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# PREPARING FOR BATTLE – STRATEGIES & OUTCOMES IN TAX DISPUTES

## From questionnaire to assessment - Defending your client during audit

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Q: What do you give someone that has everything?

A: AN AUDIT!<sup>1</sup>

## 1 INTRODUCTION<sup>2</sup>

The Australian Taxation Office (ATO) undertakes extensive review and audit activities to ensure voluntary compliance under the self assessment regime or to coerce compliance.<sup>3</sup> On 8 July 2010, the ATO released the *ATO Compliance Program 2010-11*,<sup>4</sup> which indicates that the ATO intends to increase its audit activities further.

The ATO audit segments are:

- individuals;
- micro enterprise (annual turnover under \$2m);
- small and medium enterprise (annual turnover \$2m - \$250m);
- large business (annual turnover over \$250m); and
- non-profit organisations.

This paper discusses reviews and audits in respect of individuals, micro enterprises and small to medium enterprises (SME) (including wealthy individuals,<sup>5</sup> high wealth individuals (HWI)<sup>6</sup> and self managed superannuation funds (SMSF)). This paper also discusses the ATO's powers of access to taxpayer's information prior to the assessment, objection and appeal stages and how advisers and taxpayers can best protect the confidentiality of taxation advice through legal professional privilege (LPP) and client legal privilege (CLP).

In Session 2, Jerome Tse will discuss the Accountant's concession which may protect the confidentiality of taxation advice. Some observations are made in this paper for completeness.

While most compliance investigations are conducted in a spirit of cooperation, the ATO has extensive coercive powers of access and information exchange. The procedures and limitations on the ATO's access and information exchange powers are complex. In particular, the extent to which the ATO must comply with the ATO's Access and Information Gathering Manual (Access Manual) and Guidelines to Access Professional Accounting Advisors' Papers (Accountant's Guidelines) has been the subject of recent court cases.

The Inspector General of Taxation (IGOT) will review HWI and SME audit activities, including the ATO's use of access and information exchange powers, LPP, CLP and the Accountant's concession.<sup>7</sup> The extent of the ATO's compliance activities raises a concern that unless certain compliance approaches are improved, the additional ATO compliance focus will significantly increase unnecessary costs and unmanageable workloads for taxpayers as well as creating unnecessary administration costs for the ATO.

Some aspects of this paper have previously been published in a series of articles in *Taxation in Australia*.

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<sup>1</sup> M. D'Ascenzo, 'Complex audit programs', AGS national practitioner forum on tax litigation, 20 November 1990.

<sup>2</sup> The writer acknowledges the assistance of Megan Bishop, Graduate Lawyer, in preparing this paper.

<sup>3</sup> M. D'Ascenzo, 'Self assessment: the ATO perspective', Taxation Institute of Australia, 9 May 1993.

<sup>4</sup> *ATO Compliance Program 2010-11* NAT 7769-07.2010.

<sup>5</sup> People with net wealth of \$5m to \$30m.

<sup>6</sup> People with net wealth of at least \$30m.

<sup>7</sup> Inspector General of Taxation, *Review into the ATO's small and medium enterprise audit and risk review policies, procedures and practices terms of reference*, April 2010; Inspector General of Taxation, Issues Paper Number 4, *ATO Law Enforcement and Governance*, 2003.

Legislative references are to the *Income Tax Assessment Act 1936 (ITAA 1936)*, the *Taxation Administration Act 1953 (TAA 1953)*, the *Administrative Decisions (Judicial Review) Act 1977 (ADJR 1977)*, the *Judiciary Act 1903 (JA 1903)* and the *Evidence Act 1995 (EA 1995)*.

## 2 OVERVIEW OF ATO COMPLIANCE PROGRAM 2010-2011

The *ATO Compliance Program 2010-11* identifies extensive data matching programs, automated review programs and industry benchmarking programs. The programs will continue the focus on HWI, SME and international profit shifting activities and will increase focus on wealthy Australians, executives and directors, tax agents and professional firms.

In the 2010-2011 tax year, the ATO intends to undertake at least:

- 500 million transaction data matches;
- 100 industry benchmarks;
- 100,000 micro businesses discrepancy contacts by telephone or letter;
- 48,200 micro business GST refund claim verifications;
- 26,000 audits or reviews of micro businesses;
- 17,500 unpaid superannuation complaint verifications;
- 10,800 audits or reviews of SMSFs;
- 9500 audits and 4,380 reviews of SMEs to ensure GST refund claims are correct;
- 800 superannuation payment compliance reviews of businesses;
- 450 telephone calls or letters to SMEs to identify non-compliance with Division 7A;
- 360 new risk reviews of HWI taxpayers;
- 190 audits of large superannuation funds; and
- 40 audits or risk reviews of SMEs to identify non-compliance with Division 7A.

The *ATO Compliance Program 2010-11* relevantly identifies the following audit areas:

- remuneration of public and private executives and directors, sales and marketing managers and representatives, share and option plans, income splitting and international activities;
- under reported or omitted income and cash transactions used to hide or evade tax obligations;
- non-reporting of capital gains, the property industry, work-related expenses and rental and share investment claims;
- incorrect claiming of GST returns;
- voluntary and compulsory superannuation contributions and early release arrangements, pay-as-you-go withholding and personal services income;
- retail investment products not validly implemented or abandoned, tax exploitation schemes and phoenix arrangements;
- private company wealth extraction including Division 7A ITAA 1936; and

- tax haven arrangements and Project Wickenby project compliance.

This paper does not address the substantive tax law issues underlying these audit areas, but at the centre of all audit strategies is a clearly articulated position (and an understanding of relative strengths, weaknesses and risks) of the substantive tax law.

Further, the ATO will continue the HWI program including:

- continuation with the 4 year program to risk assess all taxpayers with turnovers between \$100m and \$200m; and
- initiation of 360 new reviews.

The increasing incident of review and audit activities means advisers and taxpayers are facing the complexity of taxation administration procedures with greater regularity.

## 2.1 HWI audit program & questionnaire

HWIs are Australian residents who effectively control, individually or with their associates, \$30 million or more in net wealth. HWI audits are conducted over approximately 2 years, unless entered into a subsequent category of review and audit activity.

A detailed working knowledge of the HWI program as set out in *Wealthy and Wise A tax guide for Australia's wealthiest people* and the HWI questionnaire is invaluable. Particular review and audit processes are discussed in the chapters on *Audit process*, *Comprehensive risk review process* and *Preliminary review process*.

The HWI questionnaire is primarily concerned with gathering information on:

- tax residency;
- family and business relationships;
- direct and indirect ownership or control of assets;
- direct and indirect access to wealth in related entities;
- business and industry environment, statistics and performance; and
- business and industry tax compliance history, sociology and psychology.

The HWI questionnaire is wide ranging and is, therefore, difficult to answer in a concise manner. Particular issues about the questionnaire include:

- the HWI's ability to disclose information about siblings, adult children, grandchildren and their spouses or any 'person named' in a response in the questionnaire;
- the relevance of the HWI's office as a settlor or appointor of a private trust for third parties (e.g. accountants that act as settlor or independent appointor for their clients);
- the extent of the legal analysis of trust law and the trust deed to provide disclosure in respect of private trusts in which the HWI, family or named persons have 'a power of appointment over the assets of the trust';
- the potential requirement to consider third party documents such as powers of attorney, unit holders agreements etc to provide disclosure of private trusts in which the HWI, family or named person have power to appoint an office or any power in respect of a private trust;

- the potential requirement to consider third party documents such as put and call options, first rights of refusal, shareholders agreements etc in determining whether the HWI, family or named person controls the allotment of shares or capital of a trust;
- the difficulty in determining whether the HWI, family or named person has provided any 'financial accommodation' having regard to the current debate over the scope of the undefined term;<sup>8</sup>
- the difficulty of providing assets and liabilities financial information for estranged spouses; and
- the difficulty in preparing a structure diagram for the group in a manner that is clear and precise.

