The Institute of Chartered Accountants in Australia

22 February 2012

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

Email: GSTadministration@treasury.gov.au

Dear Brenda

Exposure Draft – Retaining refunds while Commissioner verifies information

The Institute of Chartered Accountants in Australia (the Institute) welcomes the opportunity to make a submission on the exposure draft (ED) legislation and explanatory memorandum (EM) which seeks to provide the Commissioner with a legislative discretion to hold refunds for verification prior to payment. The amendment is intended to "strike an appropriate balance between a taxpayer's right to a prompt refund and the Commissioner's responsibilities".[1]

The Institute is the professional body for Chartered Accountants in Australia and members operating throughout the world. Representing more than 70,000 professionals and business leaders, the Institute has a pivotal role in upholding financial integrity in society. Members strive to uphold the profession's commitment to ethics and quality in everything they do, alongside an unwavering dedication to act in the public interest.

Chartered Accountants hold diverse positions across the business community, as well as in professional services, government, not-for-profit, education and academia. The leadership and business acumen of members underpin the Institute's deep knowledge base in a broad range of policy areas impacting the Australian economy and domestic and international capital markets.

This submission follows a consultation meeting held by Treasury with stakeholders at short notice last Friday 17 February 2012 in relation to the ED. Due to the limited time frame to provide feedback on the ED legislation and EM, released last Wednesday 15 February 2012, this submission sets out our initial high-level comments on the proposed amendment.

Background

Prior to *Multiflex,* it is apparent that the Goverment's understanding was that:

> "the Commissioner had an implied reasonable time in which to refund a net amount, including such time as reasonably necessary to determine whether the amount was truly payable".

The proposed legislative response to the decision in *Multiflex* seeks to establish a "statutory code" under which the Commissioner may "retain" amounts that would otherwise be due and payable to taxpayers.

[1] Assistant Treasurer Media Release, 15 February 2012.

GPO Box 9985
in your capital city

Customer Service Centre
1300 137 322

NSW
33 Erskine Street
Sydney NSW 2000
Phone 61 2 9290 1344
Fax 61 2 9262 1512

ACT
L10, 60 Marcus Clarke Street
Canberra ACT 2601
Phone 61 2 6122 6100
Fax 61 2 6122 6122

Qld
L32, 345 Queen Street
Brisbane Qld 4000
Phone 61 7 3233 6500
Fax 61 7 3233 6555

SA / NT
L11, 1 King William Street
Adelaide SA 5000
Phone 61 8 8113 5500
Fax 61 8 8231 1982

Vic / Tas
L3, 600 Bourke Street
Melbourne Vic 3000
Phone 61 3 9641 7400
Fax 61 3 9670 3143

WA
Ground, 28 The Esplanade
Perth WA 6000
Phone 61 8 9420 0400
Fax 61 8 9321 5141

This is a significant change to the scheme under which the Commissioner and taxpayers had presumed that they were operating in the past. We note in passing, that this interpretation, in no small way, seems to have been based on the effect of section 17-15 of the GST law.

The proposals represent a legislative approach under which there is now an implied requirement that the Commissioner refund amounts unless he exercises a discretion to retain.

In making our response to the draft proposals, it is significant to note that the preference of introducing a statutory code for refund or retention is not the only way that the mischief identified in *Multiflex* might have been addressed. We wish to make it clear that, by responding to the proposal, we should not be taken to support the introduction of a statutory code as our preferred approach.

Consultation process and transparency

Before outlining our substantive submission on the ED, we wish to preface our comments with the following observations on the consultation process more broadly:

- Accepting that Treasury and the Commissioner may view the draft legislation as an integrity provision which does not necessarily require consultation, we nevertheless believe that given the wide application and potential impact of this provision which involves a major change to the rights of all taxpayers, a consultation period of 5 working days is inadequate and inappropriate.

- Given the extent of consultation that the Commissioner undertook with the professional bodies on the Australian Taxation Office's response to the impact of the *Multiflex* decision, the Institute is disappointed that that there was not a greater degree of transparency or the opportunity taken to foreshadow to the professional bodies during that consultation that an amendment to the law was being contemplated by Treasury or sought by the ATO. The professional bodies expressed broad support for an integrity measure during consultations with the Commissioner and we would have welcomed being involved in a true tripartite co-design of the amendments proposed.

