former section 251M). While in practice this feature of the previous regime may not have been frequently enlivened in a formal sense, its presence may well have had a practical impact, and it was an important conceptual part of the previous community standards. In other words, even in an assessment system, tax agents were expected to exercise reasonable care.

With the introduction of self-assessment, it was no longer enough for taxpayers to honestly, accurately and completely gather and present their facts to the Commissioner. Rather, taxpayers were required to themselves (or through their agent) apply the income tax law to their facts and so “self-assess” their taxable income or tax liability (depending on whether they are partial or full self-assessing taxpayers). The question therefore became what new standards of behaviour were required of taxpayers (and their agents) to fully comply under a self-assessment system. The question of the standards that ought to apply to tax agents was particularly a point of focus, as self-assessment required not just a consideration of the facts, but also of how the law applied to the facts, an area where the skills and behaviours of tax agents would play a much more significant role.

The conversation on the appropriate standards of behaviour to be expected of taxpayers and their agents under self-assessment effectively commenced on 13 December 1990 when the then Treasurer (the Hon P J Keating) released a consultative document on self-assessment and the legislative changes required to better support it. Relevantly that document stated:

“Where a taxpayer has provided a registered tax agent with all the details necessary to complete a return and to ascertain the correct amount of taxable income and tax liability, the agent should be accountable for the information prepared or returned and for the calculation of tax payable.

A system of administrative penalties for failure to adequately complete a return on behalf of a client would apply to practitioners.

The practitioner could be required to exercise due diligence in return preparation. A practitioner would be liable to a penalty where there was an understatement in the taxpayer’s liability attributable to a position taken which was not reasonably arguable and the practitioner knew or should have known that the position was not reasonably arguable……..A practitioner would also be liable to penalty for any wilful or fraudulent understatement of a taxpayer’s liability.”

This review is an opportunity to review the standards of behaviour that the community expects of tax agents in acquitting their important role in a self-assessment system.

1. And to re-examine the “safe harbour”

The current safe harbour arrangement has its origins in the thinking that underpinned the standards of behaviour expected of taxpayers in a self-assessment system. Taxpayers are expected to exercise reasonable care, and by doing so should not be at risk of any penalty if they get their self-assessment wrong (they are of course still liable to pay the primary tax and interest).

When the new penalty regime for self-assessment was initially enacted, taxpayers were made liable for penalties for a lack of reasonable care by themselves *or* their tax agent. This outcome, together with the maintenance of the former s251M, was deliberately an interim arrangement pending the development of a negotiated approach to tax agents (which, as noted above, took some time and eventually led to the TASA).

The current safe harbour, introduced with the TASA, effectively reflects the outcome that would be expected from the application of the reasonable care standard to taxpayers as originally envisaged. That is, taxpayers should be accountable for their own behaviour, and in an ordinary case a taxpayer exercises reasonable care by accurately and completely disclosing their facts to a tax agent and following the agent’s advice. Such an outcome makes sense where the tax agent is held accountable for their own behaviour which leads to an underpayment of tax. The TASA was meant to facilitate this, although in practice there has been a mismatch between taxpayers benefitting from the safe harbour and their agents being held to account for their careless mistakes.

In other words, the safe harbour arrangement has come at a cost to the community. Penalties were foregone in lieu of tax agent behaviour being regulated through a different mechanism. However, that bargain has not worked out well for the community, not only in foregone penalties, but also in foregone taxes (see tax gap section below), because the different mechanism has not been effective.

In the worst case, the mismatch mentioned above can lead to tax agents pursuing creative claims on behalf of their clients in a risk- (consequence-) free manner, provided the claims can be characterised only as lacking reasonable care and not being reckless or intentional. In such a case, if the claims are challenged by the ATO, the primary tax and interest would be payable but there would be no penalties, making the exercise risk-free.

I suspect the Commissioner at the time TASA was introduced was wary that such a mismatch would occur, and resisted the safe harbour being extended to apply to tax shortfalls caused by tax agent recklessness or intentional disregard, because of the greater risk to tax system integrity of those behaviours being similarly risk-free. On the data now available, the Commissioner’s wariness seems to have been well placed.

However, the practical compromise of the safe harbour only applying in instances of tax agent carelessness leaves taxpayers unfairly exposed to penalties for the reckless and intentional behaviour of their agent, as the Review consultation paper acknowledges. And that unfairness was exacerbated by the repeal of the former s251M in 2009.