The questions refer to knowledge so their appears to be no expected obligation to make enquiries regarding siblings, adult children, grandchildren and their spouses or any person named in a response in the questionnaire.

The art in answering the questionnaire is clearly stating the scope and limiting factors in preparing the answers.

#### Warning: Offence

It is an offence to provide false or misleading information and intention is not an element of this absolute liability offence.<sup>9</sup> Care is, therefore, required in preparing the response.

### 3 AUDITS

#### 3.1 Audit Strategies

The objective of the audit strategy is to (in no particular order):

- define clear and achievable outcomes, time frames and procedures;
- define clear lines of communication;
- promote objectivity, focus and relevance of the audit process;
- objectively, efficiently and effectively settle the matter with no or minimal tax adjustment;
- minimise time investment and resource utilisation in the audit process;
- proactively present relevant facts, tax analysis and policy considerations in a systematic manner to influence the audit outcomes; and
- extract from the ATO as much ATO intelligence on the matter before the matter becomes contentious.

An uncooperative approach will result in escalation of formality, contentious information exchange and costs while reducing settlement goodwill. However, a limited cooperative approach (exercise of all legal rights to their full limit) may be appropriate in circumstances where there is a real risk of criminal prosecution or allegations of fraud or evasion arising from the audit.

Information exchange can be undertaken on an expansive or minimalist basis. A minimalist approach (answer only the information and provide only the document requested) is usually adopted until the ATO audit issues are revealed and sufficiently developed to allow an assessment of the risk exposure of the client.

<sup>8</sup> TR 20010/3 – Income tax: Division 7A loans: trust entitlements.

<sup>9</sup> Section 8K TAA 1953 (penalty \$2,000 first offence; \$4,000 subsequent offences).

Once the ATO audit issues are sufficiently revealed and developed, a more expansive approach is usually adopted to positively influence the ATO to promote conclusion of the audit or settlement.

The issues the subject of the audit may be technical,<sup>10</sup> administrative<sup>11</sup> or policy<sup>12</sup> based. The nature of the issue may affect the approach adopted or the emphasis of correspondence. Generally, however, an approach that adopts a technical, administrative and policy based response will be more persuasive.

There is an art to audit management where reasonable and experienced practitioners can have diametrically opposed legitimate opinions. The audit Art of War<sup>13</sup> is to prepare thoroughly for likely contingencies by well prepared strategies, ensure the ATO operates within their administrative parameters, identify and seek to exploit weaknesses in legislative and administrative policy, fight only those battles with real prospects of success, don't make mistakes and don't miss the moment for settling the matter.

The involvement of lawyers in the audit process may provide an opportunity for the accountant to maintain a continuing cooperative approach and rhetoric with the ATO while using the lawyer strategically as a shield.

The ATO's audit expectations and processes are widely published.<sup>14</sup>

### 3.2 Audit Areas

Reviews and audits are authorised by the ATO's general power of administration.<sup>15</sup>

An audit is intended to gather intelligence, increase voluntary compliance and coerce compliance.

The ATO has extensive unfettered audit selection powers.<sup>16</sup> Further, audits are not generally susceptible to judicial review.<sup>17</sup> Accordingly, the review and audit process is largely about managing the taxpayer's position rather than avoiding the review and audit.

The ATO will likely select a taxpayer for review and audit where:

- the taxpayer's financial or tax performance varies substantially from industry patterns;
- the taxpayer's amounts or patterns of tax payments vary substantially from previous periods, economic indicators or industry trends;
- the taxpayer's economic performance, productivity and tax performance are not aligned;
- the taxpayer has losses or low effective tax rate that vary substantially from industry patterns;
- the taxpayer or the taxpayer's related entities, officers, executives or advisers have a history of aggressive tax planning; or
- the taxpayer has structural, procedural or governance weaknesses to their approaches to tax compliance.

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<sup>10</sup> Such as the interpretation of a word or phrase: 'income of the trust estate' for section 97 ITAA 1936 purposes.

<sup>11</sup> Such as the lodgement time, the validity of elections or the exercise of a discretion by the ATO.

<sup>12</sup> Such as the application of Part IVA ITAA 1936 anti-avoidance rules.

<sup>13</sup> D. Nelson, 'On Military Strategy and Litigation', (2003) 31 Vermont Law Review, 557, A Pribetic, 'The 'Trial Warrior': Applying Sun Tzu's The Art of War to Trial Advocacy', (2008) 45/4 Alberta Law Review, 1017-1035.

<sup>14</sup> M. D'Ascenzo, 'Commissioner's perspective on audit programs, Taxation Institute of Australia, 10 October 1990; J. Granger, 'To audit or not: the art of compliance strategy design and what's high on the radar this year', Australian Women Lawyers Conference, 29 September 2006.

<sup>15</sup> Section 8 ITAA 1936.

<sup>16</sup> *Industrial Equity Ltd v FCT* (1990) 21 ATR 934 (HCA).

<sup>17</sup> *Robinswood P/L v FCT* (1997) 39 ATR 305 (FCA); (2003) 54 ATR 658 (WASCA).

These selection criteria should form the basis of any risk assessment by the taxpayer's advisers.

### 3.3 Review and Audit Types

A review is a type of audit, but will be identified separately in this paper because a review as opposed to other forms of audit may be eligible for more generous remissions of penalty for voluntary disclosure.

Review and audit activity can be roughly categorised into the following types:

- data matching:

Information matching with BRW lists, AFR and media publications, Centrelink, State Revenue Office, Land Titles Office, AUSTRAC, ASIC, ASX, Department of Immigration records, Motor Vehicle, Marine and Aircraft Registries and other sources.

The ATO analyses the information and undertakes risk classification.

- research audits:

Industry or activity research enquiries are undertaken to gather intelligence, profile industries and trends in taxation compliance.

- desk audits:

ATO requests receipts, invoices and other documents to substantiate the return. The ATO may conduct interviews. The ATO analyses the information and undertakes risk classification. Desk audits can be subcategorised into:

- substantiation review – rental deductions or work related expense claims verification; or
- source deduction review – PAYG withholding verification;
- risk reviews:

Risk reviews are becoming increasingly common and are commenced with a questionnaire, followed by ATO analysis, detailed expert opinion and risk classification. After review the matter is closed or escalated. Risk reviews can be subcategorised into:

- preliminary risk review – general questionnaire;
- comprehensive risk review – detailed issues questionnaires with informal or formal interviews and document access; and
- specific review – specific issues questionnaires with informal or formal interviews and document access;
- audits:

Audits generally commence with an audit notification letter including a request to make voluntary disclosure. The ATO generally undertakes informal or formal interviews and document access, analysis, expert opinion and risk classification under an information gathering process. Based on the risk classification, the ATO may proceed to an audit process that can be subcategorised into:

- specific issues audit – detailed specific issue or issues information and document exchange, interviews, taxpayer systems review and analysis, ATO analysis, expert opinion, position papers exchange, audit findings paper, closure or escalation;

- comprehensive audit – detailed issues information and document exchange, interviews, taxpayer systems review and analysis, ATO analysis, expert opinion, position papers exchange, audit findings paper, closure or escalation;
- complex audits – strategic and complex industries, international groups, tax issues;
- special audits – serious non compliance activities with a prosecution emphasis (such as Project Wickenby);
- continual monitoring:

Specific taxpayer can be requested to provide expanded or special purpose tax returns. A common example is the HWI expanded tax returns.

The order of review and audit activity need not be sequential.

The review letter, audit commencement letter and finalisation letter require close consideration because they affect rights (such as voluntary disclosure remission entitlements<sup>18</sup>).

#### ✓ Tip: ATO Audit

Consider the scope of the audit as expressed in the ATO audit letter as voluntary disclosures outside the audit scope or before commencement of audit proper may attract the 80% voluntary disclosure concession. (MT 2008/3).

Note audit commencement date and schedules finalisation date to set period after which shortfall interest charge or general interest charge can be remitted (PSLA 2006/8).