General comments – overall policy concerns

While the Institute supports in principle a proposal to provide a power for the Commissioner to hold refunds in certain circumstances, the Institute wishes to register a number of key concerns regarding the proposed amendment as it is currently drafted:

1. Does not strike the appropriate balance between the need to protect the revenue, and the need to ensure that taxpayers' refund entitlements are not unduly denied

- The main operative provision appears to confer on the Commissioner an excessively wide and unqualified power to delay/deny taxpayers' entitlements, without sufficient constraints, conditions or clear time limits that the Commissioner needs to meet to invoke the power.
- Whilst the legislation is purported to be directed against careless, reckless and fraudulent claims, it is drafted so widely that it has ramifications for all taxpayers (whether or not subject to tax audit or investigation). It may therefore jeopardise the rights (and indeed solvency) of the vast majority of taxpayers, to guard against the risks posed by a small minority.
- The current drafting and terminology is unclear and ambiguous, and may allow refunds to be retained for an indefinite period – this is contrary to the effective and efficient administration of the tax system.

2. Scope of the amendment goes beyond the stated policy rationale

- The proposed amendment has been put forward as a solution to the outcome in the *Multiflex* decision which dealt with GST refunds, however the amendment goes well beyond this to cover refunds in respect of all tax amounts (i.e. Running Balance Account Credits), including income tax. There are already numerous remedies available under the *Tax Administration Act 1953* (TAA 1953) and the *Crimes Act 1958* that the Commissioner can rely on to deal with offending taxpayers. We also understand that the Australian Taxation Office (ATO) often undertakes 'verification' checks of Business Activity Statements (BAS) but does not undertake such checks on income tax returns. Accordingly, we would suggest there is not a need for the amendment to cover income tax.

3. Fundamental modification to the whole concept of self-assessment for refund taxpayers

- The self-assessment system is founded upon the principle that taxpayers have the primary obligation to self-assess their liabilities and entitlements. Conferring on the Commissioner a broad and unlimited power to modify this principle based on his discretion as to whether it is reasonable to verify the correctness of the amount claimed, undermines the self-assessment system and has the potential to fundamentally compromise its efficacy and fairness.

Specific comments - operative provisions

Initial retention period (ss8AAZLGA(1)-(3))

- The wording of proposed ss8AAZLGA(1) is ambiguous as to whether the Commissioner can withhold the entire refund or only the amount requiring verification, however on our reading it seems to apply to the whole amount. Note: a taxpayer is liable to pay assessed tax regardless of the taxpayer disputing any amount of this assessed tax under the Part IVC of the TAA 1953 process (objection, review and appeal).

- It is unclear how the proposed legislation could operate where a taxpayer's Running Balance Account (RBA) moves from credit to debit to credit during the retention period. Are the Commissioner's ss8AAZLGA(1) powers suspended or can the Commissioner re-invoke the provisions for each RBA debit period in relation to the same amount under verification? What effect does this have on the time limits under proposed ss8AAZLGA(2)?

- Under proposed ss8AAZLGA(1), there is no definition of:

    - "retain". It is unclear whether this means that the Commissioner may retain amounts before or after they have gone through the RBA, e.g. whether it applies to amounts that form part of the GST "net amount", or whether it also applies to amounts which (according to the Commissioner's view) are excluded from the "net amount" because the Commissioner has exercised his discretion under s105-65 of the TAA 1953 not to pay the refund. It is also unclear how this power to retain a refund impacts the set off mechanism and whether or how it still operates. Is there a latent GIC impact if a taxpayer only pays the excess of a tax liability over a credit entitlement and the Commissioner then retains the credit? E.g. $200 PAYG liability, less $100 GST input tax credit = $100 net tax payment.

    - "notification". How broad is this term intended to be and what is it intended to include in this context? The EM includes examples of a GST return, but are we are correct in our understanding that this may also apply to an income tax return, as well as other correspondence from a taxpayer? If the provision is to apply to other taxes (which we

do not believe that it should), the EM should contain further examples to illustrate other circumstances in which it is intended to apply.

- "verification of information". What do verification and information mean in this context? At the consultation meeting, Treasury indicated that this means verifying the accuracy of details and facts included in the notification, and is not intended to extend to verifying the technical merits of a refund or credit entitlement. We welcome this confirmation, and request that clarification to this effect be stated in the legislative provision.

  The concept of "verification of information" in a BAS is a little unusual, given that very little information is or is able to be included on a BAS. For this reason alone, the wording of the initial provisions ought to be more specific about what is the matter at issue – is it verification that a refund is payable? We note that it is this decision that, ultimately, may be the subject matter of Part IVC proceedings.