The safe harbour mechanism is also problematic in requiring a taxpayer to establish that their tax agent was careless, rather than just demonstrating that their own behaviour was careful – also acknowledged in the Review consultation paper.

Collectively, these defects have the potential to create an unsatisfactory dynamic between taxpayers and their agents, and an unfair outcome for taxpayers under self-assessment.

A better dynamic, and fairer outcomes, would ensue from both taxpayers and their agents being held to account against the standards expected under a self-assessment system in cases where a failure to meet the standards has been identified by the Commissioner as having led to an underpayment of tax. That is, both taxpayers and their agents should be expected to exercise reasonable care and to not behave recklessly or with intentional disregard.

Importantly, if both agent and taxpayer fail the standards in any given case, there should be consequences for both. I understand this is the principle adopted in the Canadian system. The idea that any penalty should be solely on one or the other seems flawed, given that the object is to promote behaviour consistent with the relevant standards by both parties.

Taxpayers effectively maintain a safe harbour under this approach. If they have met the required standards of behaviour, including through providing all relevant information to a tax agent and following their advice, they are “safe” from penalties. Similarly, tax agents can avoid the risk of penalty by meeting the required standards of behaviour.

The quantum of penalty for agents needs to be designed in a way that does not promote an arbitrage opportunity through collaboration on poor behaviour between taxpayer and agent. This would be the case, for example, if both penalties were set by reference to the tax shortfall. Again, the Canadian model may assist.

Review rights should exist for both taxpayers and tax agents on the penalties they might face, with the primary focus of both the initial decision and any review on their individual behaviour, not the behaviour of another.

The commissioner should put in place administrative mechanisms that ensure the careful, considered and consistent application of these new penalties, much as he has done for other important tools he has at his disposal to help ensure tax system integrity (eg Part IVA; the diverted profits tax; instances of fraud and evasion).

1. The Review should be guided heavily by the hard evidence of the tax gap research

Last year the Commissioner published for the first time his estimate of the tax gap for individuals. An update of that estimate is perhaps likely before the end of this year based on the latest round of random enquiries.

The Commissioner’s estimate is that individuals-not-in-business paid 93.6% of the theoretical tax payable by that group for the 2014-15 year. The net tax gap of 6.4% is worth $8.76b (for the 2014-15 year).

The detailed published analysis shows that the rate and value of adjustments made in randomly selected cases was significantly higher for tax agent prepared returns than for self-prepared returns.

While the detailed analysis breaks up the results of the random enquiries according to the size of adjustments made (by ranges), it does not expressly describe the dominant behaviours observed that were the drivers of each range of adjustments. It is perhaps implicit that small adjustments (0 -$150) were either honest mistakes or caused by carelessness, and larger adjustments (> $1000) caused by recklessness or intentional behaviour, but this is not clear. It would be beneficial for the Review to have access to the ATO’s insights on this, and to make these transparent.

It can be argued that achieving collections of over 93% of the theoretical tax payable is an excellent outcome. Equally, in the Australian context, there are significant grounds for disappointment, especially given the high rates of usage of tax agents and their relatively poor performance compared with self-preparers, especially as tax agents are regulated.

The ATO has positioned the tax gap data and research as an opportunity for the ATO, tax practitioners and the broader community to work collaboratively to improve the performance of this vital component of Australia’s revenue collection system. One important element of that opportunity is presented by this Review, which is one of the first opportunities to provide a policy response to the insights provided by the tax gap data. In this sense the Review is well timed.

The case for grasping the policy opportunity is strengthened further when the tax gap for small business taxpayers is also considered. Earlier this year the Commissioner indicated that the net tax gap for small businesses (turnover less than $10m) was in the order of $10b, a net tax gap of between 10% and 15% of the theoretical tax payable by this market. This is a much larger net tax gap than in other markets. Rates of tax agent usage by small businesses are well over 90%, much greater than for individuals-not-in-business. It would again be valuable for the Review to gain access to the ATO’s insights on the behavioural drivers behind the small business tax gap, and to make these transparent.

To help make concrete the size of the opportunity presented by these figures, we can use the net tax gap for large corporate Australia (4.4%) as a benchmark. This is arguably a conservative benchmark given the critical nature of the community debate on the tax performance of large corporate businesses. If the net tax gaps for individuals-not-in-business and small businesses were reduced to a similar level as large corporate businesses, there would be at least an extra $8b per annum in Federal government tax collections. I make this point to highlight the seriousness and importance of the Review. There is a strong public interest in the outcome, or at least there ought to be, meaning that the obtaining of a plurality of voices will be important to the work of the Review.