Record ATO response due dates that are exceeded so that shortfall interest charge or general interest charge can be remitted for the period after the response due date (PSLA 2006/8).

Advise affected entities (business partners etc) of audit so they can be proactive.

### 3.4 Assessment of Audit Processes

The *Burges Report* analysed the ATO audit performance for large business.<sup>19</sup> Where appropriate, these initiatives were to be applied to other segments.<sup>20</sup> The *Burges Report* recommended and the ATO accepted 13 initiatives including:

- Initiative 1. the early engagement of technical specialists in reviews and audits;
- Initiative 4. internal ATO technical workshops for high and contentious risks prior to finalisation;
- Initiative 5. provision of preliminary review findings and an opportunity for the taxpayer to respond;
- Initiative 6. greater communications with taxpayer stakeholders on procedures when proceeding from review to audit including communication of audit plans which clearly explain the stages of audit, scope of the audit; and
- Initiative 7. requests for information will include the reasons for seeking the information.

The ATO has also published other audit procedure standards including:<sup>21</sup>

- issuing taxpayers with review and audit notification letters;

<sup>18</sup> MT 2008/3.

<sup>19</sup> K. Burges, *Report on the concerns of a number of the largest companies in the Large Business Segment, with ATO audit, investigations, and advice procedures*, April 2005.

<sup>20</sup> M Carmody, 'Large Business and Tax Compliance', International CFO Forum, Sydney, 13 October 2005.

<sup>21</sup> <http://www.ato.gov.au/corporate/content.asp?doc=/content/25923.htm>.

- giving taxpayers reasonable time to consult with financial and legal representatives
- completing audits within the shortest possible time depending on the quality of records, availability of information, complexity of issues and level of taxpayer co-operation;
- undertake an initial interview to introduce the audit, outline the audit processes, provide taxpayers with an opportunity to make voluntary disclosures;
- arrange interviews or meeting at mutually convenient times during normal business hours;
- advise taxpayers in advance with the tax officer will have a legal adviser present during an interview;
- allow taxpayers to tape record interviews with prior notice provided a copy of the audio tape is given to the ATO at the conclusion of the audit;
- arrange for an interpreter to be present at interviews and meetings.

The ATO regularly reports against these audit processes.<sup>22</sup>

Understanding these rights can assist to progress the review or audit efficiently and with a clear exchange of information and of audit procedures.

### 3.5 Risk Assessment

A robust risk management approach to an audit is essential because an error in risk management during the audit phase can have serious consequences for defending a tax position in objection and appeal stages.

During audit, a detailed risk management process should be conducted which includes identification, analysis and management of:

- strategic risks – specific legal, technical and administrative issues;
- operational risks – implementation of tax policies and laws to day-to-day business operations issues;
- compliance risks – implementation of systems, registrations, accounting, lodgement and compliance issues; and
- reporting risks – implementation of accounting and financial standards and statutory reporting issues.
- reputation risks – business, industry and personal reputation risks; and
- detection risk – review or audit risk.

A robust tax risk management process can greatly assist a taxpayer to take a more organised, informed, proactive and responsive position in a review or audit with the ATO.

Further details on risk assessment and management have been discussed in this series of articles in *Taxation in Australia*.<sup>23</sup>

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<sup>22</sup> J. Granger, 'Challenging stereotypes', Corporate Tax Association Convention, 1 May 2006.

<sup>23</sup> R. Jorgensen, 'SME Tax Risk Management', (2010) 44/7 *Taxation in Australia*, 400.

### 3.6 Culpable Behaviour & Voluntary Disclosures

The uniform penalty provisions apply to statements made, returns lodged and scheme entered into from 1 July 2000.<sup>24</sup> The extent of the penalty is determined by the behaviour of the taxpayer and the taxpayer's advisers. Culpable behaviour may increase the penalty by 20%.

A taxpayer that makes a voluntary disclosure in the approved form to the ATO may have tax shortfall penalties and scheme shortfall penalties reduced<sup>25</sup> or administrative penalties reduced by 80% if made or deemed to be made before audit or 20% if made during audit.

The base penalty amount may be increased by 20% for culpable behaviour including:<sup>26</sup>

- taking steps to prevent or obstruct the ATO from finding out about the tax shortfall;
- failing to correct a statement made to the ATO about a shortfall amount within a reasonable time; or
- having a previous shortfall amount.

The audit strategy should not expose the taxpayer to increased penalties.

The ATO has a general discretion to further remit penalties for assistance.<sup>27</sup>

Further details on voluntary disclosure have been discussed in a series of articles in *Taxation in Australia*.<sup>28</sup>

## 4 EXCHANGE OF INFORMATION

### 4.1 Introduction

The ATO has very broad powers to investigate compliance with tax legislation. Most compliance investigations occur in a spirit of cooperation. The role of the adviser is generally to manage the exchange of information. However, the adviser is also obliged to maintain LPP, CLP and the Accountant's concession and ensure that the ATO is exercising the ATO's investigation powers appropriately.

Advisers and custodians of documents may want to conduct the compliance investigation formally as it protects them from allegations of breach of confidentiality by the taxpayer. The ATO may exercise the ATO's powers formally to ensure compliance or where there is a history of non-compliance with informal procedures.

The ATO may exercise coercive powers to access information and documents for income tax purposes, such as by:

- entering premises (section 263 ITAA 1936);
- demanding provision of information in writing or by interview (section 264(1)(a) ITAA 1936);
- demanding provision of documents (section 264(1)(b) ITAA 1936); and
- issuing an offshore information exchange demand for documents which affects the admissibility of documents not produced in response to the notice (section 264A ITAA 1936).

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<sup>24</sup> Pt. 4-25 TAA 1953.

<sup>25</sup> section 284-225 TAA 1953; MT 2008/3 (formerly TR 94/6).

<sup>26</sup> section 284-220 TAA 1953.

<sup>27</sup> section 298-20 TAA 1953; PSLA 2006/2 at [150]; MT 2008/3 at [27].

<sup>28</sup> R. Jorgensen, 'Voluntary Disclosures', (2010) 44/9 *Taxation in Australia*, 519.

The ATO has similar (but differently worded) investigation powers under other legislation. Some of the more common provisions are:

- section 353-10 TAA 1953 for indirect taxes such as GST and PAYG withholding and debt recovery;
- section 127 of the Fringe Benefits Tax Assessment Act 1986 for fringe benefits investigations;
- section 76 of the Superannuation Guarantee (Administration) Act 1992 for superannuation guarantee charge investigations;
- sections 256 and 268 of the Superannuation Industry (Supervision) Act 1993 for superannuation fund investigations; and
- section 13F of the TAA 1953 for trans-boarder investigation.


It may be an offence for the occupier to:

- make false or misleading statements;<sup>29</sup>
- fail to provide the ATO reasonable facilities and assistance to exercise the access;<sup>30</sup>
- fail to produce books or attend on ATO;<sup>31</sup>
- refuse to answer questions or provide documents;<sup>32</sup> or
- hinder or obstruct the access.<sup>33</sup>

The audit strategy should not expose the taxpayer to offences.

An important consideration during audit and access is to ensure that client legal privilege or client accounting privilege is not inadvertently waived.

This paper discusses the powers under the income tax acts. Care is required in applying the principles from the income tax provisions to similar provisions in other legislation.

|  Examples: Access and information exchange provision differences |
|---|
| 1. The access power in section 256 SISA 1993 requires the occupier's consent.   |
| 2. The access power in section 353-15 TAA 1953 permits the ATO to access goods and other property and take samples.                                 |
| 3. Section 162 ITAA 1936 can only be used on the taxpayer and not third parties.  |

The *Access Manual* states the recommended access and information gathering procedures for ATO officers to follow.

## 4.2 Section 263 Access Powers

Section 263 ITAA 1936 grants authorised ATO officers full and free access to enter and search premises, and to review and copy documents for the purposes of the tax acts. The power is very broad, but does have some limitations.

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<sup>29</sup> section 136.1 Criminal Code Act 1995.