- The proposed ss8AAZLGA(2) states that the "Commissioner must inform the entity that he or she has retained the amount." In contrast to section 46 of the New Zealand (NZ) GST Act, there is nothing in the current draft requiring the Commissioner to request any information to verify the notification, nor about when the Commissioner must commence those enquiries. As such, there should be a positive requirement that, in relation to the "amount" retained, the Commissioner's notice must also:

  (a) identify the type of item, the amount that requires verification, and on what grounds. Providing such information is fundamental to good administration practice; and
  (b) actively request information from the taxpayer or give the taxpayer the opportunity to otherwise satisfy the Commissioner in respect of the above matters;

  within the statutory time limit (discussed further below).

- As currently drafted, there are no consequences or sanctions if the Commissioner does not inform the taxpayer within the time limit in ss8AAZLGA(2), which is either the RBA interest period or a 30-day period. The requirement to meet the statutory time limit should be one of the conditions incorporated into ss8AAZLGA(1) to invoke the power, as is the case under section 46 of the NZ GST Act. Failure to inform the taxpayer should affect the validity of the power under section 8AAZLGA so that there is a clear threshold test for the Commissioner to meet. This is because this power operates to reverse the prima facie statutory duty to pay the refund under ss8AAZLF.

- The requirement to "inform" the taxpayer in subsection (2) appears to allow the Commissioner to simply advise the taxpayer verbally (orally) that the amount has been retained. We submit that the Commissioner should be required to notify or inform the taxpayer *in writing*, particularly in light of the above point.

- The initial 'notice' period under ss8AAZLGA(2) in our opinion should be limited to 14 days (which is the same as the RBA interest period) in all circumstances. We consider that it is not appropriate to allow the Commissioner up to 30 days before he is required to issue any notice to a taxpayer that he intends to withhold a refund or to request any information. This would be in line with section 46 of the NZ GST Act which requires the notice to be issued and information to be requested within a period of 15 working days.

- There are insufficient controls placed on the Commissioner for the initial retention period under proposed ss8AAZLGA(1) and (3). The Commissioner is not required to have regard to any matters whatsoever to determine what would be "reasonable to require verification of information" at first instance (unlike subsection (5)). We do not see any reason why the considerations under subsection (8) relevant to the second retention period decision are not

equally relevant to the first retention period. To the extent that there is evidence of any one or more of those factors at that point, they should be taken into account to determining whether it is reasonable to retain the amount.

- The law should be drafted in a way that makes it clear that the "reasonableness" test is an objective one, not a subjective test. We welcome the assurances of both Treasury and the ATO at the consultation meeting that it is intended to be an "objective test" of reasonableness which would be subject to the ordinary principles of judicial review...

- The act of retention under ss8AAZLGA(1)-(3) is a "decision" of the Commissioner (by inference, since subsection (9) makes clear that the act of retention under subsection (5) is a decision). As such, subsection (1) should be amended to state that the Commissioner may "decide to" retain / delay payment of a refund.

  Under subsection (3), the Commissioner should be required to refund any part of the amount retained as soon as he does not have a substantial reason to believe that the refund is excessive, i.e. there needs to an apportionment requirement, not all or nothing. We recommend that this be made clear in a distinct subsection.

- A taxpayer's right to judicial review of the administrative decision under ss8AAZLGA(1) should be acknowledged by expressly including in the law the 'escalation process' available for taxpayers in respect of the initial retention decision. We believe that this would assist in striking a more "appropriate balance" between taxpayers and the Commissioner under this provision.

- The 60-day retention period under paragraph 8AAZLGA(3)(c), commencing after the notice period under subsection (2), in our opinion is excessive. We submit that a reasonable initial retention period for the Commissioner should be no more than a further 30 days.

- Recognising the potential cash flow impact (and loss of use of funds) caused by section 8AAZLGA, we query whether it is appropriate that taxpayers are limited to the interest rates under the *Taxation (Interest on Overpayments and Early Payments) Act 1983*:

  - Whilst the Commissioner may argue that an incentive for the Commissioner to administer section 8AAZLGA in an effective and efficient manner is provided by interest being payable under the *Taxation (Interest on Overpayments and Early Payments) Act* 1983, the existing interest rates are less than those required under the GIC and SIC provisions - non-commercial rates of interest.
  - At a minimum, where the refund is retained for more than 60 days , we suggest that the rate should be lifted for example, to, the SIC rate on a compounding basis, to reflect the rate paid by taxpayers.
  - There should also be a note inserted (similar to section 8AAZLG of the TAA 1953), stating for example:
    "Note: Interest is payable under the *Taxation (Interest on Overpayments and Early Payments) Act* 1983 if the Commissioner subsequently refunds amounts previously retained under s 8AAZLGA".