This is not to say that the Review represents the only opportunity to positively impact revenue system performance, but it is difficult to think of a more fundamental building block than to strengthen the standards of behaviour expected by the community of the key system participants, especially when the current standards (and consequences of breaching them) have proven themselves inadequate.

1. The Review should look to equip both the Commissioner and the TPB to achieve the outcomes sought

The original self-assessment proposal outlined in 1990 for the tax law to set an expected standard of behaviour for tax agents, with the prospect of tax law penalties for not adhering to those standards, instead became the system that is the subject of this Review.

The current system can be critiqued on two key (inter-related) scores: an extremely high level of tax agent mistakes resulting in significant amounts of underpaid tax; and an arguably ineffective TPB.

The Commissioner of Taxation is charged with responsibility for the effective operation of Australia’s tax laws, which includes a responsibility for ensuring appropriate levels of compliance. Yet the Commissioner does not have an adequate tool kit for responding to the poor behaviour, and the resulting poor tax system performance, of a key group of tax system actors. In the same way that the Government asked whether the Commissioner had the right tools to treat the compliance of large corporate taxpayers, where the ATO’s tax gap analysis showed and continues to show a much less significant problem, and responded by introducing and strengthening a raft of tax laws, a similar response is required here.

An effective system of oversight to ensure that tax agents appropriately play their role in ensuring the integrity of Australia’s tax system requires a connected effort between the ATO and the TPB, with each adequately equipped to play their part.

The Commissioner is already the custodian of the key standards expected under self-assessment of taxpayers behaving with reasonable care, and not behaving recklessly or with intentional disregard for Australia’s tax laws, where a failure to meet those standards impacts adversely on taxes paid. The Commissioner is also custodian of the self-assessment standards that penalise participation in tax schemes.

The Commissioner is also already the custodian of laws directed at third party behaviour that can impact adversely on taxes paid, most notably the promoter penalty laws.

The Commissioner also has a sizable workforce at the frontline of tax administration that sees and deals with tax agent and taxpayer behaviour at scale, and much closer to real-time than the TPB will ever be able, even with a further injection of resources.

**Summary**

I am largely in agreement with the thrust of the Review’s consultative document in the areas I have touched on. In summary:

* The status quo, or something akin to it, would be an inadequate response to the problems highlighted under the existing framework, not least by the tax gap analysis;
* The law should clearly state that tax agents are expected to perform their role in a manner that upholds and supports the integrity of Australia’s tax system;
* The Commissioner should be given the tools to respond administratively to poor tax agent behaviour that he sees is leading to underpaid taxes;
* The standards of behaviour to be expected of tax agents should be the same as those expected of taxpayers, to act with reasonable care and to not act recklessly or with intentional disregard of Australia’s tax laws;
* Tax agents should also be expected to not put their clients into tax schemes;
* Both taxpayers and tax agents should be liable to consequences (administrative penalties) for not meeting the standards of behaviour expected, including a lack of reasonable care. Penalties should be proportional to the impact of their respective behaviours on the taxes underpaid as a result, or otherwise designed to avoid arbitrage opportunities. Appropriate administrative safeguards and review rights should be put in place. Safe harbours are implicit – if a taxpayer meets the standards of behaviour including through the use of an agent then penalties are not attracted by the taxpayer. Similarly, for a tax agent. If both fail to meet the standards, then both face consequences (penalties). If one (taxpayer or tax agent) fails to meet the standards but not the other, then the one faces consequences (penalties) but not the other.
* Tax agent behavioural drivers of the tax gap should be obtained from the ATO. If a lack of reasonable care by tax agents is *not* a key driver of the quantum of the tax gap (but rather the key drivers are recklessness or intentional disregard by tax agents), then a compromise option would be to *not* impose administrative penalties on tax agents for a lack of reasonable care and keep the current safe harbour for taxpayers, but otherwise adopt the model described above. This would limit tax agent penalties to the more serious failures of the self-assessment standards (viz recklessness and intentional disregard). However, such an approach would be a compromise and inconsistent with the not unreasonable principle that both taxpayers and tax agents should exercise reasonable care under a self-assessment system, with consequences where a lack of care leads to an underpayment of tax.