<sup>30</sup> section 263(3) ITAA 1936 (\$3,300 (30 penalty units)).

<sup>31</sup> section 8C TAA 1953 (\$3,300 (30 penalty units)).

<sup>32</sup> section 8D TAA 1953.

<sup>33</sup> section 149.1 Criminal Code Act 1995 (penalty: 2 years imprisonment).

The ATO can undertake a ‘fishing expedition’ and the access does not have to be in respect of a named taxpayer or class of taxpayers.<sup>34</sup> Once the ATO has exercised formal access, it can be difficult to effectively control and limit the informal extension of the access (investigation creep).

An ATO officer is not permitted to enter premises unless authorised. Authorisation is usually recorded in a specific authority from the Commissioner or in the ATO officer’s wallet authority. An ATO officer is not permitted to remain on the premises if upon request the ATO officer fails to show the occupier a written authority. Failure to produce a section 263 written or wallet authority upon demand may make subsequent access activities invalid and unlawful.<sup>35</sup>

The ATO can copy documents but cannot seize or confiscate documents. Accordingly, the ATO will often attend access with their own scanning equipment so that documents can be copied.

The term ‘document’ includes hard copy and electronically stored records.<sup>36</sup> Effectively managing access to electronically stored documents is very difficult.

The ATO will usually attend access with computer audit specialists to access computer systems to extract and copy data. The ATO will usually seek access to the main computer storage systems, desk top and lap top storage systems, personal digital assistants and other storage systems. The ATO is entitled to password and log in information and assistance in navigating software.

Although it is easy for the ATO to bulk copy electronic files, the ATO must make some assessment of the relevance of documents to be copied and cannot bulk copy all documents (e.g. email folders<sup>37</sup> or document folders<sup>38</sup>). The ATO will usually do key word searches to identify relevant documents.

The ATO will generally provide a copy of all hard copy documents and an electronic copy of all scanned and extracted documents upon request so that a post access analysis can be undertaken of the documents taken to identify any tax matters for further consideration.

Whether LPP, CLP or the Accountant’s concession attach to a document has been the subject of many court cases. The courts have stated that the ATO can have access to:

- banks records;<sup>39</sup>
- family court proceedings discovery;<sup>40</sup>
- lawyers trust account records;<sup>41</sup>
- lawyers bills of costs;<sup>42</sup>
- lawyers fax transmission book;<sup>43</sup>
- lawyers advice never sent or relied upon;<sup>44</sup>
- lawyer’s client lists;<sup>45</sup> and

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<sup>34</sup> *Smorgon v FCT* (1979) 9 ATR 483 (HCA).

<sup>35</sup> *FCT v Citibank Ltd* (1989) 20 ATR 292 (FCFCA).

<sup>36</sup> TD 2005/16; TR 2005/9.

<sup>37</sup> *JMA Accounting P/L v FCT* (2004) 57 ATR 365 (FFCA).

<sup>38</sup> *Prescience Communications Ltd v FCT* (2006) 64 ATR 664 (FCA).

<sup>39</sup> *Simionato Holdings P/L v FCT (No 2)* (1995) 32 ATR 298 (FCA).

<sup>40</sup> *Atkinson v FCT* (2000) 44 ATR 204 (FCA).

<sup>41</sup> *Allen Allen & Hamsley v FCT* (1989) 20 ATR 321 (FCFCA).

<sup>42</sup> *Packer v FCT* (1984) 15 ATR 1038 (FCQSC).

<sup>43</sup> *Sharp v FCT* (1988) 19 ATR 904 (FCA).

<sup>44</sup> *May v FCT* (1999) 42 ATR 270 (FFCA).

<sup>45</sup> *FCT v Coombes (No 2)* (1989) 40 ATR 403 (FCA).

- accountant's client lists.<sup>46</sup>

These classes of documents may contain tax advice information, but by their nature, LPP, CLP or the Accountant's concession does not apply. Care should be taken in administrative documents such as file titles, descriptions in bills, descriptions in letter or fax transmission books and document references so that the nature of the advice is not inadvertently disclosed.

Further matters that should be noted include that:

- reasonable force can be used by the ATO to gain access to premises and documents (e.g. destruction of locks<sup>47</sup> or windows and doors to gain access to building<sup>48</sup>);
- access must occur at reasonable times (which is particularly relevant for access to private premises);
- the ATO is entitled to a cursory view of LPP, CLP and the Accountant's concession document to determine privilege;<sup>49</sup>
- a capriciously executed search may invalidate a notice where the right to claim LPP or CLP is abrogated;<sup>50</sup>
- access after commencement of an appeal to the Administrative Appeals Tribunal (AAT) or Federal Court of Australia (FCA) may constitute an abuse of process/contempt of court permitting a stay of the access.

Failure to provide the necessary level of assistance may increase penalties<sup>51</sup> or may be a criminal offence such as for the occupier to:

- fail to provide the ATO reasonable facilities and assistance to exercise the access;<sup>52</sup>
- fail to produce books or attend on ATO;<sup>53</sup> or
- hinder or obstruct the access.<sup>54</sup>

✓ Tip: Access procedures

The adviser should:

1. have a premises access protocol which clearly identifies the procedures and person responsible for managing any access;
2. prepare a premises access protocol for appropriate clients which identify the client's rights in an access;
3. train their staff in the procedures to be adopted for any access;
4. explain to staff before the access their rights not to answer questions and be advised to clearly identify personal documents and information on their computer and work area so their privacy is not infringed;

<sup>46</sup> *Deloitte Touch Tohmatsu v FCT* (1998) 40 ATR 435 (FCA).

<sup>47</sup> *Kerrison & Banish Management P/L v FCT* (1986) 17 ATR 338.

<sup>48</sup> *O'Reilly v CSBV* (1983) 14 ATR 64 (HCA).

<sup>49</sup> *JMA Accounting P/L v FCT* (2004) 57 ATR 365 (FFCA).

<sup>50</sup> *FCT v Citibank Ltd* (1989) 20 ATR 292 (FCFCA).

<sup>51</sup> section 288-35 TAA 1953.

<sup>52</sup> section 263(3) ITAA 1936 (\$3,300 (30 penalty units)).

<sup>53</sup> section 8C TAA 1953 (\$3,300 (30 penalty units)).

<sup>54</sup> section 149.1 *Criminal Code Act 1995* (penalty: 2 years imprisonment).

5. obtain the name of the ATO access specialist for the access and discuss the scope and procedures for the access (such as copying or scanning documents, claims for LPP, CLP or the Accountant's Concession and obtaining copies of copied or scanned documents);
6. at the commencement of access, ask to see the wallet or other authority of each ATO officer and record their details;
7. appoint a staff member to file note all discussions with the ATO;
8. allocate a staff member escort to the ATO officers as they move around the office;
9. conduct a tour of the office to explain systems, location of documents and identify relevant documents;
10. locate documents and secure them in a lockable meeting room so the ATO officers do not need to roam the office;
11. advise the client immediately of any access and recommend to the client to obtain legal advice;
12. request deferral of inspection until legal advice is sought and LPP, CLP and the Accountant's Concession claims can be made;
13. request deferral of inspection until legal advice is sought on possible judicial review entitlements;
14. request an access explanation letter from the ATO to provide to the client to protect the adviser from breach of confidentiality or privacy;
15. request file copies of all documents copied so subsequent analysis of areas of interest can be undertaken;
16. dedicate desks, chairs, a photocopier, consumables, telephones and computer terminals in an isolated area for the ATO's use;
17. restrict/avoid answers to questions not directly concerning the location and access to documents;
18. clearly document and receipt any documents, goods or things agreed to be seized and removed from the premises; and
19. document any procedural irregularities or complaints about the ATO access and report these to the ATO access specialist.

### **4.3 Section 264 Information, Document & Evidence Powers**

Section 264 ITAA 1936 permits the ATO to require a person in respect of that person or any other person's taxation affairs to:

- provide such information in writing as required;
- produce all documents as required in the person's custody or control; or
- attend and give evidence, including on oath.