Extension of initial retention period (ss8AAZLGA(4))

- The drafting of proposed ss8AAZLGA(4) is convoluted and ambiguous, so it is not clear to us as to how it should be interpreted. While the EM provides an example of an extended period applying (Example 1.2), it does not provide sufficient detail to clarify the wording adopted by the drafters. Specifically, the references in paragraphs (a) and (b) to "on or before the day" and "the day" respectively are indecipherable in working out the extension applicable.

- We understand that subsection (4) is seeking to extend the ATO's holding period by any days that a taxpayer takes to answer questions to ensure that the taxpayer cannot refuse to provide

information and wait for the retention period to lapse. In preference to the current drafting we suggest that it be substituted with a 'stop the clock provision', along the lines of ss359-50(2), item 1 of the TAA 1953. This provision effectively stops the clock on the initial retention period while the ATO is waiting for the taxpayer to provide information i.e. the initial 30-day retention period (if our proposal were accepted) would be extended by the period from when the ATO requests the information to the date on which the requested information is provided, provided the information is requested within the 30-day period, or the initial notice period.

- Other concerns with the current drafting of subsection (4) include:
    - The provision does not set out any controls on the Commissioner as to the nature and extent of the information that could be requested or the reasonableness of the request.
    - This provision seems to have the effect of penalising a taxpayer in circumstances where the taxpayer is requested to provide information towards the end of the initial refund retention period.
    - There are no objection rights under ss8AAZLGA(9) in relation to this extension period.
    - Does this subsection include information that the Commissioner may request of a third party (i.e. other than the taxpayer) – for example, a bank? If so, there should be a requirement that the taxpayer must be informed.
    - It is possible that a taxpayer's refund may be withheld due to a delay by either the Commissioner or a third party pursuant to an action under ss8AAZLGA(4).

Further retention period

- Subsection 8AAZLGA(5), as currently drafted, is an open-ended retention period, under which the Commissioner can effectively hold the refund indefinitely. Once the Commissioner makes the decision under subsection (5) that it is reasonable to verify the information further, there is no time limit or requirement on him to commence or complete that verification process under subsection (7).

- We recommend that subsection (5) be deleted, as the process in subsection (1) to (4) would be adequate to allow the Commissioner appropriate powers to hold and verify refunds, and as suggested above, those powers should be made subject to the relevant considerations under proposed subsection (8).

- If the subsection (5) additional power is to be maintained, it is vital that a mechanism be included in this provision to make the period finite. We recommend that it be a limit of a further 14-day period starting on the day mentioned in subsection (6) ends, so that the refund must be released at that time (with a subsequent audit if required), or alternatively the provision should ensure that after that time a deemed assessment occurs. This is necessary to strike a more appropriate balance so that taxpayers' rights are not indefinitely kept in abeyance, and so that the objection relates to a concrete decision that can be reviewed on its merits (this is discussed further below under 'Objection rights').

- If subsection (5) is maintained, all of the points raised above under the first retention period apply equally here regarding the time limitation being a condition of the power, the notice being in writing, the notice giving full details and requesting all required information to verify the notification, and the requirement to pay so much of the amount held as soon as the Commissioner is satisfied that it has been verified.

- In terms of the relevant matters that the Commissioner is required to consider under ss8AAZLGA(8), all matters are questions of judgement, fact and degree. Our observations are as follows:

    - *Weighting*
        - The EM paragraph 1.18 states that no single factor is determinative, however it appears not all factors will be considered equally. The EM at paragraph 1.26 indicates that "if another factor, such as a risk to revenue, *outweighed* such considerations, it might be still reasonable, for the Commissioner to retain the amount. "
        - Heavier weighting should be given to certain considerations, such as paragraph 8AAZLGA(8)(e), where the taxpayer can demonstrate that their solvency is at risk.

    - *Inaccuracy*
        - Paragraph 1.19 of the EM states that the Commissioner could consider factors such as the amount of the refund claimed compared with refund amounts previously in assessing the likelihood of information being inaccurate. This is not an appropriate indicator or whether information is inaccurate, as a variation in amount could be attributable to an infinite number of legitimate factors.

    - *Fraud or evasion*
        - The EM, at paragraph 1.23, states that where the taxpayer has a good compliance history, this would be an indicator that fraud or evasion, intentional disregard or recklessness is unlikely. By reverse implication, taxpayers who are classified as higher risk taxpayers may be severely impacted by this legislation.
        - Given the subjective nature of this indicator, the EM should include reference to these indicia being required to be determined by reference to objective facts.
        - We note, in relation to this aspect, that in a carousel fraud, the fraud is with the supplier and not the claimant. Is this factor only fraud of the claimant?

