

27 July 2011

General Manager
Tax System Division
The Treasury
Langton Crescent
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Email: privilege@treasury.gov.au

Dear Sir/Madam

**SUBMISSION ON 'DISCUSSION PAPER - PRIVILEGE IN RELATION TO TAX
ADVICE'**

1. RoLIA

The Institute welcomes the opportunity to make this submission and congratulates the Assistant Treasurer on publicly raising the issue.

The Rule of Law Institute is an independent non-profit association formed to uphold the rule of law in Australia.

The Institute's objectives are:

- (a) To foster the rule of law in Australia.
- (b) To promote good governance in Australia by the rule of law.
- (c) To encourage truth and transparency in Australian Federal and State governments, and government departments and agencies.
- (d) To reduce the complexity, arbitrariness and uncertainty of Australian laws.
- (e) To reduce the complexity, arbitrariness and uncertainty of the administrative application of Australian laws.

2. The Rule of Law

- 2.1 The Rule of Law requires legal systems that adhere to its tenets to have laws that are clear, certain, result in consistent and predictable outcomes, and don't

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impose unnecessary or excessive burdens. Laws that meet these criteria create confidence in our legal system which in time creates confidence for economic activity. Laws that do not, have the opposite effect. It is time therefore for a fundamental reform of the law relating to the accountant's concession.

3. The accountant's concession should be replaced by a statutory tax advice privilege

- 3.1 The accountant's concession is the creation of the Australian Tax Office, not of the Parliament and not of the Courts. It is an administrative rule that can be applied or not applied at the discretion of the ATO. If applied it does provide a level of protection for taxpayers against the disclosure of some tax advice. However as it is not a law there has been both policy and practical difficulties with its operation which are referred to immediately below.
- 3.2 It has been held by Courts in Australia that the accountant's concession creates a legitimate expectation that the ATO will follow the accountant's concession guidelines, and that a taxpayer will be given the opportunity to put forward its case on whether the ATO should lift the concession.¹ It is the ATO guidelines themselves that have created this legitimate expectation in Australian taxpayers. The guidelines were made by the Commissioner under the general power of administration under s8 of the *Income Tax Assessment Act 1936*. The exercise by the Commissioner of his discretion to enable the ATO to obtain a document that would otherwise fall within the concession, is attributable to that general power of administration only.² The concession has no statutory basis, creates no substantive rights and is not reviewable under the *Administrative Decisions (Judicial Review) Act 1977*.³ The creation of a legitimate expectation by the ATO guidelines where in reality there is none, should not continue.
- 3.3 The Commissioner can pre-emptively determine that the accountant's concession will not operate before seeking any documents and deny a taxpayer the opportunity to claim the concession. Under s263 of the *Income Tax Assessment Act 1936* the Commissioner has full and free access to all buildings, places, books, documents and other papers for any of the purposes of the Act and may make extracts from or copies of such books, documents or papers. Such Access Authorisation Decisions generally exercised without warning and unlike a search warrant do not require Court approval. The Commissioner or his delegate can as part of the Decision determine in advance of the access (and often does) that the accountant's concession will not apply to any documents obtained during the access. There is no opportunity given to the taxpayer concerned to make any representation to the ATO that it should not lift the concession. The following paragraph is taken from an ATO Access Authorisation Decision. Paragraphs 1.2 and 2.2 refer to documents that would otherwise be subject to the accountant's concession:
- "1. For the purposes of the exercise of the Commissioner's access powers conferred by section 263 of the *Income Tax Assessment Act 1936* (Cth), I am satisfied that circumstances exist which warrant:

- 1.1 access being taken without prior notice; and
 - 1.2 for such access without prior notice to extend to restricted source and non-source documents, pursuant to the Commissioner's Guidelines for access to professional accounting advisers' papers.
2. I therefore authorise:
 - 2.1 Access to all buildings, places, books, documents and other papers related, either directly or indirectly, to:

See attached [schedule].
 - 2.2 Such access without prior notice to extend to restricted source and non-source documents
3. Access does not extend to communications that are properly the subject of legal professional privilege.”
- 3.4 The practical distinction between the accountant's concession and legal professional privilege is reflected in the last sentence of the above Decision. The statement is legally speaking unnecessary as client legal privilege cannot be abrogated by the Commissioner or anyone else. There is another important distinction between client legal privilege and the accountant's concession. For the accountant's concession to operate the Commissioner requires that the tax advice be prepared solely for the purpose of advising a client on matters associated with taxation. This is known as the sole purpose test. This test originally applied to client legal privilege. However in 1999 the High Court of Australia held that from then on the dominant purpose test should apply to client legal privilege. However the test for the accountant's concession has not been modified by the Commissioner and remains a sole purpose test. The sole purpose test is rigid and much harder to satisfy.
 - 3.5 A decision to refuse the concession is made by the same body (the ATO) that is investigating the matter to which the document or documents relate. This can and often does cause an apprehension of bias in the decision making process. In the case of legal professional privilege the decision on whether the privilege applies is not made by the ATO but by the Courts of Australia. A taxpayer, even if unsuccessful in an application for client legal privilege will be able to see that the matter has been determined after the document and all other relevant evidence is considered by an impartial judicial officer.
 - 3.6 The accountant's concession favours large taxpayers over small and medium taxpayers. In obtaining advice from the large accounting firms, large taxpayers can afford the cost of having a legal practitioner as part of the external tax advisory team. This enables a large taxpayer to claim client legal privilege and not be subject to the discretion of the ATO. A limited or broad statutory tax advice privilege will have little impact on large taxpayers. This option is not however available to medium and smaller taxpayers who don't or

cannot access the larger accounting firms who have practising lawyers on their staff.

- 3.7 According to the PWC report “2010 Total Tax Contribution Understanding the Economic Contribution of Business” Australia has the highest tax compliance costs relative to the amount of taxes borne of the six countries investigated being Japan (0.8%), Switzerland (1.3%), South Africa (1.4%), UK (1.5%), US (1.6%) and Australia (2.7%)⁴. Although this is primarily due to the complexity of Australia’s tax laws relative to its economic size, creating certainty with respect to the accountant’s concession should assist in reducing tax compliance costs even if only to a small extent relative to total compliance costs.
- 3.8 For these reasons the Institute recommends that the accountant’s concession be replaced by a statutory formulation of a tax advice privilege.

4. Parliament should adopt an appropriate Australian model

- 4.1 The appropriate model for the proposed law should preferably be one which already exists in Australia and which can have the benefit of decades of judicial review, academic commentary and parliamentary amendment. Client legal privilege (which is partly contained in s118 of the *Commonwealth Evidence Act 1995*) is simple in its operation and has a well developed body of legal principles and authorities that could be generally applied to a tax advice privilege. It has an obvious preference to any overseas model, which vary widely from country to country and do not fit within Australia’s laws and legal system.
- 4.2 There have been a number of suggestions that other models and rules should be adopted which would have the effect of confining a proposed statutory privilege.
- 4.3 It was the recommendation of the ALRC in its support of the New Zealand model that the privilege should not apply to ‘tax contextual information’. That is if the tax advice document contained information that was a fact, assumption, postulate or step involved in the transaction (upon which the advice is given) it should be disclosed and should not be subject to a statutory protection. This would add an unnecessary complication to the proposed law and should not be adopted for the following reasons:
- (i) Under the accountant’s concession guidelines, the entire document that is the subject of the concession is given protection from disclosure, not just the advice within the letter. The guidelines state:

“While recognising that the Commissioner has legislative power to request access to most documents, it is accepted that there is a class of documents which should, in all put exceptional circumstances, remain within the confidence of taxpayers and their professional accounting advisers. In respect of such documents the ATO acknowledges that taxpayers

should be able to consult with their professional accounting advisers on a confidential basis in respect of their rights and obligations under taxation laws to enable full and frank discussion to take place and for advice to be communicated on that basis.”

At no time has the Commissioner sought to amend the accountant’s concession to provide that it only covers the advice in the correspondence or to seek to obtain access to those parts of the documents that refer to facts, assumptions, postulates or steps involved in a transaction. As well as entirely unnecessary this would be a backward step.

- (ii) Limiting the protection of the privilege favours larger taxpayers as they can avoid its limited operation by ensuring that their external tax advising teams have a legal practitioner to sign off on the advice so they can claim the benefit of client legal privilege.
 - (iii) Client legal privilege applies to the entire written advice and no one has or is suggesting that the facts etc in legal advice should be revealed to a regulator or in court proceedings.
 - (iv) The facts and circumstances of a transaction including the steps involved in it are available to the ATO through a variety of means including voluntary disclosure, s264 notices, s263 notices and s264 examinations, all of which provide for criminal penalties in the event there is wrong, misleading or false information provided, or if there is non-compliance with a statutory provision. The facts and circumstances of a transaction are routinely obtained by the ATO in a risk review or audit without the necessity of obtaining access to advice documents.
 - (v) The taxpayer has the onus of showing the tax position adopted is in accordance with the tax laws and of proving an amended assessment issued by the ATO is excessive. If for any reason there is a lack of documentation that will operate against the taxpayer.
- 4.4 It has been suggested that the tax advice privilege should only apply to documents and not oral communications. It seems odd that the law which is designed to protect a written document from disclosure would at the same time permit the disclosure of an oral communication of exactly the same information. Tax advice privilege should extend to both written and oral communications, in the same way that client legal privilege applies to written and oral communications. Tax advice is legal advice and should enjoy the same protection as legal advice.
- 4.5 It has been suggested by the New Zealand Courts that statutory tax advice privilege cannot be waived⁵. If a client who obtains the benefit of tax advice privilege expressly or impliedly waives the privilege, the privilege should be lost. It is not appropriate that a taxpayer can enjoy both the benefit of the