A clear distinction exists between a request for information, for provision of documents and for giving evidence.

An adviser's role is to review the notice to identify any procedural or validity issues and to negotiate with the ATO to serve revised notices. It is not usually appropriate to refuse to comply with a notice because

of procedural or validity issues since non-compliance may increase penalties or constitute a criminal offence. For example, it is an offence for the client to:

- make false or misleading statements;<sup>55</sup>
- refuse to answer questions or provide documents;<sup>56</sup> or
- hinder or obstruct the access.<sup>57</sup>

A section 264 notice may be invalid where:

- the issuing ATO officer is not authorised;
- issued to the wrong authorised person for a company;
- it is a composite notice under different acts and the requirements for service are inconsistent;<sup>58</sup> or
- it fails to specify the correct statutory access power.

The notice must refer to the correct statutory power. A notice that simply requires production of documents cannot require the creation of a document. The ATO will generally issue multiple or composite notices to cover these circumstances.

A section 264 notice to provide information is not limited to a particular taxpayer so may be used to obtain lists of clients or transactions. The ATO may request not only facts but opinions.<sup>59</sup> The ATO cannot require a specific format of answer.<sup>60</sup>

A notice to produce documents must identify a taxpayer by name or description and the class of documents to be produced. Broad phrasing of required documents is permitted.<sup>61</sup> The documents must be in the possession and control of the recipient of the notice.

In addition to the above, a section 264 notice to produce documents may be invalid where:

- it is not limited to specified taxpayers;<sup>62</sup>
- it demands oppressively excessive production of documents;<sup>63</sup>
- it contains an oppressively or excessively vague or ambiguous description of documents;<sup>64</sup> or
- the compliance time is not reasonable.<sup>65</sup>

In determining whether a section 264 notice compliance period is reasonable, court cases regarding section 162 lodgement notices and the time periods under section 8C TAA 1953 for failure to comply offences may be relevant.

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<sup>55</sup> section 136.1 *Criminal Code Act 1995*.

<sup>56</sup> section 8D TAA 1953.

<sup>57</sup> section 149.1 *Criminal Code Act 1995* (penalty: 2 years imprisonment).

<sup>58</sup> section 28A of the *Acts Interpretations Act 1901* takes priority.

<sup>59</sup> *Perron Investments P/L v FCT* (1989) 20 ATR 1299 (FCA).

<sup>60</sup> *Access Manual* at [2.4.37]

<sup>61</sup> *Perron Investments P/L v FCT* (1989) 20 ATR 504 (FCA).

<sup>62</sup> *Clarke v FCT* (1988) 20 ATR 701 (FCA).

<sup>63</sup> *Smorgon v FCT* (1979) 9 ATR 483 (HCA).

<sup>64</sup> *Smorgon v FCT* (1979) 9 ATR 483 (HCA).

<sup>65</sup> *Ganke v FCT* (1975) 5 ATR 292 (FCFCA); *Ganke v FCT (No 2)* (1982) 13 ATR 440 (FCA).

✎ Example: Reasonable production period

1. 28 days is the usual period specified to produce documents and is generally reasonable.<sup>66</sup>
2. 21 days to produce 10 year old documents was unreasonable.<sup>67</sup>
3. 5 days to produce documents was not unreasonable.<sup>68</sup>
4. Consider the surrounding circumstances to determine reasonableness including:
  - access to and availability of the information;<sup>69</sup>
  - inclusion business holiday periods such as the Christmas period;<sup>70</sup>
  - health issues and inability to action matter;<sup>71</sup>
  - periods overseas and inability to action matter.
  - extent of any previous extensions of time.<sup>72</sup>
5. Substantially comply with the notice to raise an argument of reasonable action.
6. Ensure extension of time is negotiated or make judicial review application in FCA (not AAT).

A notice to give sworn evidence must specify that an oath will be given at the interview. The ATO and the interviewee are entitled to legal representation.<sup>73</sup> The ATO is entitled to use a barrister for the interview and the barrister can ask the questions.<sup>74</sup> A section 264 interview may be stayed to avoid self incrimination until criminal proceedings are determined.<sup>75</sup>

In addition to the above, a section 264 notice to give evidence may be invalid where it fails to specify the commencement time and sole place for attendance to give evidence.

✓ Tip: ATO Interview

1. Ensure no objection will be raised by the ATO in respect of the particular legal or accountant adviser being present before the interview.
2. Prepare the taxpayer for the formalities of an interview by explaining the warnings given as to voluntary disclosure, claim for CLP and the Accountant's Concession, abrogation of self incrimination and spousal privilege and offences for false statements, introduction of the persons present for transcript purposes and to the attending adviser not to interfere with the interview.
3. Prepare client for the formality of questions and emphasise the best practice to only answer the question, not to offer additional information that may confuse the ATO, request clarification of ambiguous questions, maintain composure, don't speculate, and distinguish between statements made with knowledge, information or belief.

<sup>66</sup> *Holmes v FCT (No 2)* (1988) 19 ATR 1173.

<sup>67</sup> *Elliott v FCT* (1990) 21 ATR 283.

<sup>68</sup> *Clarke v FCT* (1989) 20 ATR 701.

<sup>69</sup> *Waterhouse v FCT* (1986) 17 ATR 997 (FCA); (1988) 19 ATR 883.

<sup>70</sup> *Perron Investments P/L v FCT* (1989) 20 ATR 504 (FCA)

<sup>71</sup> *Case 10,532A* (1996) 33 ATR 1005.

<sup>72</sup> *Perron Investments P/L v FCT* (1989) 20 ATR 504 (FCA).

<sup>73</sup> *Dunkel v FCT* (1990) 21 ATR 1279 (FCA).

<sup>74</sup> *Grant v FCT* (2000) 45 ATR 146 (FCA).

<sup>75</sup> *Watson v FCT* (1999) 43 ATR 549 (FCA).

4. Explain tape recording and transcription process and obtain the client's instructions for the ATO to provide transcripts to the representative rather than the client.
5. Explain the presence of the ATO case officer, the ATO technical officer and the ATO rights compliance officer (when a female is being interviewed).
6. Confirm the client's preference for oath or affirmation of evidence.
7. Provide any voluntary disclosure statement before proceedings commence.

1. Provide any statement of facts or evidence in respect of which the client wishes to take an active position before proceedings commence.
2. Ensure the client answers all questions and not the adviser.
3. Actively maintain LPP, CLP and the Accountant's Concession.
4. Explain to the client that the ATO will give opportunity at end for client to provide any complaints.

The issue of a section 264 ITAA 1936 information or interview request after commencement of an appeal to the AAT or FCA may constitute an abuse of process/contempt of court permitting a stay on the notice.<sup>76</sup>

The section 264 notice is irregular but not invalid where the notice:

- requests LPP and CLP documents or does not expressly exclude LPP and CLP documents;<sup>77</sup>
- requests documents not in the custody or control of the person;<sup>78</sup>
- requests person to copy documents;<sup>79</sup> or
- issues in contempt of court.

#### 🔴 Important: Validity of Notice

1. Check the notice carefully against the requirements in the *Access Manual* particularly in respect of:
  - ensure the full name of the issuing officer is stated;
  - ensure issuing officer is a Second Commissioner or a Deputy Commissioner or obtain evidence from the ATO that
  - the person was authorised;
  - ensure the notice clearly states the relevant section under which the notice is issued;
  - ensure the service address is in accordance with statutory service rules;
  - ensure name of the recipient is correct;

<sup>76</sup> section 43 of the *Administrative Appeals Tribunal Act 1975*; Order 52A Rule 13(2) of the *Federal Court Rules 1979*.

<sup>77</sup> *Perron Investments P/L v FCT* (1989) 20 ATR 504 (FCA).

<sup>78</sup> *Perron Investments P/L v FCT* (1989) 20 ATR 1299 (FCA).

<sup>79</sup> *Hart v FCT* (2005) 61 ATR 519 (FCA).