    - *Recklessness as to the operation of a taxation law*
        - To reiterate that section 8AAZLGA is not directed at instances of disagreement as to the operation of a taxation law, the EM should include examples of how section 8AAZLGA would not apply in instances where a position is "reasonably arguable."

    - *Complexity*
        - We query how the fact that the matter is complex should be an indicator of a factor for retention (see the discussion below). Could this be expressed in a clearer manner, such as the compliance burden that would be imposed on the taxpayer and the ATO to verify the information?

    - *Financial position of the entity*
        - Only item (e) considers the impact of the decision on the taxpayer. "Financial position" is not defined, although the EM paragraph 1.26 mentions financial hardship. The EM should be broadened to provide further examples and to consider such factors as immediate cash flow, triggering of debt covenants, the need to borrow etc.

- *Any other matter the Commissioner considers relevant*
  - This catch-all provision seems to make the relevant considerations a non-exhaustive list, which would be consistent with the reference to "including" in paragraph 1.17 of the EM. We welcome Treasury's assurances at the meeting that "technical merits" are not intended to be relevant considerations that would fall within this paragraph. Accordingly, similar to the point discussed above regarding the aspects of the "information" that the power is intended to allow the Commissioner to verify, it should be made clear in the provision itself (or at the very least in the EM,) that this power is not about reviewing the technical merits.

- The relevant considerations in subsection 8AAZLGA(8) should also expressly include a consideration of the self-assessment system (where it is applicable to the tax in question), and a presumption for the processing of refunds as a matter of course unless outweighed by other factors.

Objection rights

- While there is a proposed right under subsection (9) to object under Part IVC to the decision under subsection (5), it seems effectively worthless. As drafted, the decision that would be the subject of the objection would be the Commissioner's decision to retain the amount on the basis that it was reasonable to require verification of the information. The onus on a taxpayer to establish that the Commissioner's decision was not reasonable would be practically insurmountable even on a merits appeal (and certainly under administrative law principles, since the court or tribunal does not step into the shoes of the Commissioner and make the assessment itself, but rather would be reviewing whether the decision was reasonably open to the Commissioner to make).

- In addition, the length of time (and cost after that time) that it would take to bring the matter before a court under subsection (9) would be financially prohibitive for most taxpayers (14 or 30 days + 60 days + extension period + 14 days + objection process (standard period) 56 days), then the court proceedings which takes months to bring to court, and months or years beyond that to obtain a decision.

- The objection right should apply in relation to the original subsection (1) retention decision, and should also be available in relation to any assessment or deemed assessment by the Commissioner under the provision (as discussed above). The EM should also include a statement informing taxpayers that they have objection rights and rights to judicial review of the administrative decision under the *Administrative Decisions (Judicial Review) Act 1977* (ADJR Act).

Application date

- We envisage that the proposed amendment could potentially have retrospective application. In acknowledging that the provision will apply from the date of Royal Assent, does the provision apply to RBA credits in existence as at the date of Royal Assent, or only to RBA credits arising subsequent to the date of Royal Assent?

Section 17-15 of the GST Act

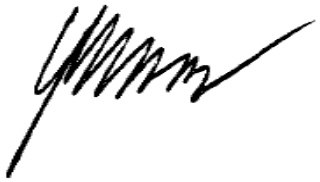
- The purpose of this provision is obscured by its tortuous drafting. Given its significance in *Multiflex* - where the court observed that it did not allow for a view that the "net amount" was incorrect – the section should be repealed or rephrased to state what it means. It is not, in our view, an option to retain the section in its present form.

Explanatory memorandum

- As a final point, the table in EM (after paragraph 1.9) entitled "Comparison of key features of new law and current law" states that the position under the "*Current law*" is that: "There is no equivalent provision but the ability to retain a refund was considered to be implied by the law". This is not an accurate reflection of the current law as the statement should refer to the Full Federal Court's interpretation in the *Multiflex* case of the Commissioner's statutory duty to pay a refund under section 8AAZLF. It is not appropriate to omit the case law, and state what the Commissioner considered to be the law. We request that the EM be amended in this respect.

We would be pleased to discuss any aspect of this submission with you. If you have any queries, please contact Donna Bagnall on 02 9290 5761 in the first instance.

Yours sincerely



Yasser El-Ansary
General Manager – Leadership & Quality
The Institute of Chartered Accountants in Australia