privilege and a benefit in disclosing the privilege as the taxpayer chooses. That would be unfair to the ATO and other regulators.

- 4.6 It has also been suggested that the privilege only apply to the Commissioner of Taxation⁶. To be a substantive right and to keep it simple the privilege should apply to any disclosure in the same fashion as client legal privilege. Further the suggestion does not take account of the many information sharing agreements and laws to permit the sharing of documents and information amongst Australian regulators, federal and state that might enable the Commissioner to obtain the advice by other means.
- 4.7 It has been suggested that adopting the New Zealand model will allow the Australian Parliament greater control over the operation and scope of the tax advice privilege⁷. Parliament should not take the view that the Courts or the Australian legal system is in general somehow going to be deficient in its consideration of any law including that which is proposed. Where Parliament has seen the need it has and will continue to amend laws to rectify any actual or perceived deficiency as it has done with client legal privilege⁸. Should at any time the proposed tax advice privilege fall into such a category there is no reason to think that Parliament would not be able to properly debate any proposed amendment.
- 4.8 There are a number of exceptions to the application of client legal privilege including in the event legal advice is used in the furtherance of a fraud or an offence or the commission of an act that renders a person liable to a civil penalty⁹. The same exemption should apply to client tax privilege.
- 4.9 There is a legitimate concern that taxpayers may attempt to improperly use a statutory tax advice privilege by providing source documents to their tax advisers for the purposes of obtaining advice. There should be a further express exception that the privilege does not apply to source documents. The tax adviser should be a registered tax agent under the Tax Agent Services Act 2009.
- 4.10 If the ATO or any other body wishes to contest a claim for tax privilege, the client should be required to have the claim certified by a legal practitioner. This will reduce the risk of inappropriate claims. The onus will always be on the client/taxpayer to substantiate the claim as it is with client legal privilege.

5. Recommendations

- 5.1 Federal legislation should provide for a new privilege called 'client tax privilege'.
- 5.2 The privilege should extend to confidential communications and confidential documents made for the dominant purpose of the tax adviser providing tax advice to the client.
- 5.3 The dominant purpose test (not the sole purpose) should apply.

- 5.4 Client tax privilege should expressly not extend to source documents even when given to a tax adviser for the purpose of obtaining tax advice.
- 5.5 Client tax privilege should expressly not apply to a communication in furtherance of the commission of a fraud or an offence or the commission of an act that renders a person liable to a civil penalty; or a communication or the contents of the document that the client or tax adviser (or both) knew or would reasonably to have know was made or prepared in furtherance of a deliberate abuse of a power.
- 5.6 Tax advice privilege can only be claimed if the adviser is a registered tax agent for the purposes of s20-25 *Tax Agent Services Act 2009* or a nominee or employee of a registered tax agent who is a qualified tax accountant.
- 5.7 The legal onus should be on the client to establish that a communication or document is subject to the privilege.
- 5.8 Claims that a communication or document is subject to client tax privilege should be required to be certified by a legal practitioner if requested by the ATO or any other regulator in the same way for claims for client legal privilege.
- 5.9 The ATO should develop guidelines for the making of claims for the privilege and for the resolution of disputes, including the commencement of court proceedings by a taxpayer in the event the ATO disputes any claim for the privilege.

Yours faithfully

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 Solicitor

¹ *One.Tel Ltd v DFCT* (2000) 101 FCR 548 at [42]

² *White Industries Australia Ltd v FCT* (2007) 160 FCR 298 at [68]

³ *White Industries Australia Ltd v FCT* (2007) 160 FCR 298 at [61]-[99]. Also referred to in para 6.230 of the ALRC Privilege and Perspective: Client Legal Privilege in Federal Investigations report 107

⁴ p32

⁵ *Blakeley v CIR* (2008) 23 NZTC 21,865

⁶ ALRC report para 6.278

⁷ ALRC report para 6.278

⁸ s118 Evidence Act 1995 (Cth) – client legal privilege – was amended in 2008 by Act No 135 of 2008

⁹ s125 Evidence Act 1995