- ensure the ATO signature is correct and execution complete;
  - ensure the date of signing the notice is stated; and
  - ensure each page is consecutively numbered.
2. Determine if the scope of request or time period for compliance is unreasonably excessive.
  3. Any invalidity of a notice should be raised as early as possible to ensure invalidity is rectified and the client is not placed in a position of potential breach.
  4. If the ATO refuses to withdraw/replace the notice then consider administrative review.
  5. Respond to the valid part of the notice (even if it is not possible to sever the invalid part of the notice).<sup>80</sup>
  6. Responses should be appropriately qualified where assumptions have been made or response is based on information or belief.

#### 4.4 Search Warrants

Search warrants may be executed by the Australian Federal Police (AFP) with ATO officers in attendance.<sup>81</sup> Search warrants are used where the AFP and the ATO suspect criminal activities. Accordingly, advisers should obtain specialist criminal legal advice if served with a search warrant.

The AFP have published Search Warrant Guidelines and Search Warrant Procedures. The search warrant should be reviewed to determine if the AFP have complied with the guidelines and procedures.

The search warrant may be invalid where the warrant does not specify the:

- alleged offences,<sup>82</sup> or
- classes of items to be searched and seized.<sup>83</sup>

Under a search warrant otherwise privileged documents may lose LPP or CLP if they relate to advice to facilitate a fraud and the search warrant expressly states that the fraud exception applies to the search.<sup>84</sup>

## 5 PRIVILEGE

### 5.1 Introduction

The law provides a number of privileges which can be used as a reason to refuse to comply with coercive powers of government agencies. The tax legislation has abrogated some of these.

Legal privilege has its source in Common Law and the uniform evidence acts, including the EA 1995. Common Law legal privilege is distinct from legal privilege under the EA 1995.<sup>85</sup> Common Law legal privilege is usually referred to as LPP and legal privilege under the EA 1995 is usually referred to as CLP.

LPP and CLP<sup>86</sup> and public interest immunity<sup>87</sup> apply to the ATO's access and information exchange powers. However, the privilege against self-incrimination<sup>88</sup> and spousal privilege<sup>89</sup> are abrogated by the

<sup>80</sup> *Richards v McDermott* (1986) FLR 48.

<sup>81</sup> section 3C *Crimes Act 1914*.

<sup>82</sup> *Beneficial Finance Corporation Ltd v FCT* (1991) 22 ATR 636 (FCFCA).

<sup>83</sup> *Beneficial Finance Corporation Ltd v FCT* (1991) 22 ATR 636 (FCFCA).

<sup>84</sup> *AFP v Propend Finance P/L* (1997) 34 ATR 130; *Arno v Forsyth* (1986) 65 ALR 125.

<sup>85</sup> *ACCC v Cadbury Schweppes Ltd* [2009] FCAFC 32 [31] (FCAFC); *Esso Australia Resources Ltd v FCT* (1999) 201 CLR 49 (HCA); *Osland v Secretary, Dept of Justice* (2008) 234 CLR 275, [49] (HCA).

ATO's access and information exchange powers, so cannot be used as a reason to refuse to comply with a valid notice.

In the *Accountant's Guidelines*, the ATO has provided for the Accountant's Concession, an administrative concession or privilege for accountant's taxation advice and some other documents which can be overridden by the ATO where exceptional circumstances exist. The extent of the protection provided by this administrative privilege is unclear in practice.

For completeness, privilege attached to documents, and objects (such as cash or bullion) cannot be privileged.<sup>90</sup> Copy documents of non-privileged documents may be subject to LPP or CLP if created for a relevant privileged purpose.<sup>91</sup>

## 5.2 Legal Privilege (LPP & CLP)

LPP and CLP are divided into advice privilege and litigation privilege, the scope of each is different.<sup>92</sup>

The scope of LPP and CLP in taxation matters is currently being tested by cases and is the subject of a review by the IGOT into the ATO's handling of HWI and SME audits and litigation.<sup>93</sup>

The scope of advice privilege for taxation advice requires clarification.

To be covered by LPP, a communication must be, or a document must be brought into existence, for the dominant purpose of giving or obtaining legal advice.<sup>94</sup> The dominant, ruling, prevailing, paramount or most influential purpose<sup>95</sup> is a question of fact determined at the time the document was brought into existence.<sup>96</sup> It is possible for only part of a document to be covered by LPP.<sup>97</sup> It is unclear whether the lawyer's factual observations and investigations of factual matters concerned in structuring are covered by LPP.<sup>98</sup>

The extent to which documents prepared by a third party are for the dominant purpose of providing legal advice was discussed in *FCT v Pratt Holdings P/L*.<sup>99</sup>

*Pratt Holdings P/L* established that LPP may extend to cover third party documents (for example accountant's documents) where those documents are prepared for the dominant purpose of enabling a client to obtain legal advice from their lawyers and that the request for preparation of the third party advice may be made by the lawyer or the client.<sup>100</sup>

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<sup>96</sup> *FCT v Citibank Ltd* (1989) 20 ATR 292 (FCFCA); see also *Daniels Corporation International P/L v ACCC* (2002) 213 CLR 543 relating to a similar power of the ACCC under section 155 TPA.

<sup>97</sup> *Middendorp Electric Co P/L v LIV & FCT* (1993) 27 ATR 64 (VSC); *LIV v FCT* (No 2) [2009] VSC 179 (VSC).

<sup>98</sup> *FCT v De Vonk* (1995) 31 ATR 481 (FCFCA).

<sup>99</sup> *Stoddart v ACCC* [2009] FCA 1108 (FCA).

<sup>90</sup> *Baker v Campbell* (1983) 14 ATR 713 (HCA).

<sup>91</sup> *AFP v Propend Finance P/L* (1997) 34 ATR 130; *Re Perpetual Trustee Company (Canberra) Ltd v CSR (ACT)* (1994) 30 ATR 1087.

<sup>92</sup> *Brookfield Multiplex Ltd v International Litigation Funding Partners P/L (No 2)* [2009] FCA 449 at [8] (FCA).

<sup>93</sup> Inspector General of Taxation, *Review into the ATO's small and medium enterprise audit and risk review policies, procedures and practices terms of reference*, April 2010.

<sup>94</sup> *Esso Australia Resources Ltd v FCT* (1999) 201 CLR 49 (HCA).

<sup>95</sup> *Mitsubishi Electric Australia P/L v Victoria WorkCover Authority* (2002) 4 VR 332 at 336–337

<sup>96</sup> *AFP v Propend Finance P/L* (1997) 188 CLR 501 at 508; *Pratt Holdings P/L v FCT* (2004) 136 FCR 357 (FCAFC).

<sup>97</sup> *GEC Marconi Systems P/L v BHP Information Technology* [2000] FCA 593 at [11]; *Grofam P/L v Australia and New Zealand Banking Group Ltd* (1993) 43 FCR 408 at 414–417

<sup>98</sup> *Z v New South Wales Crime Commission* [2007] HCA 7, Gleeson CJ *in obiter* at [35]; *cf AWB Ltd v Cole (No 5)* [2006] FCA 1234 at [47] and [56].

<sup>99</sup> *FCT v Pratt Holdings P/L* (2005) 60 ATR 466; *Pratt Holdings P/L v FCT* (2004) 56 ATR 128 (FCFCA).

<sup>100</sup> *Pratt Holdings P/L v FCT* (2004) 56 ATR 128 at [41] (FCFCA).

The court gave the following examples of circumstances where advice privilege will not apply to third party documents:<sup>101</sup>

- where advice prepared by a third party is about the commercially advantageous ways to structure a transaction<sup>102</sup> (note that in contrast commercial advice prepared by an external lawyer for the purpose of structuring a transaction is captured by advice privilege);<sup>103</sup>
- where communications which are not otherwise connected with legal advice are lodged with a legal advisor for the purpose of claiming advice privilege;<sup>104</sup> and
- where the client of the lawyer exercises discretion over which of the third party documents should be communicated to the lawyer.<sup>105</sup>

Generally, CLP granted by the EA 1995 is much narrower than LPP. For example communications between two witnesses (neither a lawyer) to prepare witness statements was not privileged under section 118 EA 1995 (advice privilege) nor section 119 EA 1995 (litigation privilege) as neither party asserted that they considered the communication to be privileged.<sup>106</sup>

The interaction between LPP and CLP is unclear. For example, to what extent does the EA 1995 limit or abrogate LPP. As the EA 1995 applies to court proceedings and not to tribunal proceedings,<sup>107</sup> it is unclear whether, or to what extent, the forum of the ultimate appeal in a tax matter will affect the scope of LPP and CLP.

Accordingly, if CLP abrogates LPP, the legal privilege protection would be very limited and more closely accord to the Accountant's Concession.

*Esso Australia Resources Ltd v FCT*<sup>108</sup> rejected the ATO's arguments that the EA 1995 limited the scope of LPP. LPP advice privilege operates unaffected by the EA 1995.<sup>109</sup> However, Kirby, J did state that over time, the influence of the EA 1995 may have an effect on the development of LPP.<sup>110</sup>

Currently, LPP applies separately to CLP so there is a clear distinction between legal privilege and the Accountant's concession, which can be overridden by the ATO where exceptional circumstances exist.

There is also conflicting law on whether communications by in-house lawyers are privileged or whether legal privilege is abrogated by the employment relationship. The better view is that legal privilege applies.<sup>111</sup> Care must be taken in relying on advice of in-house lawyers, as there are recent authorities indicating that whilst legal advice of an in-house lawyer is privileged, commercial advice and comment is not.<sup>112</sup>

In *ACCC v Cadbury Schweppes Ltd* the Full Federal Court stated:<sup>113</sup>

The scope of the confidentiality arising from litigation privilege is different from advice privilege. We say this because when dealing with third parties, such as potential witnesses, unless there is a separate confidentiality agreement with such third parties, then, subject to the principle in *Harman* [implied undertaking in relation to court proceedings] (as explained in *Hearne v Street* (2008) 235 CLR 125; 248 ALR 609; [2008] HCA 36 at [109] (Hearne per Hayne, Heydon and Crennan JJ),

<sup>101</sup> *Pratt Holdings P/L v FCT* (2004) 56 ATR 128 at [46], [47] and [106] (FCFCA).

<sup>102</sup> *Pratt Holdings P/L v FCT* (2004) 56 ATR 128 (FCFCA) at [106].

<sup>103</sup> *AWB Ltd v Cole (No 5)* [2006] FCA 1234 at [47] and [56].

<sup>104</sup> *Pratt Holdings P/L v FCT* (2004) 56 ATR 128 at [46] (FCFCA).

<sup>105</sup> *Pratt Holdings P/L v FCT* (2004) 56 ATR 128 at [47] (FCFCA).

<sup>106</sup> *Brown v Forestry Tasmania (No 3)* [2006] FCA 469 [14] – [18].

<sup>107</sup> *Evidence Act 1995* (Cth) section 4; *SZHWY v Minister for Immigration and Citizenship* [2007] FCAFC 64 [17].

<sup>108</sup> *Esso Australia Resources Ltd v FCT* [1999] HCA 67.

<sup>109</sup> *ACCC v Cadbury Schweppes Ltd* [2009] FCAFC 32.

<sup>110</sup> *Esso Australia Resources Ltd v FCT* [1999] HCA 67 at [91].

<sup>111</sup> *Waterford v Cth* (1987) 163 CLR 54; *Ritz Hotel Ltd v Charles of the Ritz Ltd (No 4)* (1987) 14 NSWLR 100.

<sup>112</sup> *Banksia Mortgages Ltd v Croker and Ors* [2010] NSWSC 535.

<sup>113</sup> *ACCC v Cadbury Schweppes Ltd* [2009] FCAFC 32 at [35].

such potential witnesses would be free to discuss with others their potential evidence. Of course, the position would be different if there was a confidentiality agreement with such a potential witness, because in that case the client might seek to enforce the obligation of confidentiality arising out of such an agreement.

When consulting third parties for advice or when preparing for tax litigation, the lawyers should prepare and distribute a LPP/CLP protocol that establishes the procedures and consultancy or litigation group amongst which privilege must be maintained. The procedures should include the mandatory identification of privileged communications and an acknowledgement by the members to maintain confidentiality of the communications. This should be sufficient to preserve legal privilege without a written confidentiality agreement in respect of advice CLP.

Legal privilege may be lost where the documents were created for an improper purpose, such as evidenced by the application of Part IVA ITAA 1936<sup>114</sup> or where the communications facilitate a crime of fraud.<sup>115</sup>

Legal Privilege may also be expressly or impliedly waived by the client.<sup>116</sup> Where documents have been circulated amongst multiple parties, joint privilege can apply but waiver is more likely.<sup>117</sup>

Communication of legal advice to a third party, and reproduction of parts of that advice by a third party, for the purpose of obtaining advice about budgeting, or to obtain litigation funding will not ordinarily be a waiver of privilege provided the communications are made on a confidential basis.<sup>118</sup>

Implied waiver of legal privilege must be considered carefully and may occur by:

- delivery and reading of the document by the ATO;
- disclosure of the contents of a document whilst giving evidence;
- provision of the disclosure in statement of facts, issues and contentions; or<sup>119</sup>
- filing and or serving final proofs of evidence in litigation on the court or the opposing party.<sup>120</sup>

Waiver may also extend to documents and information which were taken into account in formulating legal advice that a client has chosen to disclose, if that disclosure is a waiver of CLP in the legal advice.<sup>121</sup>

### 5.3 Accountant's Concession

The *Accountant's Guidelines* provide for the Accountant's concession, an administrative concession or privilege under the ATO power of general administration in section 8 ITAA 1936.<sup>122</sup> Therefore, the ATO is the only party affected by the Accountant's concession.<sup>123</sup> The Accountant's concession does not have a legislative or common law basis. The Australian Law Reform Commission recommend a form of statutory accountant's privilege be adopted,<sup>124</sup> however, this recommendation has not been implemented.

Accountant documents are divided into:

- source documents

<sup>114</sup> *Clements, Dinne & Bell P/L v AFP* (2001) 188 ALR 515.

<sup>115</sup> *AWB Ltd v Cole (No 5)* [2006] FCA 1234 [210].

<sup>116</sup> *Mann v Carnell* (1999) 201 CLR 1 at [29] Gleeson CJ, Gaudron, Gummow and Callinan JJ)

<sup>117</sup> *Rio Tinto Ltd v FCT* (2006) 64 ATR 63.

<sup>118</sup> *Tarong Energy Corporation Ltd v South Burnett Regional Council (formerly Nanango Shire Council* [2009] QCA 265.

<sup>119</sup> *FCT v Rio Tinto Ltd* (2006) 63 ATR 79 (FCFCA).

<sup>120</sup> *ACCC v Cadbury Schweppes Ltd* [2009] FCAFC 32 at [101]-[103].

<sup>121</sup> *AWB Ltd v Cole (No 5)* [2006] FCA 1234 at [198], [200]-[205].

<sup>122</sup> *White Industries P/L v FCT* [2007] FCA 211 at [68].

<sup>123</sup> *Stewart v FCT* [2010] FCA 402 at [6].

<sup>124</sup> ALRC, *A Review of Legal Professional Privilege and Federal Investigatory Bodies*, 21 December 2007 at 421.

All documents prepared in connection with the conception, implementation and formal recording of a transaction, traditional accounting records and the permanent file for statutory audits.

Client lists are source documents.<sup>125</sup>

Accountant's corporate diagrams may be source documents.<sup>126</sup>

- restricted source documents

All advices prepared by external professional accountants for the sole purpose of advising a client on taxation and prepared in connection with the conception and implementation of a transaction (front end advice at the time of conception or implementation).

- non-source documents

All advices (other than restricted source documents) created post transaction including documents in the current audit file, prudential tax advice and due diligence advices.

The Accountant's concession applies to restricted source documents and non-source documents, but not source documents.

The Accountant's concession is not absolute. The ATO maintains that access to restricted source documents and non-source documents may be sought in exceptional circumstances. The ATO considers 'exceptional circumstances' include where:

- source documents do not provide sufficient factual information or information as to purpose and the taxpayer or their professional accounting advisors have not adequately responded to information requests;
- there are reasonable grounds to believe that fraud or evasion or criminal or other illegal activities have occurred;
- the taxpayer and the taxpayers records cannot be located;
- source documents have not been provided, have been destroyed or cannot be located or have not been provided under an offshore information request;<sup>127</sup> or
- Part IVA ITAA 1936 applies (it is unclear whether there needs to be reasonable grounds for the belief that Part IVA applies).<sup>128</sup>

The extent to which the *Accountant's Guidelines* limit the ATO's powers to obtain access to documents generally or because on exceptional circumstances is unclear.

The *Accountant's Guidelines* set out procedures for access to documents based on exceptional circumstances. How the procedures are to be applied is the subject of a current federal court matter.<sup>129</sup>

The decision to grant access to documents ordinarily covered by the accountants' privilege may be made by an ATO officer by issuing a notice:

- under the access or inspection power under a taxation law;<sup>130</sup> or

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<sup>125</sup> *Deloitte Touch Tohmatsu v FCT* (1998) 40 ATR 435 (FCA).

<sup>126</sup> TD 93/222.

<sup>127</sup> *One-TEL v FCT* (2000) 44 ATR 52; PSLA 2004/14 access to board documents; *Accountant's Guidelines*, Part 6

<sup>128</sup> *Access Manual* version 1/2010, at [7.2.4].

<sup>129</sup> *Stewart v FCT* [2010] FCA 402 at [20].

- to produce in the course of litigation between the taxpayer and the ATO.<sup>131</sup>

The basis for access determines the available avenues of appeal available for the taxpayer to dispute the decision to allow access to the accountant's documents.

#### 5.4 Access Manual and Accountant's Guidelines – Legitimate Expectations

The *Access Manual* and the *Accountant's Guidelines* are not an enactment for the purpose of section 3(1) ADJR 1977 so a decision based on them cannot be directly challenged.<sup>132</sup>

If access is sought under an access or inspection power under a taxation law it will be reviewable under section 39B JA 1903 and may also be reviewable under the ADJR 1977. It is unclear whether the decision is reviewable under the ADJR 1977. *One-Tel v FCT*<sup>133</sup> assumed that the ADJR 1977 applied. *White Industries P/L v FCT*<sup>134</sup> considered it was possible because the ATO's delegates are required to have regard to the *Access Manual* and *Accountant's Guidelines* in deciding to issue a notice for inspection under the ITAA 1936.<sup>135</sup>

If access is sought under a notice to produce, the decision will only be reviewable under section 39B JA 1903.<sup>136</sup> Review under the ADJR 1977 is not available because the decision to produce is made by the court under the court's rules and not by the ATO. The ATO's decision to apply for a notice to produce is not the relevant decision to be reviewable under ADJR 1977.<sup>137</sup>

If the decision to act in a way contrary to the *Access Manual* and *Accountant's Guidelines* or lift the Accountant's concession is subject to review under ADJR 1977, it has been recognised that the *Access Manual* and *Accountant's Guidelines* do give rise to a legitimate expectation that the ATO will comply with them.<sup>138</sup>

For example, the existence of the legitimate expectation means that if the ATO does intend to depart from the *Accountant's Guidelines* based on exceptional circumstances the taxpayer affected should be given an opportunity of arguing that no exceptional circumstances exist.<sup>139</sup> A letter to a taxpayer notifying them of the intent to access documents covered by the Accountant's concession and giving the taxpayer an opportunity to respond will be sufficient to satisfy the requirements of procedural fairness even if it does not provide full particulars of why access is sought,<sup>140</sup> it is only an un-notified departure that is likely to be a breach of procedural fairness.<sup>141</sup>

✓Tip: Privilege claim procedure

1. When documents are secured, the ATO will usually permit LPP and CLP claims to be made. The process varies.
2. The lawyers will review the file under the supervision of the ATO officer.
3. Any LPP and CLP document is identified and a pro forma LPP and CLP claim form is completed with a sequential number and document details such as date, type of document, author, author's role, recipient, recipient's role and legal basis of claim.

<sup>130</sup> See *One-TEL v FCT* (2000) 44 ATR 52 where the documents were accessed under section 108 of the *Sales Tax Assessment Act* and *Stewart v FCT* [2010] FCA 402 where section 264 ITAA 1936 was the source of access to documents.

<sup>131</sup> See e.g. *White Industries P/L v FCT* [2007] FCA 211.

<sup>132</sup> *White Industries P/L v FCT* [2007] FCA 211 [29]; *Stewart v DCT* [2010] FCA 402 [29], [62] – [75].

<sup>133</sup> *One-TEL v FCT* (2000) 44 ATR 52.

<sup>134</sup> *White Industries P/L v FCT* [2007] FCA 211.

<sup>135</sup> *White Industries v FCT* [2007] FCA 211 [29]; *Stewart v DCT* [2010] FCA 402 [90], [92]–[93].

<sup>136</sup> *White Industries v FCT* [2007] FCA 211 [29]; *Stewart v DCT* [2010] FCA 402 [29], [62] – [75].

<sup>137</sup> *White Industries v FCT* [2007] FCA 211 [29]; *Stewart v DCT* [2010] FCA 402 [28], [62] – [75].

<sup>138</sup> *One-TEL v FCT* (2000) 44 ATR 52 [42].

<sup>139</sup> *One-TEL v FCT* (2000) 44 ATR 52 [42].

<sup>140</sup> *One-TEL v FCT* (2000) 44 ATR 52 [43].

<sup>141</sup> *Stewart v DCT* [2010] FCA 402 [9].

4. The pro forma CLP claim form is photocopied (4 copies), 1 copy is included in the file where the original is removed. 1 x copy is attached to an envelope in which the original is sealed. 1 x copy of LPP and CLP claim form is retained by the lawyers. 1 x copy is retained by the ATO.
5. The original sealed in the envelope is secured and delivered to the court for claim proceedings.
6. ATO officers then review the file and copy any documents.
7. Court processes for challenging LPP and CLP undertaken.

## 6 CONCLUSION

The increasing incident of compliance investigations means advisers and taxpayers are facing the complexity of taxation administration procedures with greater regularity.

One cannot absolutely avoid a risk review or audit, but one can manage the process optimally.

A collaborative approach between the client stakeholders, the accountant, the lawyer and the other advisers represents the best strategy to manage the review and audit, to settle or otherwise resolve any dispute at an early stage and to ensure that any court proceedings are not inadvertently compromised.

Experience suggests that SME and HWI clients are becoming increasingly dissatisfied by the ATO's approach to compliance investigations and the exercise of the ATO coercive powers of access and information exchange.

The IGOT review will hopefully clarify a number of uncertainties regarding the scope of the ATO's powers and moderate the ATO's use of those powers.

### ✓ Tip: Dos and Don'ts

1. Do identify clients at appreciable risks of review or audit activity.
2. Do take a proactive role in preparing for review or audit.
3. Do take a proactive role in directing and managing the review and audit processes.
4. Do make voluntary disclosure in appropriate circumstances to reduce penalties and interest.
5. Do prepare submissions and disclosures in a manner that makes it easy for the ATO officers to see the course of action required and their power to give effect to the request.
6. Don't panic under access, document exchange, review or audit and carry out the tax risk management strategy.
7. Don't make disclosure that is not substantiated by corroborating documents so as to avoid any unintended false or misleading statements or sending the ATO down the wrong line of enquiry.
8. Don't exceed deadlines to avoid unnecessary GIC or SIC accruing.
9. Don't be reactive, ensure every interaction with the ATO clearly states the policy and legal reasons the taxpayer is correct.